The Corporate Lobbying Alignment Project

Discussion note no.8

Preventable Surprises

Financial regulators and lobbying: the need for greater transparency, more robust investor engagement, and a call for applying the precautionary principle

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Regulators & corporate lobbying: the opportunity for investors to support greater transparency and integrity in financial markets

Investors know that the global financial system is vast and complex, and therefore requires robust regulation to maintain stability. In times when market regulation is undermined or weakened via excessive corporate influence, risks crystalise and damage market confidence and investor returns. This was most obvious during the Global Financial Crisis of 2008-09, when market regulators did not assess the risk profile of mortgage-backed securities adequately. Policymaker and investor concerns over financial stability following the GFC led to an unprecedented push to better regulate international financial flows and reporting.

Beginning with the G-20 Pittsburgh Declaration in 2009,[1] regulatory responses to the GFC fundamentally reformed over-the-counter derivatives markets and other areas of the financial system. In the decade since the GFC, global policymakers have focused on reducing the opacity, complexity, and interconnectedness of financial systems via macroprudential reforms. This included action at the G20 Financial Stability Board and by prudential regulators within national central banks and across the securities regulatory system to enhance transparency and stability in sensitive market segments. Yet the effectiveness of these reforms and associated improvements in transparency have been impacted and undermined by heavy lobbying of regulators and governments. Within this complex web, this Corporate Lobbying Alignment Project (CLAP) discussion note highlights certain areas where investors could engage with regulators to ensure more robust and transparent financial markets as the world economy begins to recover from covid-19.

Financial regulation includes all the rules and laws governing the financial industry and covers banks, insurance companies, financial brokers, asset managers, pensions funds, and other key players. Regulation provides rules and principles but also includes the ongoing oversight and enforcement of these regulations in a systematic and predictable way. For global finance to function and for investors to have confidence in markets, participants must believe that the regulatory system and its enforcement will happen with integrity and that the rules will be applied similarly to all actors. Financial markets with regulators who lack integrity and a robust and systematic approach to enforcement may encourage misconduct. This damages the investment prospects for genuine market participants and can lead to the build-up of systemic risks, as witnessed in the GFC.

Robust financial regulation safeguards the wider financial system and protects investors, including pension beneficiaries, when things go wrong. Forward-looking micro prudential and macroprudential financial regulation can also encompass systemic risks such as climate change,[2] biodiversity loss,[3] and economic inequality,[4] among other concerns. Incorporating systemic risk issues across the financial regulatory landscape provides safeguards for all long-term investors and society whose investment horizons put them at greater risk from these larger risk factors than short-term investors.[5]

1 http://www.g20.utoronto.ca/2009/2009communique0925.html#system

2 FSB 'Task Force on Climate-Related Financial Disclosures:' https://www.fsb-tcfd.org; 'APRA outlines plans for climate risk prudential guidance and vulnerability assessment' (24.02.2020): https://www.apra.gov.au/news-and- publications/apra-outlines-plans-for-climate-risk-prudential-guidance-and-vulnerability

3 'Final Report - The Economics of Biodiversity: The Dasgupta Review:' https://www.gov.uk/government/publications/final-report-the-economics-of-biodiversity-the-dasgupta-review;; 'Investor action on biodiversity: discussion paper (01.09.2020): https://www.unpri.org/sustainability-issues/environmental- social-and-governance-issues/environmental-issues/biodiversity

4 'Task Force on Inequality-related Financial Disclosures (TIFD):' https://thetifd.org

5 ICGN (2020) 'Coronavirus as a new systemic risk: Implications for corporate governance and investor stewardship:' https://www.icgn.org/coronavirus-new-systemic-risk-implications-corporate-governance-and-investor-stewardship; Chenet, Ryan-Collins, & van Lerven (2021) 'Climate-related financial policy in a world of radical uncertainty: Towards a precautionary approach:' https://www.ucl.ac.uk/bartlett/public-purpose/sites/public- purpose/files/final_chenet_et_al_climate-related_financial_policy_-_towards_a_precautionary_approach_20_dec.pdf

Short term gains from lobbying to undermine financial regulation amplifies long-term systemic risks

So far, the CLAP has considered systemic risks linked to corporate policy capture in detail in several sectors of the economy. This month's discussion note highlights the potential for excessive corporate influence and policy capture of financial market regulators and why this should be of concern for investors. While Covid-19 has refocused investor and regulator attention on systemic risks, there has not yet been an investor-led discussion on the regulatory responses required to preserve financial system stability in an era of climate change, pandemics, and outsized corporate influence on financial regulation.

