

Reinforcing Global Sustainable Finance by Improving Guidance on Securities Lending

“Our immediate goal on this matter is to create a forum that will be global in reach, aligned with the Principles for Sustainable Securities Lending and open to debating fresh ideas. Following this, our objective is to reinforce the global sustainable finance agenda through holistic guidance on measures affecting securities lending that will be observed by all stakeholders.”

ICSF Position Statement

Since the publication of the first ICSF position paper, *Making Sense of Sustainable Securities Lending & Short Selling During the COVID-19 Crisis*, it has become clear that global economic recovery from the effects of the COVID-19 crisis will occur at a slow pace. We recognise that the road to a sustainable recovery, and growth thereafter, must be based upon mature, consistent and evidence-based decisions that include key stakeholders and allow for appropriate reflection. We emphasise that such an approach to decision-making processes will ensure predictability that beneficial owners and underlying investors need in these extraordinary times and beyond. We believe that securities lending, and any resultant short selling, forms a backbone of good governance when aligned with the Principles for Sustainable Securities Lending (PSSL). Such activities can stimulate business, increase investor confidence, and support both liquidity and fair pricing in financial markets.

However, we also notice that inconsistent regulatory responses concerning short-selling bans, amongst other measures, have continued and created some market confusion around the role of securities lending. Therefore, pursuant to the PSSL principle on *transparency*, we call for holistic guidance on any measures that significantly affect sustainable securities lending.

Such guidance should be global in reach and, thus, complement the existing regulatory frameworks with a view to achieving an essential sustainable finance objective of good governance. It would strengthen regulators and investors' ability to leverage positive outcomes offered by securities lending, and differentiate between pro-market behaviour aligned with sustainable finance and negative (abusive) practices. This would also ensure that the underlying investors are provided with an accurate understanding of market moves.

Crucially, drawing also on the PSSL principles of *stakeholder involvement* and *innovation*, we suggest that the guidance must be applicable to the broader securities lending sector, and:

- Must be evidence-based and aligned with PSSL.
- Must ensure that any new measures are proportionate, carefully considered, and as unobtrusive as possible.
- Must ensure that regulators apprise key stakeholders of market participants' behaviour on a regular basis, in line with best available techniques (BATs).
- Must ensure that the measures are subject to constant review by regulators and that all key stakeholders are informed promptly about this review, with the objective of lifting such measures, or easing the extent to which they impede normal trade.

Further, we propose that this holistic guidance should be voluntary, but offer clear incentives to encourage observance; available online on an independent/dedicated website and updatable using BATs. Ideally, it should be co-created by regulators and key stakeholders, and ICSF will work to convene an initial roundtable in the near future. To encourage engagement in this process, and in the interests of transparency, stakeholders would be welcome to join this roundtable as observers only, if preferred.

1. Relevant Considerations

1.1 Global Cooperation Within PSSL Framework Amidst the Evolving COVID-19 Crisis

- 1.1.1 The COVID-19 crisis is unprecedented and economic recovery from the effects of this pandemic will take some time, despite resilient financial markets. The road to recovery will require global cooperation to ensure that necessary funds meet the needs of the real economy. ICSF recognises the National Competent Authorities' (NCA) need to respond decisively and, also, as stressed by the Financial Stability Board (FSB), not "compromise the underlying objectives of existing international standards."ⁱ
- 1.1.2 Sustainable securities lending will require co-ordinated global collaboration and PSSL constitutes the appropriate framework to realise these connections. One main reason for this unifying capability is that PSSL makes it clear that securities lending is a distinct finance dynamic with several benefits beyond those offered by short-selling.ⁱⁱ We have set out several benefits of securities lending in our first position paper and highlighted that we drafted the Principles to reflect the far-reaching remit of securities lending.ⁱⁱⁱ
- 1.1.3 Our concern is therefore to foster collaboration on measures that may restrict the positive role of sustainable securities lending. Since such restrictions focused on short-selling bans recently, we feel it is the appropriate time to call for a holistic guidance.
- 1.1.4 Several NCAs introduced temporary short selling bans as part of their response, whilst others stayed put^{iv}. However, most states within the FSB jurisdiction decided to adopt such measures as fiscal stimuli or government guarantees.^v On 16 April, a number of European Union (EU) NCAs decided to extend their temporary bans – a move that was authorised by the European Securities and Markets Authority^{vi} in keeping with the existing regulations. Recently, the International Monetary Fund stressed that "[r]estrictions should be temporary and only implemented within a predictable and reliable framework".^{vii}
- 1.1.5 Currently, there is no global standard that provides clear guidance on how to measure evidence and weigh sustainable finance considerations before introducing short-selling bans, and more importantly, any measures affecting sustainable securities lending. There is a need to work together and develop such holistic guidance in order to achieve the important sustainable finance objective on good governance. This would enable regulators and investors to leverage positive outcomes offered by securities lending, and differentiate between positive (market-orientated) and negative (abusive) behaviour. Further, this guidance would increase transparency in the current emergency and, going forward, it would mitigate the threat of inaccurate information being disseminated through IT.

