



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
Impact Creators.

Strengthening sustainable finance with an interconnected  
collateral for securities lending.

A forward-looking market standard.

## Consultation paper

### Comments

We welcome comments on this paper and may invite you to participate in the workstream. Please provide comments on this paper directly to Global PSSL ([radek.stech@gpssl.org](mailto:radek.stech@gpssl.org)). Global PSSL will also actively encourage feedback from workstream participants and the College of Advisors. Workstream participants will also collect feedback in their respective jurisdictions.

### Consultation timeline

The consultation period will run until the end of 15<sup>th</sup> September 2021. We will continue internal work as part of the workstream and broader roundtables organised by Global PSSL and other market participants.

---

**Authors:** Lead drafter: **Radek Stech** (Global PSSL, University of Exeter Law School); Strategic Technical Advisor: **Roy Zimmerhansl** (Global PSSL College of Advisors). This paper follows Global PSSL 'Collateral' workstream meetings and several follow-ups with significant contributions made by beneficial owners, custodian banks, triparty agents and prime brokers. Consulted with end users.

© Global Principles for Sustainable Securities Lending (Global PSSL) CIC



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

## Key background facts

Global Principles for Sustainable Securities Lending represents a holistic and principle-based approach to sustainability in the field of securities lending and borrowing. It unifies global markets at a high level of policy coordination, increases trust, confidence and transparency alongside advancing the integration of ESG.

This paper draws on Sustainable Finance – the Law – Stakeholders (SFLS) Network of University of Exeter Law School that has focussed on green bonds, project finance and broader environmental and social matters since 2015. That research led to a partnership with values-based banks and the World Bank and, in turn, led to dedicated work on sustainable securities lending from 2018.

In 2019, several beneficial owners and SFLS agreed that the “*primary purpose of the collateral in securities lending [was] to mitigate counter-party risk*” and that “[s]ecurities lending collateral parameters, such as exclusion lists, should be considered in ESG strategies”<sup>i</sup>. However, that developmental stage included a forecast that clearer and more focussed inclusion of environmental and social matters would form part of collateral later in the future. That was embedded by independent and impartial Global PSSSL in the draft principle on collateral in December 2020<sup>ii</sup>.

Having said that, this forward looking standard must be seen in the context of the broader policy, impact and research on sustainable finance. It is a natural progression from activities that contribute most to the relocation of finance towards ESG activities towards approaches that facilitate and help consolidate that relocation.

One important feature of this standard is a focus on transparency, safety and liquidity:

“By strategically aligning securities lending collateral with ESG, the stakeholders will enhance broader sustainable finance agenda and reap long-term rewards. This standard encourages this forward-looking alignment by emphasising current practices and outlining pathways to more interconnected and ambitious future capacities. Such a progressive, step-by-step approach will increase transparency whilst assuring safety and liquidity.”

Radek Stech and Roy Zimmerhansl



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

## Objectives

To create a minimum forward looking standard that will embed ESG into collateral in the securities lending and enhance broader sustainable finance agenda:

**Forward-looking and clear:** that will set out pathways to embedding ESG into collateral in the medium to long term; and provide a clear definition of ESG collateral following the consultation period.

**Ensuring safety and liquidity:** a minimum standard that advances ESG collateral without compromising safety and liquidity; this requires a pragmatic and step-by-step approach to collateral that can be taken initially by organisations that wish to show leadership in this field.

**Enabling leadership:** in line with the above, the standard does not require an immediate reorganisation of practices at large scale given the safety and liquidity considerations; as a result, the standard will put an emphasis on collaboration with those organisations that wish to show leadership in the early stages.

**Transparency:** having said that, the minimum standard puts emphasis on transparency – the lead stakeholders should be open to discuss their progress and lessons learned to demonstrate their leadership in this field.

**Streamlining technical workflows and reducing costs:** Collateral is highly specialised, and ESG considerations should not be buried under technical jargon. ESG provides an opportunity for streamlining highly technical workflows by identifying key impact points. Moreover, having a reference to one global model will drive costs down, in the long term, and form a precursor to potential formal and binding regulation.

**Flexible and complementary:** This standard does not presume to change individuals' unique business models or to standardise their various forms of collateral management. Rather, it offers a roadmap for people to align their current working practices with their ESG ambitions.

**Rewarding:** Global PSSSL will provide knowledge leverage to those organisations that wish to advance this agenda by providing a discussion platform that brings together the broader community of stakeholders including regulators, climate and bond experts and academics; this, in turn, will lead to a recognition that will benefit those lead organisations in the long-term.

**Cost effective:** Global PSSSL will advocate a consistent approach that can be taken in a cost-effective way (further assessments will be conducted with a broader stakeholder base).



Creating a Global ESG Market Standard for Owners, Lenders, Borrowers and Impact Creators.

*Aligned with Global PSSSL policy themes:*



## Structure of the Recommendations

The minimum forward-looking standard should be clear and concise. The following structure is offered as an example:

1. Objectives and key background information.
2. Major challenges and benefits of an interconnected collateral.
3. The minimum forward looking standard.

