INVESTMENT ASSOCIATION POSITION ON THE PROPOSAL ON DISCLOSURES RELATING TO SUSTAINABLE INVESTMENTS AND SUSTAINABILITY RISKS

AUGUST 2018

INTRODUCTION AND EXECUTIVE SUMMARY

The Investment Association ("the IA") welcomes the opportunity to respond to the European Commission's proposed Sustainable Finance Package, which will be of key importance in the promotion and development of sustainable finance throughout Europe and across the globe.

The IA represents 250 UK-based investment management firms who collectively manage funds totalling EUR 8.1 trillion, of which EUR 2 trillion is on behalf of European clients. The UK asset management industry is a key part of both the UK and EU's financial ecosystem, helping millions of individuals save for the long term and enabling them to enjoy a more prosperous retirement.

As significant investors in economies across Europe, it is our role to help investors and savers achieve their objectives – both financial and non-financial. Our members are increasingly witnessing a demand from investors and savers to take into account sustainability and responsible investment strategies. This trend has helped fuel the growth in the responsible investment market and our members are committed to continuing to promote and develop sustainable finance.

Our members fully support the aim of the Disclosures Proposal to increase transparency and enable investors to choose investment products and services with greater clarity and comparability. It is our firm view that any disclosures relating to sustainable investment and sustainability risks should aim to improve transparency with respect to both investment products with particular sustainability objectives and the incorporation of ESG factors into investment decision-making.

To ensure that disclosure practices convey genuinely meaningful information in the growing sustainable finance marketplace, the IA believes it is important to develop principles for disclosure, rather than an overly prescriptive approach that could risk making disclosures a tick-box exercise.

Regarding the disclosure of remuneration policies, we recognise the disincentives that remuneration policies aligned with short term gain can create in our investee companies. We are therefore supportive of aligning remuneration policy with the delivery of sustainable, long term returns for any company, including financial institutions like asset management firms.

The IA supports the European Commission's commitment to be a global leader in sustainable finance and stands ready to work with the Commission and other key stakeholders to progress this agenda and boost the role of finance in achieving both a well-performing economy and one that also delivers on environmental and social goals.

THE INVESTMENT ASSOCIATION

INDUSTRY'S COMMITMENT TO PROMOTING AND DEVELOPING SUSTAINABLE FINANCE

- It is important to clarify outright that environmental sustainability does not capture the full sustainability and responsible investment landscape.

- Whilst an essential element of this landscape, it is just one component part and it is therefore vital that the Proposals – taken as a whole – promote and develop sustainability and responsible investment in all its forms.

- To this end, each Proposal in the Sustainable Finance Package must clearly state its objectives, scope and intended uses to ensure it is delivering on the key imperatives of a sustainable European economy on a harmonious and consistent basis.

- The interaction between the Proposals is equally important, as well as the relation to global activity and globally recognised standards, such as the Sustainable Development Goals (the "SDG"s).

- If these aspects are not clarified, we risk disrupting existing activities which already contribute substantially to improving the sustainability of the European economy.

- Specifically on disclosure, we ask for greater clarity on the objectives of each disclosure component as currently put forward. In developing these Proposals further, there also needs to be a recognition of the different nature of disclosure throughout the investment process and product/services chain.

- It is our view that any disclosures relating to sustainable investment and sustainability risks should improve transparency with respect to both:
    - Investment products with particular sustainability objectives i.e. "sustainable investments"; and
    - The incorporation of Environmental, Social and Governance factors into investment decision-making.

- We note that that the ESAs have been empowered to develop draft regulatory technical standards to further specify the detail of the presentation and content of information to be disclosed on sustainable investments.

- We also note that the Commission has formally requested EIOPA and ESMA to prepare technical advice on potential amendments to, or introduction of, delegated acts under various Directives, including UCITS, AIFMD and MIFID, with regard to the integration of sustainability risks and sustainability factors.

- In particular, when developing delegated regulation on the latter, it is vital that what is meant by the incorporation of ESG factors into investment decision-making is clear and consistent with how the market carries out this process i.e. seeking to invest in an economically sustainable investment for the generation of sustainable, long term returns for investors.

- Against this backdrop, we ask that any future regulation works in harmony and that the Proposals' respective objectives, scope and uses are clarified.

OUR DETAILED COMMENTS ON THE DISCLOSURES PROPOSAL

- The IA is supportive of increased transparency and efforts to empower investors to be able to choose investment products and services with greater clarity and comparability.
- We understand that this Proposal seeks to improve disclosures both with respect to sustainability risks and opportunities across all investments and specifically with respect to products that have as their targets sustainable investments, including the reduction of carbon emissions.
- As a general approach, it is important to develop principles for disclosure and we would stress the importance of allowing the freedom necessary for the development of disclosure practices that convey genuinely meaningful information in this growing market place.
- An overly prescriptive or systematised approach could risk making disclosures a meaningless tick-box exercise, whilst the development of principles – with input from industry – should promote the exchange of decision-useful information.
- On a more granular level, we are concerned that a number of the existing provisions – if not appropriately calibrated – may cause unintended consequences to the detriment of financing sustainable growth. We explore them in more detail below.

1. CLARIFICATION OF SUSTAINABILITY RISKS

The meaning of "sustainability risks" must be clarified.