This note contributes to start that dialogue with the world's largest investors, asset owners in particular. Previous discussion notes already highlighted academic research on lack of public trust in market regulators and the perception of government corruption at the G7[6] should be of concern for long-term investors who want to invest in a global system that favours social, political, and financial stability. Transparent and reliable financial regulation is key to maintaining stability across these systems.

Growth in lobbying of financial regulators has expanded rapidly over the past decade following the GFC as banks and their lobbying partners sought to undermine regulatory action in London, Brussels,[7] and Washington, DC. The expansion in lobbying power in finance means that regulators often play catch up in addressing systemic risks like climate change. This means investors must assess risks links to systematic greenwashing[8] and other product mis-selling issues long before regulators investigate them. Asset owners and other long-term investors can take actions to support more robust regulation, and to ensure that the goals of financial regulation - financial system stability, integrity, and trust in markets - are prioritised ahead of narrow corporate interests. As active participants in the financial system with in-house legal and public affairs teams, investors understand how to change the system from the top down. To achieve this, investors must engage to ensure they are active participants in regulatory dialogues and processes across markets. <u>If the work of engaging with regulators to determine market structure and regulatory priorities is left primarily to industry lobbyists, this will continue to create new risks and market disruption like the GFC.</u>

We identify six possible areas for investor action to address negative lobbying practices that may damage the integrity of financial regulation. These are high-level engagement areas where we think investors can have an impact across the financial systems. They do not represent an exhaustive list but provide the starting point for more structured engagement plans. To start with, investors can:

1. <u>Engage with</u> financial sector trade bodies to support clear public messaging that that robust financial regulations are necessary to ensure market integrity and enable long-term capital deployment.

2. <u>Publicly communicate</u> support for the OECD Principles on Transparency and Integrity in Lobbying,[9] and associated action at international bodies, including the Financial Stability Board,[10] the International Organization of Securities Commissions (IOSCO),[11] the International Accounting Standards Board (IASB)[12] and with institutional investor associations including the UN-backed Principles for Responsible Investing and the ICGN, to ensure that anti-corruption and associated principles on for regulatory integrity in are followed across the financial system;

6 In the UK, for example, see: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/554817/Striking_the_Balance__web__-_v3_220916.pdf
7 https://corporateeurope.org/sites/default/files/attachments/financial_lobby_report.pdf
8 'SEC to Review Climate-Related Disclosure' (25.02.2021): https://alerts.davispolk.com/10/5545/uploads/2021-02- 25-sec-climate-change.pdf?sid=16ec62b1-dc4b-4bcb-a094-a15677cff2b1
9 https://www.oecd.org/gov/ethics/oecdprinciplesfortransparencyandintegrityinlobbying.htm
10 https://www.fsb.org/about/
11 IOSCO is the global standard-setter for securities regulation and publishes the 'Objectives and Principles of Securities Regulation': https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdfa
12 'Responsibilities of the IASB:' https://www.iasplus.com/en/resources/ifrsf/history/resource21

3. Support or file shareholder resolutions on lobbying transparency by companies in all sectors to send a clear and consistent message on investor expectations for transparent lobbying and influence activities. Extend these resolutions to explicitly encompass lobbying of financial regulators.

4. Instruct in-house counsel and legal and public affairs team to engage with regulators on the need for transparent and robust regulation that promotes financial stability and investor confidence, as well as greater systemic (e.g., environmental and social) stability ahead of narrower vested interests of market participants.

5. Request more transparent disclosure from regulators about the input they receive from lobbyists on key regulatory issues to better understand how corporate influence is shaping regulatory priorities.

