The Corporate Lobbying Alignment Project - Discussion Note no.7

Investor responses to corporate lobbying & policy capture by the financial services sector

January 2021

Preventable Surprises

The response to the insurrection at the US Capitol Building on 6 January 2021 showed that institutional investors are becoming more publicly engaged in the public policy conversation: public statements by the world's largest asset managers condemning the violence, including State Street,[1] BlackRock, Vanguard, and their peers, are important and welcome. These statements all included comments on these firms' respect for the democratic process. Yet their decision to reluctantly and belatedly engage in public dialogue on an existential threat to American democracy belies the financial services sector's powerful and systematic role in shaping the political and financial systems in many jurisdictions.

These companies have influenced and, in some cases, written the legislation governing the financial systems which pension funds and other long-term asset owners must invest in.[2] In the US, the financial services sector is the largest source of campaign contributions to federal candidates and parties, with insurance companies, securities and investment firms, real estate interests, and commercial banks providing the most financing for candidates and political parties and organisations.[3]

This Corporate Lobbying Alignment Project (CLAP) discussion note outlines reasons why asset owners and other long-term investors should ask financial services companies about their lobbying and influence practices. It is the seventh discussion note in a series examining how corporate lobbying and policy capture can create systemic risks for investors. It can be a challenge to develop and deploy stewardship strategies in the sector, since it can involve the lobbying practices of asset managers themselves, or more often concerns the banking and financial services conglomerates they form a part of. One the one hand, this is a conflict of interest and calls for external intervention, including from asset owners, who are the focus audience for the recommendations below. On the other hand, investors who increasingly understand the global political and economic dysfunction stemming from corporate capture would do well to begin addressing this in their own organisations.

After outlining engagement opportunities for the market as a whole, the note considers market segments in the financial services sector where lobbying and influence may be particularly important: asset management, credit rating agencies, hedge funds, private equity firms, and commercial banks. Given the systemic role of finance however, this should be considered a set of examples as opposed to an exhaustive list.

Investors can engage to address the lobbying power of the financial services sector.

The lobbying power of the financial services sector has always been strong in jurisdictions like the US and UK. For example, weak responses by market regulators following the global financial crisis indicate the effectiveness of the financial services lobbying and policy influence regime. On targeted issues like fee

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[1] 'Political Contributions and Activities Policy:' https://investors.statestreet.com/corporate-governance/political-contributions-and-activities-policy/default.aspx

[2] Regulatory comment letters from trade associations like the Institute of International Finance (IIF) help companies shape governance frameworks: https://www.iif.com/Advocacy/Regulatory-Comment-Letters; Model laws on tax and all major areas of financial regulation published by the American Legislative Exchange (ALEC) are another powerful tool for shaping the regulatory environment: https://www.alec.org/issue/tax-reform/

[3] https://www.opensecrets.org/industries/contrib.php?cycle=2020&ind=F

disclosure in the asset management industry,[4] global corporate tax reform,[5] and climate change regulation, policy influence has been particularly effective in blocking policy action. Globally, the lack of systematic enforcement of competition law in auditing,[6] commercial banking and other key areas of the financial services market indicates the breadth of influence deployed by companies and trade associations. From the fixing of benchmark interest rates including EURIBOR,[7] LIBOR,[8] CIDOR,[9] and the ISDAfix[10] to recurring hedge fund Ponzi schemes[11] and structured finance blow-ups,[12] financial firms can set the parameters of the market in which they operate and generally avoid meaningful justice or accountability.[13] This relative immunity creates risks for investors in the sector.

Engaged investors have an opportunity in 2021 to challenge companies involved in systemic misconduct and speak publicly on the role that negative lobbying can play in undermining the transparency and integrity of financial markets. As providers of capital to the asset management industry, pension funds, in particular, should consider shared statements and actions to improve the transparency of lobbying and policy influence activities in the institutional investment chain.

The longstanding lobbying power of the sector has expanded significantly since the 2008-09 Global Financial Crisis, with heavy investments in influence capabilities by asset managers, credit rating agencies, commercial banks, hedge funds,[14] private equity firms, auditors, financial advisors,[15] and other participants

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[4] Confusion over the fee structures charged by the asset management industry to asset owner clients is pervasive. 'Asset Management Fees: What's the going rate?' (2016): https://www.ipe.com/asset-management-fees-whats-the-going-rate/10012128.article. According to analysis by the FCA, confusion and lack of clarity remains a problem. See 'Review on disclosure of costs by asset managers' (28.02.2019): https://www.fca.org.uk/publications/multi-firm-reviews/review-disclosure-costs-asset-managers

[5] 'A Step Toward Smarter Taxes on Multinationals' Profits' (10.10.2019): https://www.bloomberg.com/opinion/articles/2019-10-10/oecd-tax-reform-proposal-for-multinational-companies-is-progress

[6] 'FRC tightens accounting standards after corporate failures' (30.09.2019): https://www.theguardian.com/business/2019/sep/30/frc-accounting-carillion-patisserie-valerie

[7] 'Citigroup, JPMorgan to pay $182.5 million to settle rate-rigging lawsuit' (23.11.2018): https://www.reuters.com/article/us-citigroup-jp-morgan-settlement/citigroup-jpmorgan-to-pay-182-5-million-to-settle-rate-rigging-lawsuit-idUKKCN1NS1SF?

