THE INVESTMENT ASSOCIATION

INVESTMENT ASSOCIATION POSITION ON THE PROPOSAL FOR A TAXONOMY OF ENVIRONMENTALLY SUSTAINABLE ECONOMIC ACTIVITES

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INTRODUCTION AND EXECUTIVE SUMMARY

The Investment Association ("the IA") welcomes the opportunity to respond to the European Commission's proposed Sustainable Finance Package, which is 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 witnessing growing demand from investors and savers for responsible investment strategies, as investors have become increasingly aware of the material impact sustainability issues could have on financial returns and on broader economic and financial stability. This trend has helped fuel the growth in the responsible investment market and our members are committed to continuing to promote and develop sustainability and responsible investment in all of its forms.

The IA therefore welcomes the Commission's Sustainable Finance Package with its broad objectives to 1) reorient capital flows towards sustainable investments, 2) manage financial risks stemming from ESG issues; and 3) foster transparency and long-termism in financial and economic activity.

As this is a comprehensive and far-reaching Package, it is vital that the scope of each of the individual Proposals is clarified and that they work harmoniously with each other to progress this broad agenda.

The European Commission should also consider the global implications of its Proposals. A lack of coordination between different approaches addressing taxonomy and disclosure, both within the European Commission and across different global initiatives, could have unintended consequences which may risk putting a brake on existing economic activities that already contribute to a more sustainable economy, as well as on further innovation and growth.

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.

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 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.

- The Commission's High Level Expert Group (HLEG) identified two imperatives for Europe's financial system:

1) Improve the contribution of finance to sustainable and inclusive growth as well as the mitigation of climate change;
2) Strengthen financial stability by incorporating Environmental, Social and Governance (ESG) factors into investment decision-making.

- It is vital that mechanisms are in place to allow clients to express their preferences for any particular and distinct sustainable investment objectives.

- These preferences may take forward either, or both, of the above imperatives and they might fall into any number of sustainable investment strategies.

- Below is a list of just some of the different strategies that are often deployed in support of sustainable finance:
    - Negative Screening
    - Best in Class
    - ESG Integration
    - Thematic Investing
    - Shareholder Engagement
    - Impact-driven investment
    - Norms-based approach

- Expressing a sustainable investment preference does not necessarily mean that an investor wishes to be invested in a product that is linked to the environmentally sustainable economic activities captured by the proposed Taxonomy.

- We understand from dialogue with the Commission pursuant to the launch of the Consultation that the Taxonomy is not intended to reflect the whole of the sustainability and responsible investment landscape, and that, instead, it is designed to be a tool purely to illustrate environmentally sustainable economic activities.

- Given this limited intended use and the time necessary to finalise the proposed taxonomy, it is vital that elsewhere in the Proposals or any future draft regulation –

where there is a link to investors' sustainability and responsible investment preferences – these preferences are allowed to be connected with the full range of sustainability and responsible investment approaches, and not just environmentally sustainable investments and activities.

- This would include (but not be limited to):
  - Any changes to the MiFID Delegated Act on Suitability Assessment;
  - Any future changes to MiFID, AIFMD, UCITS with regard to the integration of sustainability risks and sustainability factors.

- Only then, will we develop and promote sustainability and responsible investment in all its forms and ensure that investors are investing in investments that align with their investment objectives – both financial and non-financial.

INDUSTRY'S ROLE IN DELIVERING SUSTAINABILITY AND RESPONSIBLE INVESTMENT

- We believe the long-term interests of investment firms, their customers and the wider economy are all aligned.

- As asset managers, it is our responsibility to help end investors achieve their goals and objectives – both financial and non-financial – and in the process we contribute to economic growth through the efficient allocation of capital.

- Whilst a significant number of firms in the investment management industry are already embedding ESG considerations into the fabric of their investment process, there is clearly more to do in order to promote sustainable finance, including bringing consistency of language and disclosures.

- We also recognise the key role that our industry can play in signposting opportunities/products for investors that contribute to particular sustainability objectives and in the development of innovative products to contribute to investors' investment goals.

- Along with integrating relevant and material ESG factors into the investment decision-making process, asset managers will often actively engage with companies to identify and manage ESG risks – and to benefit from ESG opportunities – in order to ensure these companies remain a sustainable long-term investment proposition.