**Q1. Do you agree with the suggested overall design and structure?**

## Objectives and key background information

We will build upon the above objectives and key background facts.







# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

## Key action points:

- ✓ ESG appetite, profile and expectations: 1) beneficial owners should express these when choosing their agent lender and ensure it can be implemented by agent's service providers such as triparty collateral agent; 2) end users may wish to express their ESG and liquidity expectations when engaging prime brokers.
- ✓ Availability of tools: Agent lenders and triparty agents should communicate costs and benefits of opening bespoke or aggregate accounts for beneficial owners; platforms, indices and other methods for assessing and identifying ESG ratings; availability of automated systems; and mechanisms for substitution of collateral in case of collateral recalls.
- ✓ Constraints: beneficial owners, agent lenders/triparty providers, prime brokers and end-users should communicate on the constraints that may arise due to liquidity requirements or particular local rules. Particular attention should be given to the emerging markets' perspective.

**Agreements (collateral schedules):** ESG expectations must be translated into formal agreements and such considerations are often made at the onboarding stage. Suffice to say that appropriate legal departments will be engaged in formalising these agreements in line with the local rules (e.g. securities lending based on the title transfer or pledge agreements; bilateral and triparty agreements).

## Key action points:

- ✓ Clarify your position regarding the eligibility criteria, the relationship between voting and collateral and further ramifications for liquidity and costs.
- ✓ Consider how you can facilitate and influence broader sustainable finance and ESG by referring to the available tools in Table X below.



# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard for Owners, Lenders, Borrowers and Impact Creators.

Positive screening	Negative screening	Concentration limits	Turnover limits	Haircuts
<ul style="list-style-type: none"><li>• Preference for security X over security Y.</li></ul>	<ul style="list-style-type: none"><li>• Exclusion of security X due to ESG strategies.</li></ul>	<ul style="list-style-type: none"><li>• Limiting concentration of given securities in the portfolio of accepted collateral: asset limits, issuer limits, rule limits, industry limits, bespoke approaches.</li></ul>	<ul style="list-style-type: none"><li>• Prescribed by regulation the ratio of the maximum number of shares of a collateral equity to the turnover of the equity provided by the stock exchange.</li></ul>	<ul style="list-style-type: none"><li>• Investor requirements</li><li>• Sector - specific regulatory drivers</li><li>• General guidelines (e.g. BIS)</li></ul>

**Implementation and optimisation:** once the agreements have been put in place, normal trade and associated collateral flows as well as mark to market and optimisation activities commence.

#### Key action points:

- ✓ Monitor pricing fluctuations caused specifically by ESG factors and communicate clearly to beneficial owners and end users, as appropriate (agent lenders/triparty agents).
- ✓ Reduce collateral costs through ongoing optimisation and risk management – obtain ESG data from relevant data providers, per availability.

**Corporate actions:** the collateral in a form of a security which was posted to protect securities lending transactions may be subject to corporate actions and, in turn, substituted by the owners (e.g. prime brokers and hedge funds). The process will be dependent on the underlying legal agreements and requires further exploration in the ESG context (e.g. title transfer may require a recall of the collateral posted as opposed to the pledge agreement)). Global PSSSL suggests a broad understanding of corporate actions to include voting, spin offs, mergers and acquisitions etc.

#### Key action points:

- ✓ Beneficial owner, prime broker, end user: have a clear voting policy in place;
- ✓ Agent Lenders/Prime Brokers: Monitor life cycle of exposure and have mechanisms to mitigate any potential risks resulting from potential changes;

# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

**Reporting:** the stakeholders may already be subject to reporting requirements in the respective jurisdictions and Global PSSSL takes a neutral stance on this matter. In line with the feedback principle, Global PSSSL requests organisations to share their best practice voluntarily with Global PSSSL with the view to strengthening this market standard.

Q3. Would you have any comments on Embed in Current Practice section of the standard?

---

*Second current element: Engage in data-driven global evaluation*

---

This element of the standard encourages global debates and evaluation through an annual roundtable that will complement the day-to-day activities of Global PSSSL.

The annual roundtable should bring together the Global PSSSL leadership, regulators, central banks and data providers to discuss the challenges, barriers and opportunities in moving forward the collateral agenda.

Q4. Would you have any recommendations on this element of the standard?

---

*Third forward-looking element: Influence by dynamic approaches*

---

This element of the standard is forward-looking to encourage a more dynamic approaches to selecting securities collateral schedules by the beneficial owners (and their agents, when appropriate) as well as taking a more proactive approach to cash reinvestments and re-use of collateral by stakeholders.

# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

## Dynamic collateral schedules:

Currently, ESG strategies for collateral rely on long-standing exclusion schedules and concentration limits. This means that beneficial owners choose which securities they don't want to accept as collateral by reference to a given industry or security.

The dynamic approach involves a closer monitoring of the performance of given securities in collaboration with the fund managers, internal/external data providers and other stakeholders, including international organisations. In practice, it means that beneficial owners could include and/or exclude securities based on ESG performance of the underlying assets including prevailing company-specific issues. It is reasonable to expect that as ESG evaluation technology improves, this could become near-real time.