In the context of the HLEG's imperative to strengthen financial stability by incorporating Environmental, Social and Governance factors into investment decision-making, we envisage "sustainability risks" would not be scoped as something different to widely adopted ESG risks deemed to have a material impact on the propensity of an investment to generate long term returns for investors.

Moreover "Sustainability risks" are *not* risks *to* environmental sustainability.

They are risks to the *economic* sustainability of an investment which derive from environmental, social and governance concerns.

It is vital that any future proposals intended to give more detail on how sustainability risks and sustainability factors should be integrated reflect the comments above.

It is vital that such risks are identified and managed in order to strengthen financial stability and contribute to a sustainable European financial system.

It is similarly of great importance to investors that ESG opportunities are integrated into investment decision-making to the extent that they can be seen to contribute to the economic sustainability of an investment.

It is vital that the difference between (i) sustainable investments according to the Taxonomy and (ii) the incorporation of ESG risks and opportunities is recognised and that the HLEG's imperative "to strengthen financial stability" through ESG integration is given adequate attention, resource and time and that it is not crowded out by undue concentration of focus on "environmental sustainability".

2. THE HOLISTIC NATURE OF INCOPORATING ESG RISKS AND OPPORTUNITIES

The incorporation of ESG risks and opportunities into the investment decision making process has to do with:

- Strengthening financial stability (from the HLEG final report); and
- Managing financial risks stemming from climate change, resource depletion, environmental degradation and social issues (from the Action Plan).

It is an approach to investment used to identify investments that bring improved long term returns to investors based on an holistic assessment of their economic viability and strategic value creation. It takes into account environmental, social and governance factors (alongside traditional financial analysis), but it is not carried out with the express aim of fulfilling environmental, social or governance outcomes or targets.

As such, it is an entirely separate approach and process from investing into particular products designed to contribute to environmental sustainability or social sustainability (although it may be layered on top).

It is important to stress that the "E" in the Taxonomy of environmentally sustainable economic activities is not the same as the "E" in "ESG integration". The "E" in "environmentally sustainable economic activity" that will arise from the Taxonomy is – and must be – different to the "E" that is necessary to the integration of ESG risks and opportunities into the investment-decision making process. ESG integration is an entirely separate process to the reallocation of capital to green investment products. It has an entirely separate objective and outcome and – of crucial importance – the "E" in ESG can only be viewed holistically in the context of E, S and G.

Therefore, an economic activity that has been deemed environmentally sustainable does not automatically become economically sustainable if it happens to comply with minimum social and governance standards.

We too want a European economy that benefits the planet and our society. To achieve this noble aspiration, we cannot look at environmental, social and governance considerations in isolation. This could impose serious limitations on sustainable growth. It is only by managing all relevant environmental, social and governance considerations, that we will manage the best possible outcome for a sustainable EU economy.

3. COORDINATION OF EXISTING FRAMEWORKS

As greater detail is developed in the form of delegated regulation, we would ask that the authorities consider the merits of existing global standards and draw on existing expertise and frameworks. For example, we ask that the Commission is mindful of the recommendations from the Taskforce on Climate-related Financial Disclosures as well as the Sustainability Accounting Standards Board (SASB) and other prevailing global market practice where appropriate.

Moreover, we would highlight the interrelatedness with other EU Directives, including the implementation of the Shareholders Rights Directive and ask that this is well aligned and that these Directives complement one another.

The Eurosif Transparency Code and the UN PRI Principles for Responsible Investment could also provide a useful starting point for the development of disclosure principles which are already very well socialised in the market.

4. REMUNERATION POLICY

We recognise the disincentives that remuneration policies aligned with short term gain can create in our investee companies.

We are therefore supportive of aligning remuneration policy with the delivery of sustainable, long term returns for any company, including financial institutions like asset management firms.

There are already provisions in place to align the long term interests of the investor with those of the individual working in asset management. We would like to express our support for these existing provisions under UCITS V, AIFMD and CRD IV and ask that they are given a chance to bed in before the introduction of any additional requirements. Moreover, UCITS already contains both financial and non-financial criteria in the context of remuneration policy.

FINAL REMARKS

- Sustainable finance is a market that is growing and innovating at high speed. We ask that it is given the flexibility to grow and innovate to the benefit of clients, the environment and society.
- This involves the promotion and development of sustainable finance in all its forms.
- Our key concerns are around the lack of coordination between different initiatives; a lack of clarity around which imperative is being taken forward by the constituent parts of the package; and what this means in terms of unintended consequences restricting sustainable finance.
- Unintended consequences risk putting a brake on existing economic activities that already contribute to a more sustainable economy as well as further innovation and growth.
- We also ask that the Commission and the co-legislators consider alignment with other initiatives globally.
- It is only through coordination and cooperation that we can face and tackle the global issues that stand before us.
- Industry is ready to offer technical support to policy makers on this journey to transition to a more sustainable European economy.

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents asset managers based in the UK, whose 250 members collectively manage over €8.1 trillion on behalf of clients across the globe.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- ***Build people's resilience to financial adversity***
- ***Help people achieve their financial aspirations***
- ***Enable people to maintain a decent standard of living as they grow older***
- ***Contribute to economic growth through the efficient allocation of capital***

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 36% of European assets.