[8] 'Barclays Bank PLC Admits Misconduct Related to Submissions for the London Interbank Offered Rate and the Euro Interbank Offered Rate and Agrees to Pay $160 Million Penalty' (27.06.2012): https://www.justice.gov/opa/pr/barclays-bank-plc-admits-misconduct-related-submissions-london-interbank-offered-rate-and; 'Libor: Bank of England implicated in secret recording' (09.04.2017): https://www.bbc.co.uk/news/business-39548313

[9] 'Lawsuit in U.S. accuses nine banks of rigging Canadian rate benchmark' (15.01.2018): https://www.reuters.com/article/idCAKBN1F42IN-OCABS?edition-redirect=ca

[10] 'CFTC Orders Goldman Sachs to Pay $120 Million Penalty for Attempted Manipulation of and False Reporting of U.S. Dollar ISDAFIX Benchmark Swap Rates' (21.12.20160: https://www.cftc.gov/PressRoom/PressReleases/7505-16. The administration of ISDAfix has been reorganised and it is now called the 'ICE Swap Rate'.

[11] 'SEC Settlements in Ponzi Scheme Cases: Putting Madoff and Stanford in Context' (13.03.2009): https://www.lexissecuritiesmosaic.com/gateway/sec/testimony/www.securitieslitigationtrends.com_PUB_Ponzi_Schemes_0309.pdf

[12] IOSCO (2008) 'Report on the subprime crisis:' https://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf; 'The Financial Crisis Inquiry Report': https://www.govinfo.gov/features/financial-crisis-inquiry-report

[13] 'Those who caused the financial crisis still haven't been held to account' (20.09.2018): https://www.theguardian.com/business/2018/sep/20/those-who-caused-the-financial-crisis-still-havent-been-held-to-account

[14] 'Regulating investment funds' (10.11.2010): https://corporateeurope.org/en/2010/11/regulating-investment-funds

[15] 'Fiduciary rule opponents not throwing in towel just yet' (27.06.2016): https://www.cnbc.com/2016/06/27/financial-advisor-fiduciary-rule-opponents-not-throwing-in-towel-just-yet.html

in the chain of actors managing “other people’s money.”[16] Any attempt to proactively regulate any market segment in the public interest is generally met with a standard refrain that "thousands of jobs and millions in tax revenues could be at stake,"[17] or the creation of astroturf groups, including the Mainstreet Investors Coalition, a creation of FTI Consulting.[18] Astroturfing is one influence approach that relies on the creation of grassroots or local organisations to represent the interests of corporate sponsors as coming from local people or communities.[19]

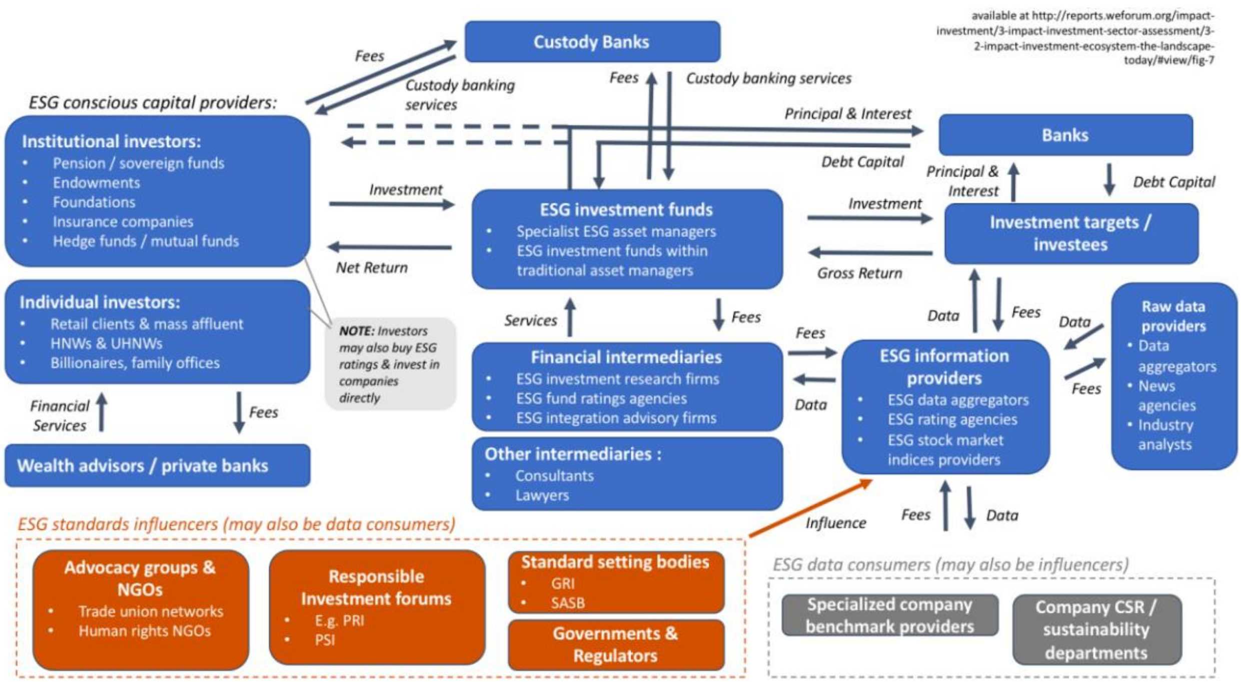

Figure 1: The institutional investment chain includes many actors and lobbying occurs by all stakeholders who seek to represent their interests and shape policies accordingly. The complex chain of intermediation increases the importance of transparency. Investors building engagement programmes to address lobbying should seek to identify the largest risks and opportunities to create change within this larger system. Diagram via Ruggie, J. (2018) 'Money, Millennials and Human Rights: Sustaining ‘Sustainable Investing:' https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/FWP_2018-01.pdf

[16] Kay, J. (2015) 'Other People’s Money: Far too much of a good thing:' https://www.johnkay.com/2015/06/15/other-peoples-money-introduction/