1.2 Key Guidance Requirements

- 1.2.1 Drawing on existing regulatory regimes, and the PSSL principles on *Transparency*, *Stakeholder Involvement*, and *Innovation*, ICSF suggests a set of requirements that are necessary for achieving holistic guidance.
- 1.2.2 ICSF recognises that the current decisions affecting securities lending were evidence-based and, in the case of the EU, they aligned with the principle of *Proportionality*, thus considered some less restrictive measures^{viii}. Nevertheless, our assessment is that there was scope for a more robust analysis from a sustainable finance perspective, that would benefit from key stakeholders' inputs. For example, such analyses should have factored in, more clearly, the costs and benefits of short-selling for real economy and the benefits of utilising innovative solutions to minimise mis-information^{ix}.
- 1.2.3 Therefore, guidance that employs these existing practices, but (crucially) also aligns with the tenets of PSSL, will offer a more holistic approach to leverage positive outcomes offered by securities lending. In practice, this holistic guidance should move beyond short selling and cover all areas of sustainable securities lending.
- 1.2.4 Further, we firmly believe that regulators should apprise key stakeholders regularly about the market participants' behaviour, in line with BATs. Such an approach will reduce the likelihood of overly-stringent measures and help to maintain market confidence during critical periods.
- 1.2.5 In particular, ICSF advocates measures that are subject to constant review by regulators and that all key stakeholders are informed promptly about this review, with the objective of lifting such measures, or easing the extent to which they impede normal trade. This, in turn, will strengthen regulators' ability to identify players who align with Economic, Social and Governance (ESG) criteria to foster positive change and those who might resort to abusive practices.^x Blanket bans, for example, do not differentiate between responsible and abusive behaviour within markets and, ultimately, fail to eliminate inappropriate behaviour in the long term. This, in turn, damages investor confidence.
- 1.2.6 *Innovation*, as a PSSL principle, will play an essential role in leveraging the aforementioned BATs. This will ensure that future measures affecting securities lending in exceptional circumstances and beyond, are suitable and fit for purpose. This is because such factors as the spread of rumours, and other matters relating to advances in information technology, have-played a significant role in authorities' assessments in the past.^{xi} We propose that the guidance would draw on the best available techniques resulting from advances in information technology. It is essential that such innovation embeds best ESG practices, as stressed by the PSSL principle 8:
- “As market participants collaborate to enhance market efficiency through new technologies or routes to market, the importance of Environmental, Social and Governance factors as well as Sustainable Development Goals criteria must be taken into account and be fully documented. As innovation continues to drive the securities lending market, all participants must remain vigilant of these principles and strive to adopt them in all future securities lending endeavours.”^{xii}
- 1.2.7 We strongly believe that innovation combined with transparency will offer clear added value to beneficial owners' portfolio managers who will gain clearer insights into the market moves. This, in turn, will improve

market confidence in the benefits of sustainable securities lending programmes and, ultimately, deliver greater value to the underlying investors.