- Fundamentally, this engagement, or "Stewardship", aims to promote the long-term success of companies so that the investments of the ultimate providers of capital, our clients, also prosper over the longer term. This is because our industry believes that well run companies that take a long-term approach and proactively identify and manage ESG risks, are more likely to deliver longer term returns for their clients.

- It is in this capacity – as stewards of the companies in which we invest on behalf of clients – that asset managers are able to effect change and assist businesses in transitioning to more sustainable practices by engaging on governance, and increasingly so on social and environmental risks and opportunities, including the low-carbon transition and human capital development.

- On a more granular level, stewardship leads to better run, more sustainable companies, which are the building blocks of a fully transformed, "greener", more sustainable and resilient economy.

- It is therefore very important to view the effects of shareholder and bond holder engagement in the context of sustainability and to promote the role that this plays in the transition to a more sustainable economy.

- With all of this in mind, we would also like to take this opportunity to reiterate our support for implementation of existing initiatives, namely, the Shareholders Rights Directive, which will further increase disclosure by asset managers, and asset owners, of the execution of their shareholder engagement activities.

OUR DETAILED COMMENTS ON THE TAXONOMY PROPOSAL

- **Industry's key concern is the intended use of the Taxonomy.**
- We are supportive of the proposed Taxonomy on the basis that its intended use is only to help identify the economic activities that investors would want to invest in to fulfil their environmental sustainability objectives, including for example the 2 degree goal.
- It should provide economic actors and investors with clarity on which activities are considered environmentally sustainable so they make better-informed investment decisions.
- We are of the opinion that the Taxonomy should help to identify these activities in all funds (regardless of whether they are mainstream or explicitly marketed as "sustainable").
- We would welcome further clarification that the key purpose of the Taxonomy is the prevention of "green-washing" and would be supportive of such a purpose.
- As such, we understand it to be the intention of the Commission that the Taxonomy will only capture activities that account for a very small proportion of the market. The Taxonomy is not intended to reflect the wider sustainability and responsible investment landscape through investment which may help promote a more sustainable economy – but which for example would fall short of supporting the 2 degree goal.
- We also understand, but would welcome further clarification, that the Taxonomy is intended for use by asset managers as a helpful framework to assist with disclosure, rather than as a compliance exercise.
- We welcome the Commission's acknowledgement that this Proposal is intended to be fluid and to provide a starting point for building out a more complete and constantly-evolving Taxonomy.
- We are supportive of the Taxonomy being such an evolving tool. The science around sustainability is dynamic and evolving, as are social expectations as well as investor and market needs. Therefore, the Taxonomy should be considered to represent the best of the currently available knowledge and will require continuous review.
- It is also important that we give due consideration to the Taxonomy being a useful tool for the providers of capital – our clients. Given that many of them will be individuals as well as institutions, simplicity is key if they are to understand the choices they can make.

1. USES OF THE TAXONOMY

A. INTERACTION OF TAXONOMY AND OTHER PROPOSALS

It is important to be aware and considerate of the interaction between different Proposals within the Sustainable Finance Package and what this could mean with respect to the use of the Taxonomy and potential unintended consequences.

We understand the Taxonomy to be a tool to identify those economic activities that are deemed to be environmentally sustainable. It should therefore represent only a very niche pool of investments – and intentionally so – as it is designed to prevent "green-washing".

The Taxonomy is therefore important in an environmental context for its potential to "improve the contribution of finance to sustainable and inclusive growth as well as the mitigation of climate change".

However, it should not be used in the context of "strengthening financial stability by incorporating Environmental, Social and Governance (ESG) factors into investment decision-making."

In the context of the provision of financial advice, if a client indicates that they would like ESG considerations to be taken into account, this does not necessarily mean that they wish to direct capital flows towards particular environmentally sustainable investments. Instead, they may in fact wish that any relevant ESG factors (including any financial risks stemming from climate change, resource depletion, environmental degradation and social issues) are incorporated into investment decision-making.

Given this, the reference to the Taxonomy in the proposed changes to the MiFID Delegated Act of Suitability Assessment is very worrying.

It reads:

"'ESG considerations" means a consideration related to environmentally sustainable investments, social investments or good governance investments."

'Environmentally sustainable investment' is defined as "an investment in an economic activity that contributes to an environmental objective, and in particular an environmentally sustainable investment as defined in Article 2 of [insert reference to taxonomy Regulation]'

This particular interaction of the MiFID DA and the Taxonomy Regulation would force investors into being invested into a particular sustainable investment and would not give them the choice of being invested into, say, mainstream listed equities that are managing their ESG risks and opportunities – despite this perhaps being the best fit to their investment objectives.