6. Engage in targeted dialogue with the largest credit rating agencies regarding incorporation of ESG risks into ratings methodologies and the need for greater simplicity and transparency in ratings on structured finance products that led to the GFC.[13]

7. Support the application of the precautionary principle in financial regulation.[14] The precautionary principle seeks to improve decision-making under conditions of uncertainty. The principle, with origins in international environmental law, indicates that if an action or policy has a suspected risk of causing harm to the public then, in the absence of a clear consensus among researchers, the burden of proof that it is not harmful falls on those taking an action rather than on those who seek to prevent it.

Financial regulation should support more transparent markets

The goals of financial regulation are generally to maintain trust in the financial system and its stability, ensure market integrity via regulatory and supervisory actions, and to protect investors. In most markets, these regulators have concentrated powers, exercise a high degree of discretion in determining enforcement priorities, have political independence and must adhere to market confidentiality requirements.[15] The US Commodities and Futures Trading Commission, for example, has around 500 staff and oversees US actors in a global market for derivatives with the value of outstanding contracts in 2019 estimated at $640 trillion by the Bank of International Settlements.[16]

13 The business model for rating agencies continues to rely on fees that are paid by bond issuers, the "issuer-pays" business model which creates conflicts of interest and may lead to systematic ratings inflation and associated collapses in shareholder value, like Carillion, WireCard, Enron and other corporate implosions.

14 Chenet et al (2021): 'Climate-related financial policy in a world of radical uncertainty: Towards a precautionary approach:' https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/final_chenet_et_al_climate- related_financial_policy_-_towards_a_precautionary_approach_20_dec.pdf; and 'How should regulators deal with uncertainty? Insights from the Precautionary Principle' (27.01.2017): https://bankunderground.co.uk/2017/01/27/how-should-regulators-deal-with-uncertainty-insights-from-the- precautionary-principle/

15 Russo C (2016) 'The Ethics of Banking and Financial Regulatory Authorities: a study of the Bank of England, the Prudential Regulation Authority, the Monetary Policy Committee and the Financial Conduct Authority', a report annexed to the CSPL Commanding report to the UK Parliament on 'Striking the Balance: Upholding the Seven Principles of Public Life in Regulation': ttps://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/554355/Ethics_of_B anking_and_Financial_Regulatory_Authorities_by_Dr_Costanza_Russo.pdf

16 The BIS estimate of contracts outstanding is for the global derivatives market, where regulated US-based participants are major market players. The gross market value of all contracts (i.e., if they were all to be settled) is significantly less, estimated at $12 trillion. See: 'How Big Is the Derivatives Market? (28.04.2020): https://www.investopedia.com/ask/answers/052715/how-big-derivatives-market.asp The mission of the Commodity Futures Trading Commission (CFTC) is to foster open, transparent, competitive, and financially sound markets, to avoid systemic risk, and to protect the market users and their funds, consumers, and the public from fraud, manipulation, and abusive practices related to derivatives

The Bank of England and the Prudential Regulatory Authority have a much broader regulatory remit that covers all core segments of the financial system across the £3 trillion UK derivatives market[17] and the banking, insurance, pension sectors.[18] Long term investors and asset owners in particular have a role to play in ensuring the integrity of these important regulatory institutions.
Despite regular reminders of the importance of market oversight, a failure to maintain robust financial regulatory standards routinely impacts all market participants. Weak regulatory responses to the Libor benchmark rigging scandal[19] and the GFC demonstrates how policy capture by market participants can result in poorly regulated financial institutions engaging in risky conduct that then undermines the stability of the global financial system. During the GFC, financial system failures caused by corporate policy capture and a failure to effectively regulate large segments of the derivatives market transformed the lives of millions of people and continues to impact the global economy. In the case of Libor and other interest rate benchmarks, commercial banks colluded to set global interest rate benchmark rates, distorting global markets to the benefit of individual banks.[20]

The GFC also led to the creation of new institutions, including the European Systemic Risk Board[21] and the G20's Financial Stability Board. The response included a financial regulatory reform agenda consisting of Basel III in the EU and the Dodd-Frank Act in the US;[22] attempts to clarify international accounting standards,[23] the regulation of credit rating agencies,[24] strengthened derivatives market rules, corporate governance reforms, the introduction of financial transactions taxes, and other measures. Significant aspects of the post-GFC regulatory reform agenda have been dampened through lobbying efforts, and investors have not yet shared a strong public view on the importance of regulatory integrity in the financial system.[25]