**Q5. Global PSSSL is currently gathering evidence on the feasibility of a more dynamic approaches to collateral schedules. Would you share your views on the barriers and opportunities relating to such an approach?**

## Dynamic cash reinvestments:

Cash as collateral is preferred or required in certain markets and may generate additional profit and value to beneficial owners through reinvestments. In the context of sustainable finance, those reinvestments may be placed in ESG money market funds and other short-term funds.

Money market funds may provide safe, consistent but small returns and, in turn, may have little impact on the broader sustainable finance agenda. Yet, such approaches may allow beneficial owners to pursue consistent ESG strategies across their whole value chains and portfolios. Moreover, such reinvestments may allow the allocation of cash on the basis of religious and cultural reasons.

**Q6 Do you invest your funds in ESG-oriented funds today? If not, why not? Are there any obstacles preventing you from such reinvestments?**

**Q7. Global PSSSL is currently gathering evidence on the feasibility of ESG cash reinvestments. Would you share your views on the barriers and opportunities relating to such an approach?**

## Dynamic re-use of collateral:

Similarly, collateral may be re-used by various stakeholders for the purpose of generating additional returns where permitted and desirable.

**Q8. Global PSSSL is currently gathering evidence on the feasibility of ESG related re-use of collateral. Would you share your views on the barriers and opportunities relating to such an approach?**

# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

---

## *Fourth forward-looking element: Impact by embracing sustainable instruments*

---

Currently, stakeholders prefer to accept liquid and safe collateral in order to ensure the regulatory compliance and micro- and macro-economic safety.

Global PSSSL would like to encourage and promote consideration of the use of green/sustainability/social and other sustainable finance related bonds as collateral. Such bonds are usually long-term instruments which are less liquid. However, investors may accept these as being consistent with overall portfolio objectives and be prepared to own, rather than liquidate collateral in the event of borrower default.

**Q9. Global PSSSL is currently gathering evidence on the feasibility of green and other sustainable finance related bonds as collateral. Would you share your views on the barriers and opportunities relating to such an approach?**

---

## *Sixth supportive element: Increased transparency*

---

Sustainable finance is complex, and the overall objective is to redirect capital into programmes and projects that align with the climate agenda and sustainable development goals. This raises the risk of green washing, social washing and governance failures if stakeholders become over-optimistic and either jump to conclusions too early or accept proclamations at face value. Transparency is the key mechanism that can mitigate this risk.

Global PSSSL will not expect that all organisations follow one uniform collateral eligibility schedule or direct their cash collateral to specific ESG financial instruments. However, the expectation is that organisations are transparent in terms of the availability and use of ESG tools for collateral management. The organisations must also be transparent in terms of the potential and real impacts of these instruments. In so doing, data providers will play an important role in collating, integrating/interrogating and disseminating data for ESG tools in securities lending.

Such an approach will increase transparency in the long term and Global PSSSL will work with all stakeholders to realise this ambition.

**Q10. Do you have any comments on this element of the standard?**



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

---

*Seventh supportive element: Liquidity and safety in line with investor criteria*

---

## **Macro-perspective – costs to the financial system**

All organisations engaged in securities lending should ensure that collateral management and associated eligibility schedules and collateral re-use do not pose risks to global financial stability and liquidity. In so doing, there are appropriate regulatory frameworks that organisations must adhere to.

The broader community of stakeholders should ensure that new sustainability solutions and proposals for securities lending are adequately considered and attributed to the impact creators (if such solutions improve the safety of financial systems).

There should be proactive dialogue between global and regional organisations (both systemically important and smaller and niche organisations). The former need to abide by liquidity requirements whereas the latter often pioneer new ESG solutions. Global PSSSL is the appropriate organisation to facilitate such a dialogue as it is home to a broader stakeholder base than any other organisation in this area of expertise.

## **Micro-perspective – costs to individual organisations**

Collateral flows can be very extensive, often spanning organisations and jurisdictions. Agent lenders, tri-party collateral agents and prime brokers all play key roles in facilitating these collateral flows within securities lending but also in the wider securities finance spectrum. These activities rely on best available technology to enhance the benefits to the ultimate beneficiaries of the securities lending transactions: beneficial owners and end users.

# Global Principles for Sustainable Securities Lending



Creating a Global ESG Market Standard  
for Owners, Lenders, Borrowers and  
**Impact Creators.**

## **Disclaimer:**

**Global PSSSL and this minimum standard are voluntary and do not create any legal rights or obligations. Global PSSSL will work on the recognition scheme in due course.**

## **Funding:**

**Funded by the Economic and Social Research Council (ESRC), part of UK Research and Innovation, through Sustainable Finance – Law – Stakeholders (SFLS) Network at Exeter Law School.**

---

<sup>i</sup> PSSSL from 2019 as presented by Stech in the Bank of England in December 2019.

<sup>ii</sup> *“We stress that the primary purpose of the collateral in securities lending is to mitigate counter-party risk. Securities Lending collateral parameters, such as exclusion lists, should be considered in ESG strategies. The portfolio will not benefit from performance, distributions (such as dividends, coupons) and voting rights must not be exercised on any asset held as collateral.”*