[17] 'How the financial lobby won the battle in Brussels' (13.09.2018): https://corporateeurope.org/en/financial-lobby/2018/09/how-financial-lobby-won-battle-brussels

[18] 'How One Firm Drove Influence Campaigns Nationwide for Big Oil' (11.11.2020): https://www.nytimes.com/2020/11/11/climate/fti-consulting.html; Working for the National Association of Manufacturers, FTI produced a study arguing that activist shareholders tend not to help shareholder value. The report’s five authors were employees of the consulting firm Compass Lexecon, a wholly owned FTI subsidiary. This research informed the Main Street Investor Coalition’s work. See 'Political, social and environmental shareholder resolutions: do they create or destroy shareholder value?': www.shopfloor.org/wp-content/uploads/2018/06/nam_shareholder_resolutions_survey.pdf; 'Sustainability Matters: New SEC Rule Weakens Influence of Main Street Investors' (24.09.2020): https://www.morningstar.com/articles/1002322/sustainability-matters-new-sec-rule-weakens-influence-of-main-street-investors

[19] 'The role of anti-corruption laws in the fight against astroturfing' (20.03.2019): www.oecd.org/corruption/integrity-forum/academic-papers/Lima-Carvalho-anti-corruption-laws.pdf

Enhanced lobbying and influence disclosure a starting point for change

For investors, enhanced company disclosure of lobbying and influence spending is necessary to begin to assess the risk profile of these activities, and to identify opportunities for engagement. A financial services company that is focused on maintaining the status quo via lobbying may be sending a signal that it is focused on short-term influence and not on assessing forward-looking risks and opportunities. In addition, when resources are deployed in a way that may appear fraudulent as in the case of Wells Fargo mis-selling products,[20] or criminal in the case of HSBC's serial money laundering convictions,[21] or in which the primary beneficiaries are the company's managers or individual shareholders and not the company as a whole, companies might face reputational risks. These reputational risks may have a negative impact on financial results and damage the long-term viability of the business, particularly if they lead to class action litigation and criminal prosecutions.[22]

In order to benchmark a programme of engagement focused on lobbying conduct, investors should start with information requests. This process can include shareholder resolutions but should not stop there. Shareholder resolutions and negotiated disclosure requests are established areas for investor action. What is now required is persistence and a scaling up of engagement to cover the largest firms in a coordinated way. Scaling up engagement across the sector and increasing the demands for both disclosure and reforming influence practices, particularly by trade associations, is essential in order to have an impact on the financial sector. This coordination work could happen through existing investor networks coordinated by the UN-PRI, Ceres, the International Corporate Governance Network and others. Significantly, the largest investment managers are not yet providing this disclosure in a systematic manner, indicating opportunities to scale up engagement in 2021. BlackRock, for example, has had its own shareholder resolution from investors requesting more detailed disclosure of political spending. The resolution called for an annual report disclosing the company's trade association and lobbying expenditures, and BlackRock's procedures and guidelines for determining lobbying communications and payments.[23]

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[20] 'Wells Fargo to Pay $500 Million for Misleading Investors About the Success of Its Largest Business Unit' (21.02.2020): https://www.sec.gov/news/press-release/2020-38. According to the SEC, from 2002 to 2016, Wells Fargo opened millions of accounts of financial products that were unauthorized or fraudulent. Wells Fargo's Community Bank also pressured customers to buy products they did not need and would not use. Wells Fargo, via its employees, is one of the largest political finance providers in the US. See: https://www.opensecrets.org/orgs/summary?id=D000019743&cycle=2002

[21] 'Timeline: History of HSBC controversies' (09.02.2015): https://www.ft.com/content/28c5744a-b03f-11e4-92b6-00144feab7de; 'HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement' (11.12.2012): https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations

[22] 'Corporate Lobbying: Can Transparency Mitigate the Risk for Investors?' (27.06.2013): https://blogs.cfainstitute.org/investor/2013/06/27/corproate-lobbying-can-transparency-mitigate-the-risk-for-investors/

[23] 'Shareholder Proposal – Production of an Annual Report on Certain Trade Association and Lobbying Expenditures:' https://www.sec.gov/Archives/edgar/data/1364742/000119312519104809/d632173ddef14a.htm#toc632173_33

BlackRock rejected this resolution, but this work could serve as a model for coordinated disclosure requests across the largest companies in the sector.