Revolving doors & conflicts of interest in the global financial regulatory system

One important case study of corporate influence over financial regulators is the use of post-public sector employment opportunities to influence conduct. This can create conflicts of interest when financial regulators, lawmakers and/or their family members have direct financial stakes in the industries they are meant to regulate, particularly when they expect to have a highly remunerated position waiting for them upon exit from public service. A common practice in the United Kingdom, for example, is the granting of advisory roles or seats on company boards to former or serving politicians. Academic research explains how a 'revolving door' of exchange of staff between corporations and regulators dampens regulatory action to prioritise public interests, and enables the business interests to influence and control political decisions.[26]

17 'Total derivatives assets held by banks in the United Kingdom from the first quarter of 2011 to the third quarter of 2020:' https://www.statista.com/statistics/1214272/outstanding-derivatives-assets-banks-uk/

18 'Financial market infrastructure supervision:' https://www.bankofengland.co.uk/financial-stability/financial-market- infrastructure-supervision. The PRA oversees all the major UK banks, building societies, credit unions, insurers and investment firms in the UK, and the Bank of England oversees all payments infrastructure, benchmark rate for interest rates, currency, commodities, and additional financial system infrastructure.

19 'Barclays fined £59.5 million for significant failings in relation to LIBOR and EURIBOR' (27.06.2012): https://www.fca.org.uk/news/press-releases/barclays-fined-£595-million-significant-failings-relation-libor-and-euribor

20 'Deutsche Bank hit by record $2.5bn Libor-rigging fine' (23.04.2015): https://www.theguardian.com/business/2015/apr/23/deutsche-bank-hit-by-record-25bn-libor-rigging-fine

21 https://www.esrb.europa.eu/about/background/html/index.en.html

22 Basel III is a global, voluntary regulatory framework on bank capital adequacy, stress testing, and market liquidity risk.

23 https://www.fasb.org/news/nr032409.shtml

24 FSB (29.08.2013) 'Credit Rating Agencies Reducing reliance and strengthening oversight: Progress report to the St Petersburg G20 Summit:' https://www.fsb.org/wp-content/uploads/r_130829d.pdf. The EU has made some progress in this area. See: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial- supervision-and-risk-management/managing-risks-banks-and-financial-institutions/regulating-credit-rating- agencies_en

25 Spitler (2020) 'The Long Game: The Decade-Long Effort to Dismantle the Dodd-Frank Act': https://scholarship.law.unc.edu/ncbi/vol24/iss1/5 'Dodd-Frank's Regulatory Morass' (10.11.2014): https://www.theregreview.org/2014/11/10/romano-dodd-frank-consequences/

26 'Still Going Round in Circles: The Revolving Door Between Banks And Their Regulators' (27.02.2019): https://www.finance-watch.org/still-going-round-in-circles-the-revolving-door-problem-between-banks-and-their- regulators/

Former Governor of the Bank of England Mervyn King's senior advisor role at Citi,[27] Mark Carney's new role with Brookfield Asset Management,[28] former Governor of the Bank of Canada Stephon Poloz's move to Enbridge two days after finishing his Governorship,[29] and former President of the European Commission José Manuel Barroso's decision to become the executive chairman of Goldman Sachs are all examples that indicate the potential for revolving door influence over regulators.[30] In jurisdictions with large financial sectors such as the UK, regulated banks and the government often speak publicly with one voice on regulatory matters, with the distinction between public and private interests increasingly blurred.[31] If regulators are too close with regulated entities this may lead to lax enforcement of rules designed to protect all market participants.