If the Commission text is left as is at the conclusion of negotiations between the co-legislators, asset managers would have no choice but to put investors into an investment strategy that may not be right for their clients' investment objectives. This is deeply concerning.

We are confident that the Commission does not intend for the Taxonomy Proposal to result in such an outcome.

We would therefore ask that the Commission provide further clarity on the Taxonomy's proposed use and scope in the Level 1 Proposal to ease any confusion around this.

B. GREENING THE BROWN SECTOR

We understand that the Commission appreciates the important role that asset managers have in helping companies transition from less sustainable to more sustainable practices.

We support the notion that the taxonomy can be used to provide a helpful tool to articulate the effect of shareholder and bond holder engagement – and as such – to identify how investors are helping companies to transition from less to more sustainable activities, by agreeing what those activities are.

2. NEXT STEPS FOR THE TAXONOMY

A. MINIMUM SAFEGUARDS (ARTICLE 13)

For businesses to attract capital on the scale necessary to fulfil the Commission's goals, they need to have good long-term prospects. Well-governed companies will attract capital as they are more likely to deliver long-term returns. Good governance practices are essential to those investments looking to achieve environmental change who wish to attract large capital flows.

Furthermore, good corporate governance is a necessary prerequisite to progress the ambitious aims of the Sustainable Finance Package through our investments. It is an important tool to help bring about more environmentally responsible practices by companies. If a company is run well, this should also help it to achieve any environmental objectives it might have.

We are concerned that the minimum safeguards as set out in Article 13 may not demand rigorous enough corporate governance standards to help promote more sustainable practices.

Whilst certain activities might be deemed environmentally sustainable on the basis of their environmental contribution (or lack of harm to environment), it is not clear how sustainability risks would be sufficiently integrated into investment decisions, in particular, those that stem from corporate governance concerns, including, for example, provision of wrong incentives through badly-aligned executive pay, or lack of independent directors on boards.

We would like to bring to the table our experience promoting good corporate governance by businesses and offer to help develop greater rigour around the safeguards set out in the Proposal.

B. DEVELOPING THE DETAIL

The detail around the technical screening criteria by which a specific economic activity will be determined to contribute substantially to the environmental sustainability objectives or to cause significant harm to one or more of those objectives will be key.

We recognise that its detailed development will fall into the remit of the European Commission's Technical Expert group and look forward to engaging with this Group where we can assist in any way.

C. EU ECOLABEL

We recognise that the Taxonomy does not establish a label for sustainable financial products and that, instead, it is designed to set out the criteria that need to be taken into account when setting up such labels at national or EU level at a later date.

Like the Taxonomy itself, it is vital that any label developed at EU level clarifies its scope. If it is intended to highlight green products, this should be made clear. If this is to be the case, it should not call itself a "sustainable" label. Instead, it should be referred to as a "green" label or an "environmentally sustainable" label. This should help to prevent confusion among investors.

We look forward to working with the Commission and other relevant policy makers to develop such a label.

D. GLOBAL COORDINATION

We are supportive of the European Commission's commitment to be a global leader in sustainable finance.

At the same time, it is of course essential that the Commission consider the global implications of their proposals.

Environmental issues and threats are not a uniquely European concern. Far from it, climate change mitigation and adaptation; sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; and protection of healthy ecosystems are all global issues. As such, their resolution requires global coordination and input.

We ask that the Commission use its leading position to coordinate efforts to bring about a more sustainable EU economy.

Against this backdrop, we ask that the Commission:

- **Clarify – or provide some form of guiding framework for – the interaction of the Taxonomy with globally recognised standards like the SDGs and the UN Global Compact as well as those that will likely follow to fill the gap on social and governance in an interim period, as well as many investors' own taxonomies;**

- **Include provision for the ongoing international input into the development of the Taxonomy – namely provision for ongoing international input through the Platform on Sustainable Finance.**

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 concern is the lack of coordination between different initiatives – both within the European Commission and across global initiatives – and what this means in terms of unintended consequences restricting sustainable finance.
- These unintended consequences risk putting a brake on existing economic activities that already contribute to a more sustainable EU economy as well as on 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.
- The investment management 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.