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Governance tectonics

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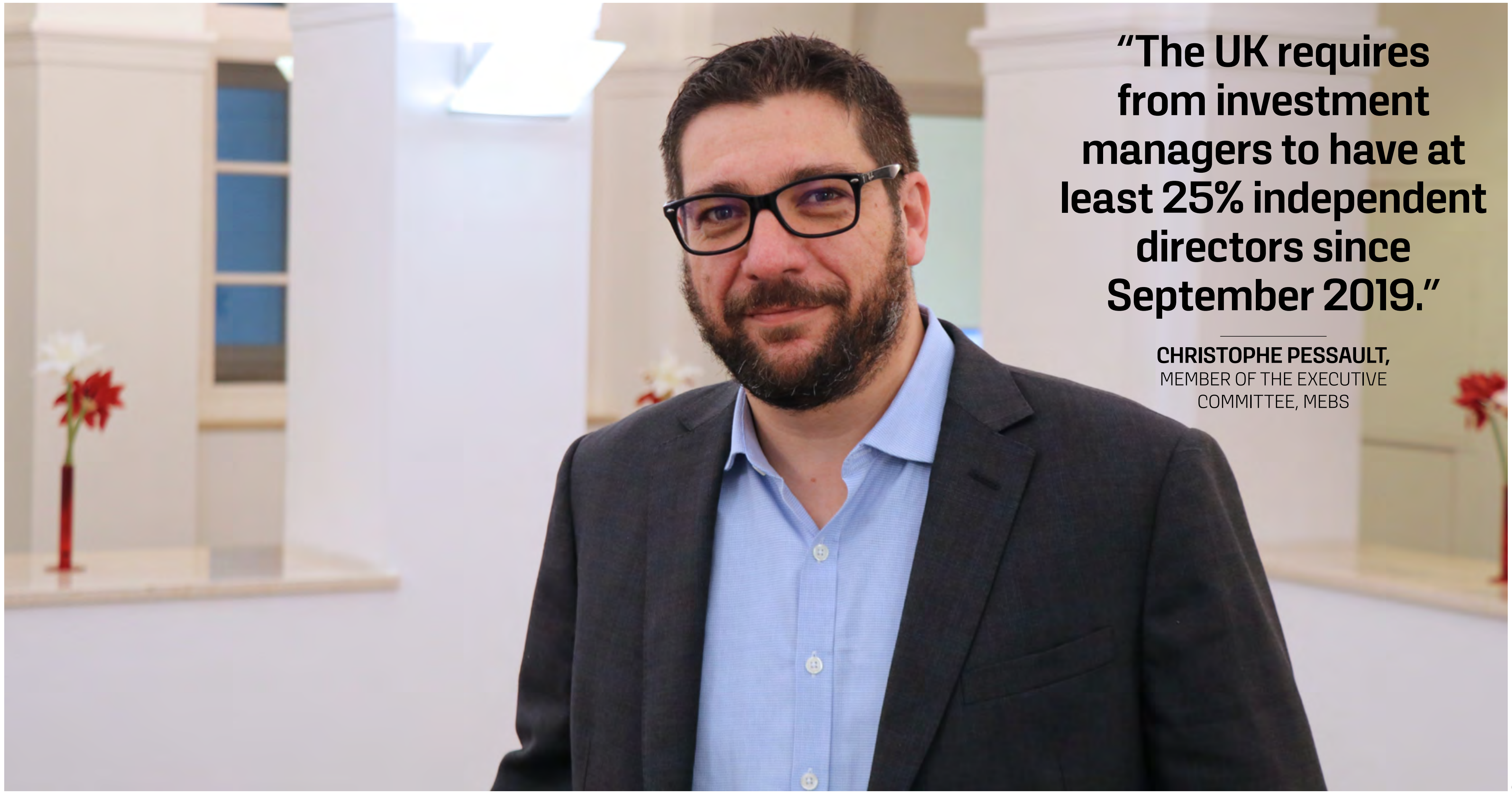
PRIOR TO THE COVID-19 CRISIS, CHRISTOPHE PESSAULT, MEMBER OF MEBS' (ME BUSINESS SOLUTIONS) EXECUTIVE COMMITTEE, DISCUSSED CURRENT TRENDS IN THE FUNDS SECTOR: LIQUIDITY RISK MANAGEMENT, GOVERNANCE AND ESG. INTERVIEW.



