



Buy Side Cafe Advice

Assessing the trading implications of ESG on the desk: What changes can buy side heads make to positively impact the trading ecosystem?

What is ESG and how does it apply to the trading desk?

- There is a tremendous focus across the buy side on ESG currently. It is the fastest growing department within firms, and traders are now expected to be conscious of and start implementing ESG across their portfolios – however, it is not clearly defined as to exactly what this means.
- Buy side still have many questions on how ESG affects the desk, how far do traders need to go with it, how do you define ESG in trading, and how can you implement measures and actions across the desk.
- No one has all the answers at the moment, and there needs to be an industry consensus to work together on ESG and define its scope and focus.
- ESG now should be focused on improving how buy side and their counterparties can work closer together to improve the ways they work and develop greater corporate responsibility.

How to begin thinking about ESG from a trading perspective

- Buy side traders should look to let their internal ESG/stewardship teams set the focus of ESG. Traders should have conversations internally with these teams and then align their desk with the overall vision of the business. Your preconceptions of what ESG might look like are likely entirely different to your internal teams' view.
- For the most part Heads of Desk should expect ESG to be an operations led initiative across the firm – however, if these discussions haven't started yet heads should look to be proactive.
- Most firms will be part of the net zero asset management initiative. The initiative aims to reduce the carbon footprint not only of your individual firm – but also to assess and help to reduce that of your counterparties and supply chain. This is a good place to begin when looking at meaningful changes the trading desk can make to start implementing ESG across the desk.
- Some simple criteria to start ranking counterparties include: Are you Paris 2030 aligned? Do you have a net 2050 policy? If not, why not?
- ESG has been implemented into the investment process for a long time, but is very new to trading. To set standards for measurement work through your listed counterparties and develop a rating for them. Keep a human touch to review these, move them into pockets rank them and feed this into an algo.

Challenges implementing ESG

- Traders will need to work with internal teams to set criteria and ranking metrics for measuring ESG against their counterparties. Research into the underlying metrics and how these can be applied is an extremely time-consuming process.
- There is no established industry standard for what ESG looks like on the trading desk. Currently there is little regulatory backing to help push this forward – and a dialogue needs to be opened to push forward standardisation.
- There is great difficulty when deciding which entity to base your information gathering on. Many companies will have multiple entities – each of which may not be ranked equally when it comes to your internal ESG metrics, they will all have different structures and boards. Buy side will need to be able to determine which entity should be focused on.
- When ranking non-listed counterparties, buy side should be aware that they will need to rate them manually, which is an extremely time intensive process. Buy side participants mentioned needing to hire a separate resource for this.
- Smaller firms may not have the resource to pursue a fully quant led ESG policy.
- There is currently very little or no data available to help firms make meaningful decisions.
- Best Execution poses some difficulties when considering ESG – should buy side prioritise one broker over another because of ESG? There was general agreement that best execution should remain the fiduciary duty of the trader and should trump all other considerations.

What does an ESG conscious marketplace look like?

- Buy side agreed that currently they would not turn off a broker if they ranked badly on ESG metrics. Instead, the focus should be on identifying firms willing to make the journey alongside you rather than holding them accountable – everyone is in the early stages.
- To help motivate counterparties to change, if your data is developed enough, you can start making changes to the flow of your trades – brokers with a lower ESG ranking receiving less flow.
- Regulators need to come onboard and partake in the ESG discussion to address the short-term conflict between best execution and sustainable trading. Once a compromise can be agreed with regulators to work ESG into best execution calculations real change can begin.
- Breaking ties with counterparties based on ESG scoring will become a reality once best execution involves ESG metrics. Buy side will need to be comfortable and confident that the judgement they are making is based on the right criteria, and accurate data. The middle ground in the short term will be ESG implementation when best price is not the paramount concern, with fee-based business filtering in metrics first.