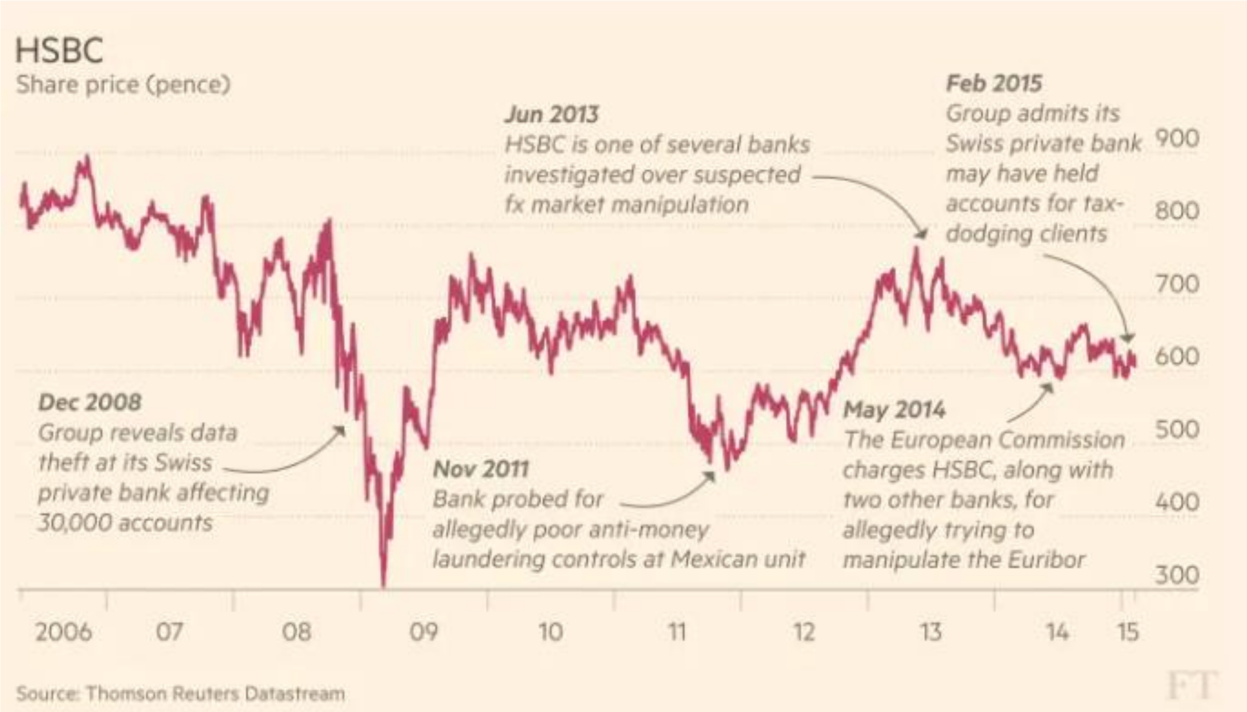

Figure 2: HSBC's struggle with regular controversy shows that lobbying and influence cannot prevent the crystallization of reputational risks. Investors should ask for full disclosure on lobbying and influence spending and make clear that smokescreens, astroturf and the use of other influence tactics are not a replacement for robust corporate governance, adherence with regulations, and systems to integrity in business operations. Source FT: https://www.ft.com/content/28c5744a-b03f-11e4-92b6-00144feab7de

Addressing the need for enhanced disclosure and guidelines for lobbying & influence in the financial services sector

Long-term asset owners, particularly pension funds, can engage with the financial services sector to better understand and then address reputational, legal, and market risks created by lobbying and influence spending by companies and their trade associations. In 2021, asset owners can:

1. Bring shareholder resolutions requesting greater disclosure of lobbying spending and other influence spending by financial services firms and their trade associations.[24]

2. Meet with corporate counsel and the global public affairs directors at the ten largest investment banks to request an explanation of their lobbying practices and use of external influence channels, including trade associations such as the National Association of Manufacturers and the American Legislative Exchange Council (ALEC). Investors can request regular updates on this information to create a systematic dataset on policy influence in the asset management sector.

3. Communicate a public position on the need for transparency on corporate lobbying and robust enforcement of financial regulations across the G7.

4. Publish a financial services sector engagement strategy that addresses lobbying and influence activities that weaken the integrity of and stability of global financial markets.

5. Collaborate on shared public statements and engagement programmes to improve the transparency of lobbying and policy influence activities by all financial services companies and their trade associations.[25]

Corporate lobbying & influence by financial services companies

Financial services sector firms dominate all aspects of the global economy. This makes the sector important for engagement from ESG investors and others considered with systemic risks and long-term financial stability. As part of the global expansion of the sector, financial services firms are now deeply involved in regulatory and policy processes across all areas of public policy. While most lobbying is benign, or may even have a positive educational element, where lobbying is opaque and disproportionate, it can lead to policy capture and create new risks. The extensive resources at the disposal of financial services trade associations and interest groups and the close relationship that exists between some financial services companies, regulators, and lawmakers can lead to undue influence over public policymaking.

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[24] 'Citigroup and Goldman face shareholder pressure on lobbying' (03.04.2018): https://www.ft.com/content/33285f2e-3471-11e8-ae84-494103e73f7f. CtW Investment Group requested the bank to provide an annual report on its lobbying activities. The requested report would break down payments for direct lobbying and indirect lobbying through trade associations such as the US Chamber of Commerce, the Business Roundtable and the Securities Industry and Financial Markets Association. US investor groups have a long history of bringing lobbying disclosure resolutions at banks, with growing support. See 'Goldman dodges a shareholder battle that dogs rivals' (14.04.2014): https://www.reuters.com/article/us-goldman-shareholders-analysis-idUSBREA3D06X20140414

[25] Investors can take inspiration from existing shared statements on the need for lobbying disclosure, including the European investor expectation on corporate lobbying on climate change: https://www.churchofengland.org/sites/default/files/2018-10/Investor.Expectations.Climate.Lobbying.Oct_.2018.pdf

For commercial banks,[26] and other segments of the financial services sector, lobbying, and policy influence to weaken regulation are a key part of the incumbent business strategy. Academic research describes how banks are more likely to lobby when they are larger, have more vulnerable balance sheets, are less creditworthy, and have more diversified business profiles. According to the IMF, banks engaged in non-traditional businesses such as securitization and trading, or highly regulated business lines such as insurance, hire more lobbyists and spend larger amounts on lobbying.[27] In an increasingly concentrated sector like commercial banking, the role of corporate influence grows. Investors should have strategies in place to manage the risks associated with the expansion of financial services lobbying and influence tactics. Investors can draw on this existing research to build effective engagement programmes with the banking sector.