"The UK requires from investment managers to have at least 25% independent directors since September 2019."

CHRISTOPHE PESSAULT,
MEMBER OF THE EXECUTIVE COMMITTEE, MEBS

What are the recent changes regarding liquidity risk management?
In December 2019, the Commission de Surveillance du Secteur Financier (CSSF) issued a circular on the matter, based on the recommendations of the International Organisation of Securities Commissions (IOSCO). It sets out the regulator's expectations regarding the processes to be put in place to better understand and to better manage liquidity risk, as from the fund design phase. It also requires one or more contingency plans to be put in place so that the fund can use liquidity management tools if and when necessary. It is interesting to note that this circular was published a few months after the European Securities and Markets Authority (ESMA-EMF) issued guidelines on liquidity stress-testing, to which UCITS and AIF are required to comply with by 30 September 2020. These guidelines aim to standardise and to strengthen the practice at the European level. ESMA also published a case study – using its own methodology – with a sample of 6,000 bond funds. Among other things, it showed that 40% of high-yield vehicles could face liquidity problems in certain severe but plausible crisis scenarios. Implementing and complying with these regulations poses a number of challenges, particularly in terms of access to consistent data on which to rely on.

And what about governance?
Governance is a central element. Firstly, I observe that no process can be effective without a strong and adapted governance structure; to some extents, the CSSF and the ESMA stressed this fact in the circular and guidelines I mentioned earlier. Secondly, let me quote B. Shaw: "You see things; and you say "Why?" But I dream things that never were; and I say "Why not?". And when I am looking at our English fellows who have required investment managers to have at least 25% independent directors since September 2019, I am saying: "why not us?". I'm not dogmatic about it, I am relying on my practical experience and pragmatic observations. Independent directors have no strong emotional ties to the organisation and are less sensitive about the "freezing effect" of decisions. With the benefit of hindsight, they are able to raise the right questions, even if painful, and to create positive tension by challenging a business model, for instance, to contribute to a sustainable growth. At mebs, we believe that this should be applied outside of the fund industry and this is why we have also responded positively to commercial companies asking us to join their boards. We recently accepted an independent director mandate in a start-up company which I am sure you will hear about soon.

Should ESG be integrated into risk management framework?
ESG is a subject which is becoming exponentially important but there is still a lot to be explored. Indeed, the regulations surrounding ESG and the tools to assess and rate are not yet mature. As a consequence, ESG ratings sometimes contradict between each other. In-depth work is therefore still necessary and must be done seriously, taking into account every aspect of the ESG concept – environmental, social and governance. We can take the social aspect as an example; it can be divided into two fields: the internal impact of a company with regard to its employees and the external impact. At an internal level, indicators have emerged such as the happiness index at a global level, as well as more scientific indicators regarding quality of life at work. Regarding external impact, multi-criteria scorecards could be established to assess impacts. These scorecards could, for instance, include the objective of the investment, key performance indicators and a contribution "score". In my view, ESG is not a fashionable or "on-trend" subject. It is a fundamental trend that needs to be addressed at a strategic level – and as such, it should be taken into account in a risk-management process. Let's imagine, for example, a company with 100% of its production located in a flood zone within three years, caused by global warming. Taking these elements into account will enable the company to anticipate and to take the appropriate decisions concerning production continuity. For an investment fund, this will help to assess the long-term sustainability of the company's performance. This is the approach we want to promote at mebs.