Competition regulators

Competition law is an area where lobbying has dampened enforcement of existing regulations in North America and Europe across industries. In the United States, the currently dominant judicial interpretation holds that corporate antitrust liability should be based purely on whether an action increases economic efficiency with reference to lower consumer prices and is not based on broader concerns over the competitive process and concentrations of power. In general, the consumer welfare standard holds that if a company's actions result in lower prices for consumers in the short term, then courts should not find it guilty of breaking the antitrust laws.[32] This approach was taken up by the US and in other G7 jurisdictions[33] but it also led to high levels of concentration across different sectors of the economy, resulting in a number of risks for investors.[34] In particular, regulatory responses to perceived market concentration in the pharma, tech, defence,[35] and financial services sectors could create litigation and regulatory risks for investors in these companies.[36]

27 'Lord King's Citi role highlights need to police revolving door' (01.08.2016): https://www.ft.com/content/9cb6669c- 57ec-11e6-9f70-badea1b336d4

28 'Brookfield Announces Appointment of Mark Carney as Vice Chair and Head of ESG and Impact Fund Investing' (26.08.2020): https://bam.brookfield.com/press-releases/2020/08-26-2020-131930311

29 'Enbridge Appoints Stephen S. Poloz to its Board' (04.06.2020): https://www.prnewswire.com/news- releases/enbridge-appoints-stephen-s-poloz-to-its-board-301070475.html; 'One Week Out of Bank of Canada, Poloz Lands Two Plum Board Seats' (09.06.2020): https://www.bloomberg.com/news/articles/2020-06-09/one-week-out-of- bank-of-canada-poloz-lands-two-plum-board-seats

30 Other examples include JPMorgan's hiring of former British prime minister Tony Blair in 2008 to advise on strategy, alongside former Italian finance minister Vittorio Grilli and ex-Israel central bank boss Jacob Frenkel serving as vice- chairmen. See 'Citi appoints former UK foreign minister Hague as senior adviser' https://www.reuters.com/article/us- citi-moves-idUSKBN1511HY

31 'Statement from the Chancellor and international investment banks on London as a world leading financial centre' (07.07.2019): https://www.gov.uk/government/news/statement-from-the-chancellor-and-international-investment- banks-on-london-as-a-world-leading-financial-centre

32 A brief history of the consumer welfare standard:' https://springboardccia.com/2020/05/28/a-brief-history-of-the- consumer-welfare-standard/

33 The Common Understanding of G7 Competition Authorities on "Competition and the Digital Economy": https://www.agcm.it/dotcmsdoc/allegati-news/G7%20Common%20Understanding%20final.pdf

34 'Big Companies Are Getting a Chokehold on the Economy' (22.02.2018): https://www.bloomberg.com/opinion/articles/2018-02-22/big-companies-gaining-monopoly-power-pose-risk-to-u-s- economy; 'Democratising Markets:' https://www.economicliberties.us/wp-content/uploads/2021/02/Democratizing- Markets.pdf?; 'Market Power and Monetary Policy:' https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/market-power-and-monetary-policy-speech-by-andy- haldane.pdf?la=en&hash=ECC7B63705847EC5E68DEFC86C56B887B9DBD0CD

35 'The Incredibly Shrinking Defense Industry' (01.08.2019): https://www.pogo.org/analysis/2019/08/the-incredibly- shrinking-defense-industry/

36 'Antitrust Enforcement Beyond Big Tech: Other Industries to Watch' (11.03.2021): https://news.bloomberglaw.com/antitrust/antitrust-enforcement-beyond-big-tech-other-industries-to-watch; 'The State of Congressional Investigations in 2021' (26.01.2021): https://www.skadden.com/insights/publications/2021/01/2021- insights/litigation-controversy/the-state-of-congressional-investigations-in-2021

Securities regulators

According to IOSCO, "the three core objectives of securities regulation" are (1) protection of investors; (2) to ensure that markets are fair, efficient and transparent; and (3) to reduce systemic risk."[37] Yet IOSCO's Objectives and Principles of Securities Regulation do not mention lobbying.[38] In the US context, a single piece of legislation responding to the Global Financial Crisis, the Dodd-Frank Act, 2,961 organizations participated in the lobbying process either during the congressional bill stage, the agency rulemaking stage, or both.[39] More recently, the US SEC has been lobbied to limit access of investors to bring shareholder resolutions on ESG issues, and in other areas.[40] In order for the SEC and other securities regulators to be able to fulfil their core mandates, investors must ensure that corporate lobbying and political interference is minimised.