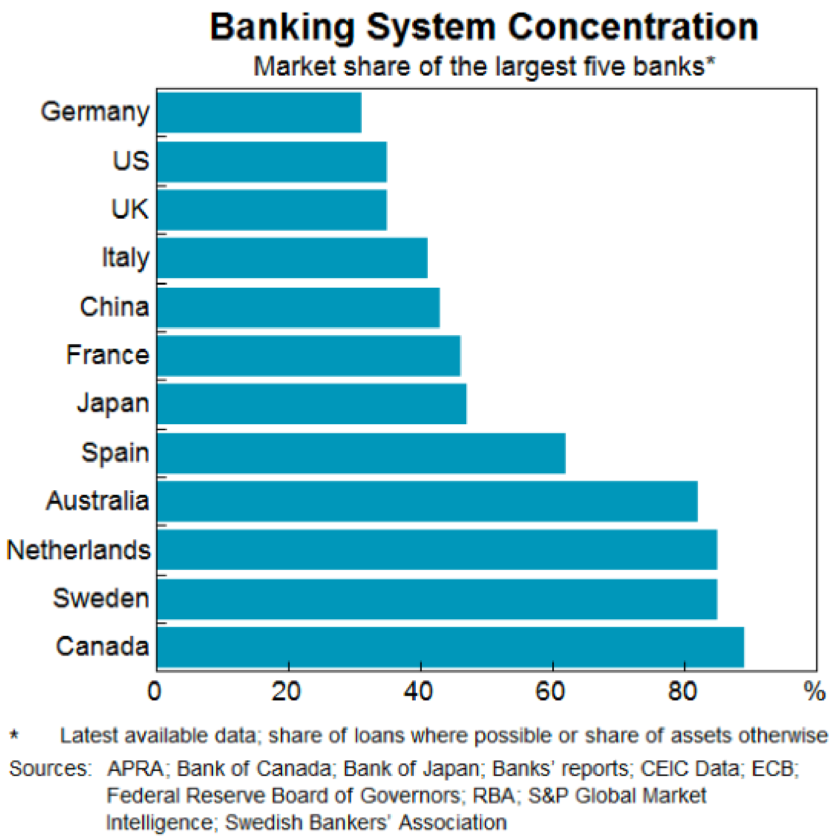

Figure 3: Concentration in the banking sector creates new opportunities for investor engagement with a concentrated group of companies which dominate the sector in most large economies. Market concentration may also amplify the risk of overt influence and lobbying activities which undermine long term financial outcomes for investors and create new systemic risks. From: https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html

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[26] The Determinants of Banks' Lobbying Activities before and during the 2007-2009 financial crisis: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1785435

[27] Id. And 'British Bankers Association claimed key lobbying victories' (09.07.2012): https://www.theguardian.com/business/2012/jul/09/british-bankers-association-lobbying-victories

Financial sector influence includes successful opposition to a financial transaction tax following the Global Financial Crisis,[28] a well-established revolving door between regulators and regulated companies,[29] the use of smokescreens to divert public attention away from the core issues of how the global financial system is regulated and the exercise of influence via trade associations and astroturf[30] organisations like the Main Street Investors Coalition, as discussed above. Coordinated investor action to engage with the largest financial services companies can help to improve the sector's risk profile and support a more stable financial system for all investors.

Why corporate lobbying & policy capture matters for investors: industry snapshots

The discussion below provides examples of segments of the financial services sector where policy capture and lobbying by companies and industry associations may create new risks for investors or amplify existing market risks. This is not a comprehensive treatment of the issues across the financial services sector but rather an introduction to areas that may merit further action and engagement by investors. These issues will be analysed in greater detail in the CLAP final report in spring 2021.

Asset managers and climate engagement

Asset managers lobby across many issues, but the current sustainable finance push in Brussels provides a useful case study on their approach. In response to a regulatory push to better align the financial system with climate targets,[31] a coalition of asset managers are urging Brussels to delay implementation of its landmark sustainable investing rules, arguing that the deadlines for enhanced ESG disclosure are too ambitious. A large trade association, the European Fund and Asset Management Association has written to regulators asking for more time for the industry to gather information about the environmental, social and governance risks in their portfolios.[32] According to NGO Reclaim Finance, financial institutions are the largest block opposing a taxonomy for polluting activities, with 74 institutions making up 45% of the indicated opposition to these proposals.[33] Though the financial sector is divided, many influential global financial institutions and several professional federations or associations have sought to block the introduction of a benchmark taxonomy that would punish polluting activities, particularly the fossil fuel sector.

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[28] 'Lobbying to kill off Robin Hood' (2012): https://corporateeurope.org/sites/default/files/publications/killing_robin_hood.pdf; 'The future of capital taxation' (13.12.2018): https://responsibletax.kpmg.com/page/the-future-of-capital-taxation

[29] 'Osborne criticised over Treasury job for former bank lobbyist' (09.12.2015): https://www.theguardian.com/politics/2015/dec/09/former-bank-lobbyist-to-head-treasury-office-tax-simplification

[30] 'How to stop 'astroturf' campaigns and the spread of misinformation' (25.11.2020): https://impactalpha.com/how-to-stop-astroturf-campaigns-and-the-spread-of-misinformation/

[31] See 'A European Green Deal:' https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en#policy-areas; and 'Commission action plan on financing sustainable growth:' https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en

[32] 'Joint letter on a European ESG database' (09.06.2020):https://www.efama.org/Publications/20-024%20Joint%20industry%20letter%20ESG%20EU%20data%20register_EACB_EBF_EFAMA_ESBG_IE_PE.pdf

[33] 'In the Shadow: Who is opposing the taxonomy for polluting activities? (04.12.2020): https://reclaimfinance.org/site/en/2020/12/04/who-is-opposing-the-taxonomy-for-polluting-activities/

Resistance from the investment management industry to the European Commission's Sustainable Finance Action Plan points to the gap between policymaker and asset owner ambitions for green finance and the reality of corporate influence over public policy goals. This includes revolving door appointments[34] and uneven reporting of public policy engagement and lobbying across markets. The European Commission has prioritised the development of the world's first rulebook for sustainable finance, but financial services sector incumbents could frustrate the timely achievement of this important goal. Investors in the largest listed asset managers, including BlackRock,[35] should be asking these firms to provide clarity on how their lobbying activities in Brussels and Washington, DC, align with public commitments to climate action.