1.3 Co-creating Holistic Global Guidance

- 1.3.1 Only through positive and inclusive engagement can we achieve the scope and depth of the sustainable finance agenda. Therefore, ICSF stresses that there is a need to work together to create holistic guidance. The guidance should not replace, but go above and beyond the existing formal regulatory mechanisms that, in the case of the EU, aim at removing disagreements between NCAs in this context^{xiii}.
- 1.3.2 This guidance should be co-created by regulators and key global stakeholders through a series of roundtables that will foster cooperation and the productive exchange of information. To encourage engagement in this process, and in the interests of transparency, stakeholders would be welcome to join this roundtable as observers only, if preferred.
- 1.3.3 The guidance should be voluntary, but offer clear incentives to encourage compliance. We believe that such incentives will occur naturally when key stakeholders meet regularly to monitor developments and assess available evidence (subject to confidentiality requirements). To enable this trust-based forum, the guidance should be available online on an independent/dedicated website and updatable in concert with technological advancements.

2. Next Steps Towards the Guidance

- 2.1 ICSF, with its global mission and Partners, is well positioned to identify the key stakeholders and facilitate a forum with a view to testing the ideas outlined in this paper.
- 2.2 ICSF will offer to chair the first roundtable meeting by leveraging its existing operational capabilities. Subsequent meetings within the forum could be chaired by other stakeholders, in turn, to achieve the required buy-in and foster trustworthy relationships.
- 2.3 Our immediate goal is to create a forum that will be global in reach, aligned with the PSSL and open to debating fresh ideas. Following this, our ultimate objective is to reinforce the global sustainable finance agenda through holistic guidance on measures affecting securities lending that will be observed by all stakeholders.

The work on this paper was led by Dr Radek Stech^{xiv}, the ICSF Chair, with considerable contributions from members on the Council Executive. We would encourage any responses to this paper to be sent to Dr Radek Stech at icsfchair@isla.co.uk

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ⁱFinancial Stability Board (2020). *COVID-19 pandemic: Financial stability implications and policy measures taken*. Available at: <<https://www.fsb.org/wp-content/uploads/P150420.pdf>> accessed 11 May 2020.

ⁱⁱResearch directly underpinning the rationale for co-creating PSSL at the initial high-level working group related to the concept of finance dynamics. Hence, such complex finance dynamics as project finance and bond finance “are finance structures that are based on a series of legal deals shaped by several stakeholders” and, therefore, require a dedicated sustainable finance mechanism. Even though securities lending is a much simpler structure, it is a distinct finance dynamic as it benefits from dedicated legal and regulatory regime and is shaped by several unique stakeholders. Hence, it would benefit from an exclusive sustainable finance mechanism such as PSSL. See, Stech R. (2019). ‘Sustainable Finance, the Law and Stakeholders: Towards Responsible Social Movements.’ In: Onyeka, K. O, Ngwu, F. N. and Jamali, D. eds. *Corporate Social Responsibility in Developing and Emerging Markets. Institutions, Actors and Sustainable Development*. Cambridge University Press, pp. 365 -394; ISLA Council for Sustainable Finance (2020). *ICSF Vision and Mission*. Available at: <https://www.isla.co.uk/wp-content/uploads/2020/02/ICSF_vision_mission.pdf> accessed 11 May 2020; ISLA Council for Sustainable Finance (2020). *Making Sense of Sustainable Securities Lending & Short Selling During the COVID-19 Crisis*. ICSF Position Paper (1) 2020. Available at <<https://www.isla.co.uk/regulation-and-policy/environmental-social-governance-esg/principlesfor-sustainable-securities-lending-pssl/>> accessed on 11 May 2020.

ⁱⁱⁱ“PSSL is unique as it is the first dedicated global mechanism that combines finance and sustainability expertise with the view to advancing sustainable securities lending. Hence, we drafted PSSL to bring to light ‘specialist’ and sector-specific principles (tax, voting, collateral and short selling), and generalist principles that form part of other sustainable finance mechanisms (alignment, transparency, and stakeholder involvement). We have also introduced a new principle on ‘innovation’ to bring to light pioneering solutions that take place in this rapidly evolving market”. See ICSF Position Paper (1) at 1.1.4.

^{iv}See ICSF Position Paper (1) supra note ii.

^vFinancial Stability Board (2020). *COVID-19 pandemic: Financial stability implications and policy measures taken*, p. 11. Available at: <<https://www.fsb.org/wp-content/uploads/P150420.pdf>> accessed 11 May 2020.