Central banks & prudential regulation

Central bank monetary policy and prudential regulation are key to maintaining the financial stability and transparency that investors require to deploy capital with confidence. From a public policy perspective, the goal of banking regulation is:

to ensure the stability of the financial system...The failure of a large bank or multiple bank failures may force a sudden contraction of the money supply, a failure of the payments system, a severe dislocation of the real economy, and real or implicit obligations on the part of the government. The failure of any bank, no matter how small, may lead to contagion and loss of coincidence in the system, unless the government can demonstrate its ability to handle bank failures in an orderly and systematic fashion.[41]

Despite these well-established principles, successful lobbying to weaken oversight of the banking sector has led to a series of scandals including systematic product mis-selling at Wells Fargo.[42] Large scale fraud allegations at Credit Suisse in relation to its Mozambique 'tuna bond' loan[43] and the collapse at the Greensill Bank in Germany and its UK sister company Greensill Capital indicate the extent of systematic weaknesses in the prudential banking regulatory framework. Routine investigations and deferred prosecution agreements with US regulators at banks including Deutsche Bank[44] and HSBC,[45] among others, indicates a belief that regulatory enforcement will always be weak. and Investors concerned with the stability of both individual institutions and the wider financial system should consider actions to remedy these shortcomings.

37 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf
38 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf
39 'Presence and influence in lobbying: Evidence from Dodd-Frank:' https://www.cambridge.org/core/journals/business-and-politics/article/presence-and-influence-in-lobbying-evidence- from-doddfrank/C75E6EFC1109A84676EF6ABD0B2BC588
40 'The Main Street Investors Coalition is an Industry-Funded Effort to Cut Off Shareholder Oversight' (14.06.2018): https://corpgov.law.harvard.edu/2018/06/14/the-main-street-investors-coalition-is-an-industry-funded-effort-to-cut-off- shareholder-oversight/
41 Polizatto, V. (1990): 'Prudential Regulation and Banking Supervision Building an Institutional Framework for Banks:' documents1.worldbank.org/curated/en/389501468764981235/pdf/multi-page.pdf
42 'Wells Fargo Agrees to Pay $3 Billion to Resolve Criminal and Civil Investigations into Sales Practices Involving the Opening of Millions of Accounts without Customer Authorization' (21.02.2020): https://www.justice.gov/opa/pr/wells- fargo-agrees-pay-3-billion-resolve-criminal-and-civil-investigations-sales-practices
43 Ex-Credit Suisse bankers arrested in $2bn fraud investigation '(04.01.2019): https://www.theguardian.com/global-development/2019/jan/04/ex-credit-suisse-bankers-arrested-in-2bn- investigation; 'Mozambique files case against Credit Suisse' (28.02.2019): https://www.bbc.co.uk/news/business-47405071
44 'Deutsche Bank to Pay $800 Million Penalty to Settle CFTC Charges of Manipulation, Attempted Manipulation, and False Reporting of LIBOR and Euribor' (23.04.2015): https://www.cftc.gov/PressRoom/PressReleases/7159-15; 'Deutsche Bank to Pay Over $10 Million to Settle Two CFTC Cases' (18.06.2020): https://www.cftc.gov/PressRoom/PressReleases/8185-20; 'Deutsche Bank pays nearly $125m to resolve US bribery and fraud claims' (08.01.2021): https://www.ft.com/content/8bdf8fc9-0820-437c-b18c-fb6be6a517c0
45 'HSBC wins OK of record $1.92 billion money-laundering settlement' (03.07.2013): https://www.reuters.com/article/us-hsbc-settlement-laundering-idUSBRE9611B220130702; 'HSBC Holdings Plc Agrees to Pay More Than $100 Million to Resolve Fraud Charges' (18.01.2018): https://www.justice.gov/opa/pr/hsbc- holdings-plc-agrees-pay-more-100-million-resolve-fraud-charges

Prudential regulation

Banks lobby regulators to weaken the enforcement agenda across key areas of the banking system.[46] With many central banks now tasked with implementing a prudential regulatory regime for climate risk, lobbying extends to the use of climate VAR models and associated reporting requirements for banks, insurance companies, and pension funds. Yet prudential regulation has not yet evolved to address the systemic nature of climate risk comprehensively. Investor engagement could help to ensure that central bank action on climate change is robust.[47]