Credit rating agencies

Credit ratings agencies (CRAs) are essential to the functioning of modern capital markets as they provide an opinion on the relative ability and willingness of corporate issuers to meet financial commitments. Yet the industry is weakly regulated and dominated by just three companies. The risks posed by conflicts of interest and a business model that encourages ratings inflation were made clear in the Global Financial Crisis.[36]

A business model defined by conflicts of interests requires lobbying to block reform.

The influence wielded by credit ratings agencies became most apparent following the 2008-09 crisis. In July 2009, S&P parent company McGraw-Hill hired the Podesta Group and its owner, Tony Podesta, a lobbyist, to tackle "liability provisions in credit rating agency reform," according to the group's lobbying disclosure reports.[37] Tony's brother, John Podesta, was President Clinton's chief-of-staff and co-chairman of President Obama's transition committee.[38] Subsequent to heavy lobbying, the Dodd-Frank Act (2010) found credit ratings to be systemically important to the financial system,[39] but regulation of the sector did not increase or address structural conflicts of interest.[40]

Global consolidation of ESG data providers. More recently, consolidation and business growth through acquisition means that a credit rating agency oligopoly now each has an ESG data arm, including S&P

[34] 'Former Goldman Sachs partner Richard Sharp to become BBC chairman' (06.01.2021): https://www.ft.com/content/ab426971-e904-49b8-acc4-dd75dba50305

[35] Change Finance (2020) 'The BlackRock Model:' https://s3.eu-central-1.amazonaws.com/euobs-media/0f8a453730d35813560ca6188cfea823.pdf

[36] IOSCO (2008) 'The role of credit rating agencies in the structured finance market:' https://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf; 'The Icarus Syndrome: How Credit Rating Agencies Lost Their Quasi Immunity:' https://core.ac.uk/download/pdf/216915472.pdf

[37] 'What's (Still) Wrong with Credit Ratings' (31.05.2017): https://corpgov.law.harvard.edu/2017/05/31/whats-still-wrong-with-credit-ratings/

[38] 'Facing crackdown, credit raters bring on heavy hitters' (08.04.2010): https://publicintegrity.org/inequality-poverty-opportunity/facing-crackdown-credit-raters-bring-on-heavy-hitters/; 'Podesta Group:' https://en.wikipedia.org/wiki/Podesta_Group

[39] 'Credit rating agency reform is incomplete' (06.03.2017): https://www.brookings.edu/research/credit-rating-agency-reform-is-incomplete/#footnote-9

[40] 'SEC Amends Rules Related to Credit Rating Agencies' (10.12.2009): https://corpgov.law.harvard.edu/2009/12/10/sec-amends-rules-related-to-credit-rating-agencies/

Trucost, Moody's ESG Solutions, and Fitch.[41] Ongoing consolidation increases lobbying power and reduces competition and the need for transparency. Investors in these companies, and who are making investment decisions based on ratings should be asking for greater regulatory oversight to prevent a repeat of the 2008-09 crisis.

Hedge funds

The nature and volume of lobbying by hedge funds and groups representing them has changed dramatically following the Global Financial Crisis.[42] Prior to that hedge funds and their representatives engaged in a limited amount of direct lobbying, relative to various other industries, and this lobbying was generally focused on preventing legislation or regulation that would require registration of hedge fund managers with the SEC.[43] More recently, there is interest in "the tactical short-term use of political lobbying to create a single windfall gain in the financial markets."[44] Hedge fund political spending is also increasing.[45]

Private equity

The private equity industry is well established in lobbying for financial rules that enable their leveraged buyout business model.[46] A key theme in US private equity industry lobbying has been the preservation of the carried interest loophole.[47] As private equity firms use the promise of outsize returns to maintain pension funds interest, industry lobbyists push for the continuation of tax reforms that would maintain carried interest - the tax-advantaged profit share that enables private equity managers to extract wealth from investee companies. In the US and UK, private equity owned companies have been able to access Covid-19 bailout funds, in spite of their debt-financed investment model, indicating the extent to which regulators respond to the industry's needs.[48] Changes to the US regulatory regime to enable retail savers to invest in private equity funds, a new source of capital for these firms, is a further indication of their lobbying powers.[49] The American Investment Council (AIC), a high profile industry association, continues to push the House of

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[41] 'Fitch Ratings Assigns 380 New ESG Scores for FIs with Support-Driven Ratings' (10.11.2020): https://www.fitchratings.com/research/banks/fitch-ratings-assigns-380-new-esg-scores-for-fis-with-support-driven-ratings-10-11-2020

[42] 'Hedge Funds Increasing Lobbying Efforts, Focusing On Shaping Regulations Rather Than Preventing Them' (16.07.2009): https://www.hflawreport.com/2538546/hedge-funds-increasing-lobbying-efforts-focusing-on-shaping-regulations-rather-than-preventing-them.thtml

[43] 'Hedge funds - summary:' https://www.opensecrets.org/industries/indus.php?ind=F2700&cycle=2020

[44] 'When hedge funds lobby' (11.03.2014): blogs.reuters.com/felix-salmon/2014/03/11/when-hedge-funds-lobby/

