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Road to COP27: ESG, Asset Ownership, Modern Securities Lending Transforming Capital Markets in ASEAN & G20 Nations

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This is the first of a series of seven ‘Road to COP27’ papers by M. Nicolas J. Firzli, the Hon. Nick Sherry and Dr. Guan Seng Khoo. The primers will look at the notions of ‘asset ownership’ and ‘fiduciary capitalism’ in light of the evolving geo-economic and risk management dynamics of the ‘Post-Covid Era’. The authors will also discuss and develop some of the notions presented here in a series of high-level roundtables and symposia held in Paris, Washington D.C., Brussels, and Beijing in the weeks preceding the 2022 **G20 Pensions Forum**, Singapore, 27 – 28 October, the **G20 Summit**, Bali, 30 – 31 October and the United Nations Climate Change Conference, **COP27**, Sharm el-Sheikh, 7 – 18 November 2022.

ESG Moving Center Stage from Main Street to Wall Street

Last week, the **Securities and Exchange Commission** (SEC) surprised observers by moving to ‘reform’ the securities lending market, a highly strategic segment of the financial industry, sometimes associated with short-selling: “The SEC today published proposed Exchange Act Rule 10c-1, which would require lenders of securities to provide the material terms of securities lending transactions to a registered national securities association, such as the Financial Industry Regulatory Authority. The registered national securities association would then make the material terms of the securities lending transaction available to the public. ‘Securities lending and borrowing is an important part of our market structure. Currently, though, the securities lending market is opaque,’ said SEC Chair **Gary Gensler**. ‘In today’s fast-moving financial markets, it’s important that market participants have access to fair, accurate, and timely information. I believe this proposal would bring securities lending out of the dark’..”¹

Albeit valid, perhaps, to a certain extent, when it comes to some calcified corners of Wall Street, Gensler’s sweeping generalisations regarding the securities lending industry come across as dated and unfair. In London, Toronto, Paris, and Hong Kong, securities lenders, and their clients (more asset owners and central bankers than ‘hedge funds’) have often been at the forefront of the ESG revolution, empowering key players at every step of the asset ownership chain, from issuers to pension trustees, to engage positively across the board. Here, the SEC chair is simply echoing the old conventional wisdom, or, as Nicolas Firzli puts it: “for many, sustainability (long-term fiduciary stewardship) and securities lending (a short-termist activity by design) seem incompatible in the ‘Age of Fiduciary Capitalism’..., but they needn’t be. If done properly, securities lending can actually empower pension investors, giving them more effective control over key ESG and fiscal parameters in the chain of ownership – including AGM voting rights, the cornerstone of corporate governance, and modern risk mitigation (collateral management, transparency).”²

The cultural-societal exigencies of the moment (‘post-Trump’, post-Covid era) are putting pressure on US financiers and regulators to step up their work in that regard. But, in Europe, efforts to bring sustainability at the heart of the financial industry were already under way: “in London, the **International Securities Lending Association** (ISLA) was prepared for the crisis, which they had largely anticipated: their original reflexion



around notions such as ‘ESG and securities lending’, ‘risk mitigation in an evolving regulatory environment’ and ‘short selling in times of crisis’ go back to the start of the previous decade. **Ed Oliver**, board member & director, ISLA, chaired a special session on these [very] issues at the IMN Summit in London as early as September 2014, with **Matthew Chessum**, Investment Director, Liquidity Management, Aberdeen, **Xavier Bouthors**, Head of Securities Lending, NN Investment Partners, **Nicolas Firzli**, DG, World Pensions Council, and veteran ETF expert **Andrew Jamieson**. Andrew Dyson, CEO, ISLA, who delivered the opening keynote address [...] also spoke at that seminal event, laying the groundwork for future policy thinking and advocacy”.³

Paris Forum and G20 Pensions Dialogue: Thought Leadership in Action

The authors of this article recently co-chaired the **G20 Pensions Dialogue & Paris Forum**, held 28 October 2021, a high-level hybrid event held in Paris (USIC, Centre Varenne) and digitally (Zoom, YouTube), organised jointly by the World Pensions Council (WPC) and the **EU ASEAN Centre**, Singapore Economic Forum (SEF). **Andrew Dyson**, Chief Executive Officer, International Securities Lending Association (ISLA), chaired a special session titled ‘**Financial Markets of the Future: Framing Securities Lending for the Sustainability Era**’. Dyson first gave an overview of the securities lending (SL) activities and its main players before proceeding to discuss the issues arising from empowering SL actors to be fit and ready for the sustainability era. He said: "We all like to live in a rules-based world [...] With the sustainability agenda, it's all about values and it's hard to comingle a [essentially ethical] values-based agenda into a [normative] rules-based environment [...] If the SL activities are done in a responsible way, SL can add value for funds investors [...] thus contributing to improved market liquidity and efficient price discovery [...] For example, active stewardship and participation in voting is an important way to influence corporate behaviour on ESG and sustainability issues [...] likewise collateral selection and disclosure, thus enhancing markets transparency across the board."