^{vi}European Securities and Markets Authority (2020). *ESMA issues positive opinions on short selling bans by Austrian FMA, Belgian FSMA, French AMF, Greek HCMC and Spanish CNMV*. Available at: <<https://www.esma.europa.eu/press-news/esma-news/esma-issues-positive-opinions-short-selling-bans-austrian-fma-belgian-fsma>> accessed 11 May 2020.

^{vii}Stafford, P. and Fletcher, L. (2020). Europe extends short-selling bans despite hedge fund pressure. *The Financial Times*. Available at: <https://amp.ft.com/content/d615a15d-c524-4383-b829-4f1a244db28a?__twitter_impression=true#> accessed 11 May 2020.

^{viii}Consolidated version on the Treaty of European Union (2012). *Official Journal of the European Union* C 326/13. Article 5. Available at:<https://eur-lex.europa.eu/resource.html?uri=cellar:2bf140bf-a3f8-4ab2-b506-fd71826e6da6.0023.02/DOC_1&format=PDF> accessed 11 May 2020).

^{ix}See, for example, these papers that consider broader benefits of sustainable securities lending: Bouthors, X. and Lindeman, F. (2020). *How ESG principles can make a difference in securities lending*. NN Investment Partners. Available at: <<https://www.nnip.com/fr-FR/professional/insights/how-esg-principles-can-make-a-difference-in-securities-lending>> accessed 11 May 2020; Van Der Struik, R. (2015). Securities lending as part of responsible and risk-averse asset management. *Journal of Securities Operations & Custody*. 7 (3); BlackRock (2020). *Securities Lending Viewed through the Sustainability Lens*. Available at: <<https://www.blackrock.com/corporate/literature/publication/securities-lending-viewed-through-the-sustainability-lens.pdf>> accessed 11 May 2020; Technical Committee of the International Organisation of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems (CPSS) (1999). *Securities Lending Transactions: Market Development and Implications*. 61. Available at: <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD96.pdf>> accessed 11 May 2020; Dreff, N. (2010). *The Role of Securities Lending in Market Liquidity*. *The Bank of Canada Financial System Review*; Faulkner, M. C. (2007). *An Introduction to Securities Lending*. 4th edn. Spitalfields. 13, 39.

^xLa Perla, B. and Whitmore, T. (2020). *Beyond Mechanics: The Intersection of Securities Lending and ESG Investing*. State Street Corporation, Boston MA. Available at: <https://www.statestreet.com/content/dam/statestreet/documents/Articles/SSA_ESG_SF_paper.pdf> accessed 11 May 2020.

^{xi}See, for example, arguments invoked by the Austrian Finanzmarktaufsicht (FMA) “AMF has observed examples of disinformation, rumours and false news in media and social networks regarding activities that could be affected by decisions of the Government or by the evolution of the crisis. Such rumours may affect listed companies and damage the confidence of investors in an efficient market, where prices should be formed with public, reliable information.” European Securities and Markets Authority (2020). *Opinion of the European Securities and Markets Authority of 15 April 2020 on a proposed emergency measure by the Austrian Finanzmarktaufsicht under Section 1 of Chapter V of Regulation (EU) No 236/2012*, p. 3. Available at: <https://www.esma.europa.eu/sites/default/files/library/esma70-155-9848_opinion_on_fma_emergency_measure_under_the_ssr.pdf> accessed 11 May 2020.

^{xii}Principles for Sustainable Securities Lending (2020). Available at: <https://www.isla.co.uk/wp-content/uploads/2020/02/ICSF_Principles.pdf> accessed 11 May 2020.

^{xiii}See for example Art 23 of Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (2012). *Official Journal of the European Union* L 86/1. Available at: <<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:086:0001:0024:en:PDF>> accessed 11 May 2020 and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (2010). *Official Journal of the European Union* L 331/84. Available at: < <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32010R1095>> accessed 11 May 2020.

^{xiv}He is also a Founder of SFLS Network and a Senior Lecturer in Law at Exeter Law School, and received a grant from the Economic and Social Research Council (grant no ES/R004293/1) that was also used to underpin research for the ICSF position papers (1) and (2).