[45] https://www.opensecrets.org/industries/lobbying.php?cycle=2016&ind=f2700

[46] 'How the World's Biggest Buyout Deal Crashed and Burned' https://www.bloomberg.com/features/2017-bce-oral-history/

[47] 'Buyout Firms In 'Grassroots' Lobbying Effort to Preserve Tax Loophole' (19.08.2010): https://www.huffingtonpost.co.uk/entry/private-equity-grassroots_n_685190?ri18n=true

[48] 'Private equity groups push for access to UK loans scheme' (10.04.2020): https://www.ft.com/content/d11f626f-ab56-45e4-91d6-4684cd6b4118

[49] In June of 2020, the US in June, the Department of Labor issued a letter telling retirement plan fiduciaries they could include private equity in professionally managed asset allocation funds they offer to plan participants. See 'Private fund group lobbies to get products in 401(k)s' (): https://www.investmentnews.com/private-fund-group-lobbies-use-products-retirement-plans-197262. SEC Commissioner Jay Clayton was a strong proponent of these changes. See 'Clayton wants retirement investors to have more access to private funds' (09.04.2019): https://www.investmentnews.com/clayton-wants-retirement-investors-to-have-more-access-to-private-funds-79000; 'SEC Private Investment SubCommittee Update' (27.05.2020): https://www.sec.gov/files/PrivateInvestmentsSubcommitteeUpdate.pdf

Representatives to pass a resolution “affirming that private equity plays an important role in growing and strengthening the United States … and that it has fostered significant investment in the United States economy.”[50] Influence campaigns seek to portray the private equity industry in a positive light in spite of private equity-owned companies frequent debt implosions.[51] Investors must scrutinise claims alongside the longstanding marketing of PE funds as a consistent source of investment outperformance for pension investors.[52]

Selling to yourself - sidecar deals & conflicts of interest in private equity

The ability of the private equity industry to engage in self-dealing transactions demonstrates their ability to shape an accommodative regulatory environment that enables high risk business practices. The Covid-19 crisis means that the private equity industry has found it harder to maintain its commitment to investors to sell portfolio companies to outside buyers after a set period of ownership. When traditional routes to exit are reduced, private equity owners need an alternative by selling these firms to themselves. Blackstone, EQT, BC Partners and Hellman & Friedman are among the private equity groups to have sold companies to funds that they themselves control this year or have published plans to do so. Although the model emerged before the pandemic, its use has increased. The value of such deals is expected to hit $35bn this year, up from $7bn just four years ago.[53] Long term investors who are concerned about sustainable economic recovery from Covid-19 should be concerned about transactions that involve self-dealing and the limited regulatory oversight of these deals.

Commercial banks

Commercial banks have ramped up stock buybacks through the pandemic period,[54] with US, UK, and European banking regulators allowing banks to return to business as usual, returning capital to shareholders and executives while weakening banks’ resilience against a potential credit collapse. These decisions reflect the extent of influence over policymakers that banks continue to wield, from direct political lobbying to a well-entrenched revolving door between regulators and the largest banks in the US and UK.[55] Beyond the UK, Canada, and the US, there are fewer examples of financial regulators taking on roles in the regulated industry and then going back again as most other countries tend to rely on career civil servants to staff their top regulatory bodies. Investors can communicate their support for transparent and robust anti-corruption practices and statutory limits on revolving door appointments in the largest capital markets to address this trend. Beyond enrichment via share buybacks, banks have been adept at undermining attempts to limit the flow of criminal money into the formal financial system.[56]

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[50] https://www.govtrack.us/congress/bills/114/hres464

[51] 'The Demise of Toys ‘R’ Us Is a Warning' (2018): https://www.theatlantic.com/magazine/archive/2018/07/toys-r-us-bankruptcy-private-equity/561758/

[52] 'Private Equity’s Biggest Critic Sounds Off With His Final Warning' (23.07.2020): https://www.bloomberg.com/news/articles/2020-07-23/private-equity-s-big-returns-aren-t-what-they-seem-academic-says

[53] 'How selling to yourself became private equity’s go-to deal' (28.12.2020): https://www.ft.com/content/ee914ea4-4ad9-4eec-97c3-95af841122bf

[54] 'Top US banks set for $10bn round of buybacks (10.01.2021): https://www.ft.com/content/c2b155a3-8901-4011-be32-fde3f4bad740; 'Big Bank Buybacks: JPMorgan Leads The Field' (11.01.2021): https://seekingalpha.com/article/4398362-big-bank-buybacks-jpmorgan-leads-field

[55] 'Enter the revolving regulators' (23.04.2012): https://www.ft.com/content/2f5790fa-8d50-11e1-9798-00144feab49a

[56] 'Banks Suspected Illegal Activity, but Processed Big Transactions Anyway' (20.09.2020): https://www.nytimes.com/2020/09/20/business/fincen-banks-suspicious-activity-reports-buzzfeed.html

Share buybacks & dividends through the Covid-19 period. Analysts expect the buybacks to come in close to the maximum permitted under a Federal Reserve decree in late December,[57] which surprised investors by allowing banks to resume buybacks and return billions to shareholders while also flattering banks' earnings per share. The banks voluntarily halted share repurchases last March, as the pandemic threatened a steep recession and catastrophic loan losses. The US Federal Reserve's June 2020 stress tests banned buybacks until the end of 2020 and capped dividends at a level linked to recent profits and pay-outs. In Europe, The European Central Bank indicated that the largest eurozone banks would be permitted to resume paying dividends from the start of 2021,[58] subject to conditions based on profitability and capital ratios. While the resumption of dividend payments may be of short-term interest to investors, resuming the practice in the midst of a global pandemic and economic depression in the UK and US raises questions about the medium-term stability of the banking sector.