Sustainable Finance & Governance at the Heart of Modern Securities Lending
pictured here clockwise:

Andrew Dyson, ISLA
Mary Jane Schuessler, CASLA
Nancy Foster, Risk Mgmt. Association
Arnaud Fransioli, Société Générale
Marion Lepoivre, Natixis TradEx
Xavier Bouthors, NN IP

Benoit Uhlen, Head of Client Management for Market and Financing Services, **BNP Paribas Securities Services**, added that, “while [ensuring] securities lending activities meet [increasingly demanding] ESG criteria can require additional work, these specific efforts often yield positive outcomes to ‘the ESG chain’ as a whole, beyond securities lending, and can even bring more actors, such as pension investors, into the SL market, thus further enhancing liquidity for all parties”. **Arnaud Fransioli**, Executive Director, **Société Générale** Corporate & Investment Banking (SGCIB), Board Member, ISLA, also pointed out that they were working more closely with [pension and asset management] clients especially on collateral and securities selection, ensuring they’re always within their ESG comfort zone and tolerance levels, while **Xavier Bouthors** of **NN Investment Partners**, said when they lent their securities, they ensured that their corporate social responsibility (CSR) parameters were [constantly] aligned throughout the securities lending lifecycle with the relevant ESG criteria.

It was clear from these thoughtful exchanges that Europe’s leading players had already embraced the sustainable finance agenda and put in place inter-active processes allowing them to act according to the specific requirements of individual beneficial owners. When asked about short-selling and short-termism in the marketplace, Fransioli felt that in some cases, it wasn’t, as it were, only about being ‘sustainable’ or ESG compliant, but “more as part of the [natural] market function of enhancing liquidity or unearthing some ‘pent up issues’ about a particular security’s risk profile”. **Remy Ferraretto**, Securities Finance & Repo Expert, **Caceis Investor Services** (Caceis), the asset servicing banking group of **Crédit Agricole** and **Santander**, concurred, saying: “I also see similar behaviour among our clients in their investment activities to be ESG compliant and to seek more transparency in the securities financing processes, including selection of borrowers based on their specific CSR policies.”



Engagement, Transparency & Innovation Shaping the Future of Capital Markets

pictured here clockwise:

Benoit Uhlen, BNP Paribas Securities Services
The Hon. Nick Sherry, G20 P20 & Singapore Forum
Remy Ferraretto, Caceis Investor Services
Paul Bureau, Manaos, ‘The Open ESG Marketplace’



Marion Lepoivre, Equity Finance Trading/Repo, **Natixis TradEx** Solutions, Banque Populaire Caisse d'Épargne, added: "It's very important for Natixis TradEx Solutions to have a very transparent and clear communication with the funds' managers about our securities lending activity and to be able to take into account their constraints in term of ESG. That is why we have put in place some good practices framing the activity. Securities lending activity is a tool for market liquidity and this liquidity is very important in an ESG perspective. We have to make sure that regulations or restrictions on specific stocks (for example during the AGMs) won't affect market liquidity. Otherwise, it can have a negative impact on ESG investments. Another point of attention is the harmonization of labels and of the activity's framing if not this will create an asymmetry of the market."

Paul Bureau, Head of Business Development, **Manaos**, 'The Open ESG Marketplace', a subsidiary of **BNP Paribas**, gave an introduction on his company and the challenges dealing with the emerging ESG wave and awareness, especially amongst asset owners such as pension funds "to address the ESG criteria in their investment activities incl. securities financing. Some of these challenges arise from the specificities of their current circumstances, as they have to deal with new types of data/requirements and related technological issues, including the current lack of consistency in benchmarking and [sometimes] regulatory ambiguity with regards to ESG investing." He described Manaos as a one stop shop, designed to streamline access to best-in-class service providers in the sustainability area, by "match-making investors to their personalized ESG ecosystem of expert providers, allowing them to experiment and improve the ESG expertise they need in a sandbox environment, including to test, fail, enhance, and scale in a circular manner" until they achieve an ideal equilibrium which truly fits their needs.

In the days following the 28 October 2021 Future of Finance Roundtable at the Paris Forum & G20 Pensions Dialogue, the International Securities Lending Association (ISLA) announced it was joining forces with leading regional and international securities lending and risk management industry groups, including the **Canadian Securities Lending Association** (CASLA), the Pan Asia Securities Lending Association (PASLA) and the **Risk Management Association** (RMA), to form the **Global Alliance of Securities Lending Associations** (GASLA), a collaborative working group aimed at further strengthening the alignment of securities lending programmes with environmental and social sustainability. Speaking in the name of the Singapore Economic Forum (SEF), the Hon. Nick Sherry welcomed this "important development for the financial firm of the future, which will be defined by fiduciarism, mutual trust, and a resolutely iterative, holistic approach to risk management."

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ENDNOTES & RESOURCES

- ¹ SEC Proposes Rule to Provide Transparency in Securities Lending: Proposed Rule Would Increase Availability of Information re: Sec. Lending Transactions, Nov. 18, 2021, <https://www.sec.gov/news/press-release/2021-239>
- ² cited in Fordham, Louise. "Securities Lending and Sustainable Finance: Addressing Misconceptions." *Global Investor ISF*, Asia Pacific edition (28 Jan. 2020)
- ³ Weeks, David P., and Nicolas Firzli (2021). "Boardroom Revolution: ESG Data, Ai and Engagement Future-Proofing Financial Markets." *Institutional Investment Review (IIR)*, <https://worldpensions.org/boardroom-revolution>