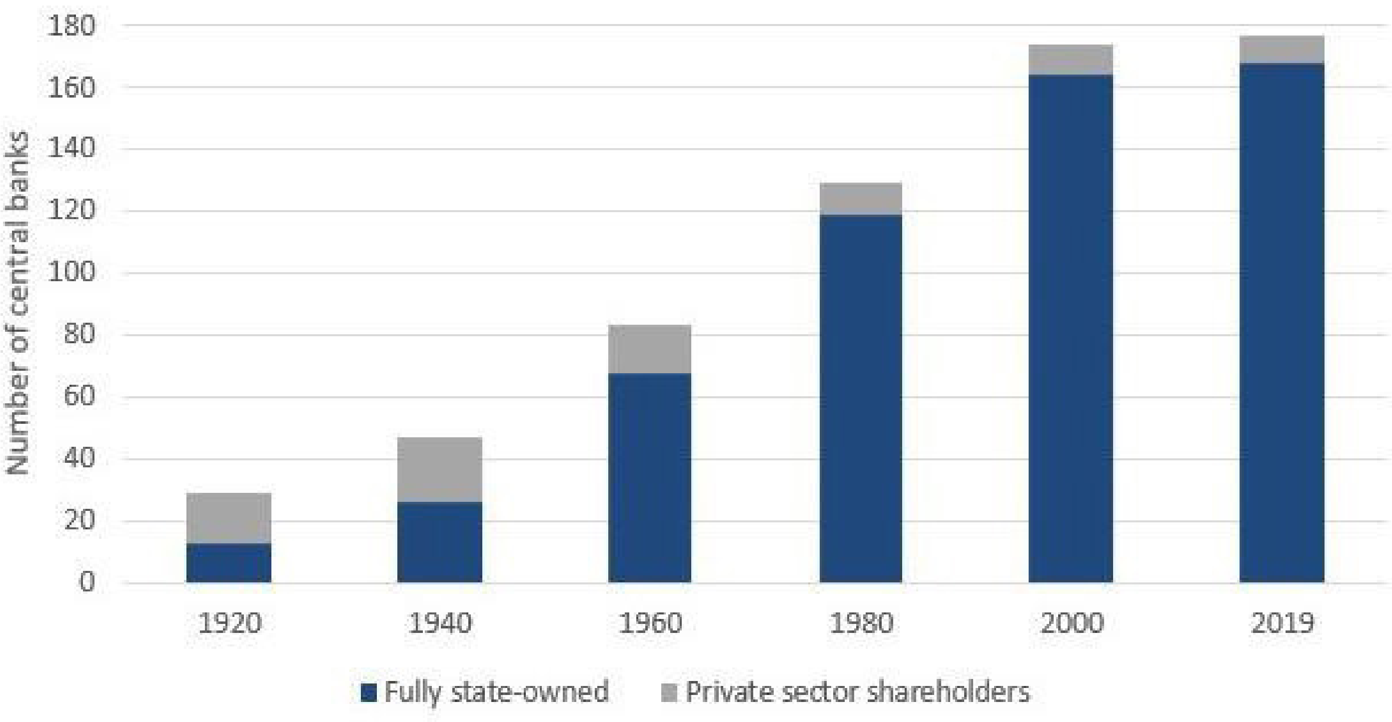
Regulatory flexibility allowed national authorities to set a more lenient definition of loan default in terms of several days past due, permitting potential forbearance on non-performing loans, or to apply a lower risk weight for short-term interbank exposures (reducing regulatory costs for interbank loan supply). These rules would apply to all banks subject to the supervision of national authorities. Furthermore, supervisory discretion allowed national supervisors – based on a case-by-case assessment – for example, to set a 0% risk weight for banks' exposures guaranteed by the governments, and to apply a more favourable credit risk treatment to banks' exposures to public sector entities (potentially increasing the nexus between banks and sovereigns, or public sector institutions).[48]