At the global scale, IMF research shows how the world's largest financial institutions lobbied on specific issues related to mortgage lending and securitisation adopted significantly riskier mortgage lending strategies in the run-up to the crisis.[59] The Covid-19 period and the ongoing support for the commercial banking sector's special relationship with regulators from central banks to financial regulators demonstrates the extent of their influence.

Institutional investors who want to dampen systemic risks through the 2020s should consider engaging with the largest financial services companies to address lobbying and influence which weakens the financial systems and encourages excessive risk taking.

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57 'U.S. Bank Shares Climb on Promise of $11 Billion Buyback Bonanza' (21.12.2020): https://www.bloomberg.com/news/articles/2020-12-21/u-s-bank-shares-climb-on-promise-of-11-billion-buyback-bonanza

58 'ECB extends recommendation not to pay dividends until January 2021 and clarifies timeline to restore buffers' (28.07.2020): https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200728_1~42a74a0b86.en.html

59 Simpson, Glenn R (2007), "Lender Lobbying Blitz Abetted Mortgage Mess", *The Wall Street Journal*, 31 December.; https://voxeu.org/article/lobbying-and-financial-crisis; Igan, Deniz, Prachi Mishra, and Thierry Tressel (2009), "A Fistful of Dollars: Lobbying and the Financial Crisis", IMF Working Paper 09/287.

Appendix 1 - Top 10 financial services companies by industry segment

Asset managers[60]	ESG data providers	Credit rating agencies	Investment consultants	Hedge funds	Private equity firms[61]	Accounting & auditing services
BlackRock	MSCI	Moody's	Mercer (Marsh & McLennan)	Bridgewater Associates	The Carlyle Group	PWC
The Vanguard Group	S&P TruCost	S&P Global Ratings	Aon Willis Towers Watson[62]	Renaissance Technologies	Kohlberg Kravis Roberts	Deloitte
Charles Schwab Corporation	Morningstar (Sustainalytics)	Fitch (Hearst)	Hewitt EnnisKnupp (Aon)	Man Group	The Blackstone Group	KPMG
UBS	Moody's ESG Solutions Group[63]	DBRS	Cambridge Associates	Millennium Management	Apollo Global Management	EY
State Street Global Advisors	Vigeo Eiris	Morningstar	Russell Investments	Elliott Management	TPG	McKinsey
Fidelity Investments	Bloomberg	ARC Ratings	Capita Employee Benefits	Two Sigma Investments	CVC Capital Partners	Baker Tilly
Allianz	Sustainalytics	Japan Credit Rating Agency	Hymans Robertson	The Children's Investment Fund Management	General Atlantic	Grant Thornton
J.P. Morgan Asset Management	TrueValue Labs	A.M. Best	Buck	Citadel LLC	Ares Management	BDO
BNY Mellon Investment Management	Sensefolio	Kroll Bond Rating Agency	Deloitte	D.E. Shaw & Co.	Clayton Dubilier & Rice	Smith & Williamson
PIMCO	Clarity AI	Dominion Bond Rating Service	PWC	AQR Capital Management	Advent International	RSM Tenon

Appendix 2 - Trade Associations

American Bankers Association & state affiliates

60 Listed in order of approx. AUM.
61 List in order of approximate capital raised.
62 Merger in progress.
63 https://ir.moodys.com/news-and-financials/press-releases/press-release-details/2020/Moodys-Launches-Comprehensive-ESG-Solutions-Group-Appoints-Global-Head/default.aspx

Asociacion de Bancos de Mexico

Asociacion Mexicana de Administradores de Fondos Para El Retiro

UK Finance Association

Business Roundtable

Consumer Bankers Association

Financial Services Forum Bank Policy Institute

Global Financial Markets Association & affiliates SIFMA, AFME, ASIFMA

Institute of International Finance

International Capital Markets Association

International Swaps and Derivatives Association

Managed Funds Association

Partnership for New York City

The CityUK

The Clearing House

US Chamber of Commerce

Structured Finance Association

The Loan Syndications and Trading Association (LSTA)

About this discussion note

This note is designed to introduce and update investors on the scope, role, and potential negative impact of lobbying and policy capture by the financial services sector, and to propose options for investor responses. Addressing corporate lobbying on public policy and regulatory issues will be of immediate interest for asset owners who have long-term investment time horizons and are concerned about stability and transparency in the financial system. The discussion note is intended as a work-in-progress, to be complemented by examples, and feedback we will receive from the investment community and other stakeholders. It is the seventh in a year-long series on different themes, sectors, and geographies that will form part of a final report at the end of the project period.

About Preventable Surprises

Preventable Surprises is a ‘think-do’ tank focused on systemic ESG risks in the financial system. We work with positive mavericks within the investment industry to persuade the financial sector to better address systemic risks. Legislators, regulators, the media, NGOs, and consumers each have a role to play in building a more transparent and sustainable market system, yet much of the power lies with corporations and their investors. Preventable Surprises focuses on institutional investors because, through the trillions of dollars in assets under their management, they have enabled corporate and market dysfunction.

About the Corporate Lobbying Alignment Project

The Corporate Lobbying Alignment Project (CLAP) is an applied research and engagement project launched in June 2020 working to make corporate political capture a central component of investors’ approach to ESG stewardship and integration. It seeks to leverage information on the state of play for key sectors and share lessons learned from past investor engagements. Through research interviews and a series of events, the programme will engage the global investment community to help prioritise and inform areas for action.

If you are an investor or other stakeholder in the institutional investment or policy system with insights into how corporate lobbying affects public policy related to climate action and other key public policy areas, we would like to hear from you. We will not share your name or any identifying information without your express permission. **Get in touch today: research@preventablesurprises.com**