Monetary policy

The key policy instrument of modern central banks is short-term interest rates, and in the covid era, quantitative easing programmes have been added as a key tool. Current and expected levels of interest rates are a central element in the valuation of almost all financial securities, so monetary policy has an impact on a broad range of asset prices and yields and is fundamental to asset owner investment considerations and asset class-based investment decisions. The investment decisions made by institutional investors in response to interest rate scenarios then influence real economic activity and inflation, which have an immediate impact on investment strategies.[49] This makes central bank policy an important focus area for influence by commercial banks. Lobbying and influence practices differ by jurisdictions, as central banks have different ownership structures. Some, including the Bank of England, and the Bank of Canada are wholly publicly owned, with others like the Banca d'Italia, have private shareholders, while the Bank of Japan is a hybrid of public and private ownership.[50]

46 https://projects.iq.harvard.edu/files/pegroup/files/ignatowskikortewerger2014.pdf?m=1420559680
47 'Finance, climate-change and radical uncertainty: Towards a precautionary approach to financial policy': https://www.sciencedirect.com/science/article/pii/S092180092100015X
48 'Prudential regulation, national differences and banking stability' (23.05.2019): https://www.ecb.europa.eu/pub/economic-research/resbull/2019/html/ecb.rb190523~65756630c3.en.html
49 https://www.ecb.europa.eu/pub/pdf/other/pp85-98mb200808en.pdf, at 4.
50 'The ownership of central banks' (18.10.2019): https://bankunderground.co.uk/2019/10/18/the- ownership-of-central-banks/. The authors note that the shares of central banks in Belgium, Greece, Japan, and Switzerland are even publicly traded on stock exchanges.

FIGURE 1: Ownership model of central banks globally over time, 1900 to the present. Today, most central banks are government owned entities, but are still the subject of intense engagement and lobbying given their influential position in the global financial system.



Source: 'The ownership of central banks' (18.10.2019): https://bankunderground.co.uk/2019/10/18/the-ownership-of-central-banks/

The addition of quantitative easing policies following the GFC, and more recently during the Covid-19 period, means central bank policy is more important than ever. The low interest rates in G7 markets since the GFC mean that some institutional investors such as pension funds and insurance companies have turned to investing increasingly in debt-supported assets.[51] Corporate and government bond buying programmes in the pandemic and the competition to access Covid-19 recovery loan facilities show the extent to which central banks are another focus for corporate lobbying.[52]

At the Bank of England, for example, the Monetary Policy Committee (MPC) sets interest rates and is also in charge of the bank's new quantitative easing powers.[53] This makes the MPC a target for influence by all actors interested in maintaining access to Covid-19 related programmes. Market participants regularly provide the Bank, on an informal basis, with confidential client information to assist the Bank's understanding of the market for its policy purposes, which shows that there are well established informal communication channels to influence policy outcomes.[54] It is important that formal and informal influence channels are managed with integrity by central banks and other regulators. Investors can make clearer their expectations for robust processes to maintain regulatory integrity through a period of unprecedented volatility in the covid era.

51 In the US alone, from 2008 to 2017 total alternative assets under management (AUM) grew from $3.1 trillion to $8.8 trillion, and analysts expect it to reach $14 trillion by 2023. See 'Alternative Assets Industry Set to Hit $14 Trillion by 2023' (23.10.2018): https://docs.preqin.com/press/Future-of-Alts-Oct-18.pdf. 'Harvard, Princeton Rush to Sell Debt to Yield-Hungry Buyers' (10.09.2020): https://www.bloomberg.com/news/articles/2020-09-10/harvard-princeton- rush-to-sell-debt-to-yield-hungry-investors

52 'Central Bank Market Neutrality is a Myth' (16.10.2020): https://www.cepweb.org/central-bank-market-neutrality-is- a-myth/

53 Quantitative easing measures mean central banks issue electronic money to buy financial assets, usually government bonds from commercial banks. In the covid period, these purchases have been extended to corporate bonds and shares, a practice which seeks to lower the cost of capital and help firms survive and continue to have access to capital in the form of new debt and equity issuance. See Joyce et al (2011) 'The United Kingdom's quantitative easing policy: design, operation and impact:' https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2011/the-uks-quantitative-easing-policy-design-operation-and-impact.pdf

54 54 Bank of England Foreign Exchange Market Investigation A Report by Lord Grabiner QC: https://www.bankofengland.co.uk/-/media/boe/files/report/2014/foreign-exchange-market-investigation-report-by-lord- grabiner , at 40.

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 financial market regulation 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

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