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The European Commission

Director-General for Financial Stability,

Financial Services and Capital Markets Union

Horizontal Policies – Sustainable Finance

Online response

15 July 2020

Dear Sir/Madam

Thank you for the opportunity to respond to the Consultation on The Renewed Sustainable Finance Strategy.

PIMFA has submitted responses to the questions in the limited format and appreciate being able to now submit a more substantive additional document setting a wider perspective in more substantive responses.

Unfortunately, no response to future planning consultations can be made outside the context of responding to the coronavirus crisis, which has caused upheaval and uncertainty across the world, on a scale, no one could have predicted even in January, never mind have been able to plan and prepare for. When it passes, conditions in which economic and personal stability are re-built, will be completely different to anything that was assumed at the start of 2020 and the EU must base its actions on this new reality.

However, like all crisis’ it also offers a unique opportunity (and cover) to break with old and unsustainable habits and instead build a new sustainable circular, competitive and innovative economy suitable for the challenges we face in the coming decades.

Covid is unlikely to disappear fully and the consequences for people and their families and economic health, and not only their medical health, will be profound with frontline workers exposed to risks they were ill-prepared to face, workers losing jobs, the self-employed and other business owners facing unprecedented pressure on their business models and plummeting economic indicators. It can be hard to see the light at the end of the tunnel from this point in time.

Our focus is rightly on fighting the virus and taking steps to keep our economy and financial system alive. But as we emerge from the crisis, steps will be needed to kick-start the economy as quick as possible, get production lines running and get people back to work and earning an income again and avoiding mass unemployment.

It also presents us with fundamental choices. Do we try to put the clock back to January 2020 or take steps to create a better new normal, will this be our 1945 pivot?

Before Covid, it’s true that not everything was working fairly for the majority. There was a struggling, top down, carbon heavy economy struggling to provide new employment opportunities for marginalised sectors, or in general and where quality of life issues where gaining strength. We were depleting natural resources, still churning out toxic pollution and not really winning the climate change battle. Do we want to go back to that?

Is it unreasonable now to aim for quality economic growth in a sustainable circular, competitive and innovative economy? We know there is a route to this through replacing outdated and polluting infrastructure with new modern, efficient and green alternatives and that this should apply for all sectors, which has the potential to generate massive job growth and increase GDP in a sustainable way.

Therefore, it’s difficult to make a case that we cannot afford a green deal, especially for those who are directly facing the consequences of climate change via flooding, fires, droughts and deforestation and a decline in the resilience of our natural environment.

The sudden stop to our normal lives has given us a taste of what the new normal could be like. Less noise pollution and clearer air and less pressure to shop for things we do not need may be a release for most. A green deal and climate related economic policies should be a strategy for growth that aims to protect the environment. Renewable energy and clean technology are a huge economic opportunity and more credible for long term planners than trying to re-create the economy that stopped at the beginning of 2020.

For those who do not think emotions make for good decision making, the answer remains simple. Clean technology can pay for itself due to the energy and resource costs it saves. It is not a cost to invest in a green economy, it is an investment that will pay dividends just like previous shifts in the economy from horsepower to cars or from steam to electric or the internet required active investment choices and who would credibly argue those investments have not paid off handsomely.

The knowledge exists to build a renewable energy network based on solar, geothermal, wind and biomass technology and more. The choices include charging and hydrogen stations for all kinds of appliances, tackle building energy gaps relating to heating, ventilation, insulating and other options.

There is huge potential in farming to finance new innovative solutions that protect the environment and cater to our need for healthier products and less meat. The technologies for all of this already exist but requires greater attention to ensuring the levers to make it happen are better oiled and align with the Paris Agreement, which places legal obligations on those who have signed up to it.

Rather than using greater borrowing just to return to ‘business as usual’ –we should be investing in new approaches to ensure a new economy can emerge that will meet our future needs and be sustainable, competitive and offer opportunity to everyone. No more trickle-down fantasies.

Facing the future with confidence and despite feeling the fear, doing it anyway, will help to make the pivot to a circular and sustainable economy that is innovative and protects the environment.

Again, thanks for you for the opportunity to submit our view and if you have any queries about our response, please do not hesitate to contact us: we would be happy to discuss and provide further information.

Yours sincerely



Desmond FitzGerald

Senior Policy Adviser PIMFA

**PIMFA reply to Consultation on The Renewed Sustainable Finance Strategy**

**Question 1. With the increased ambition of the European Green Deal and the urgency with which we need to act to tackle the climate-related and environmental challenges, do you think that:**

A: Major additional policy actions are needed to accelerate the systemic sustainability transition of the EU financial sector.

**Question 6. What do you see as the three main challenges and three main opportunities for mainstreaming sustainability in the financial sector over the coming 10 years?**

Awareness of sustainable finance issues has increased to such a degree that legislators and regulators are bound to act.

But there remain systemic issues that may prevent consumers turning their sustainability preferences into practical decisions and these include:

The investment framework

Historically negative screening was a simpler approach but harder to implement evenly. Consumers seeking a more balanced portfolio were still exposed to risks such as climate change, lines of production or employment practices.

There is still space for asset owners could devise new investment options and add bulk to existing ones and issue practical guides that help upskill consumers to embed sustainability in their portfolio.

These could educate on what a sustainable portfolio could look like for that consumer, how they can compare and contrast investment options and understand how to balance out short term investing against suitable longer term investments which are crucial to the evolution of a new sustainable economic model.

New sustainable finance frameworks need to have a longer-term view and more consistency for how investment opportunities are evaluated. This is crucial so consumers, who must be central in this process, are able to have the skills they need to be systemic in how they build their savings and investment portfolios factoring in sustainability opportunities but risk too.

Reporting standards and data

There has been a huge increase in ESG data and a firming up of disclosure requirements but there has not been a similar standardisation of the metrics used for providing ESG data and this will limit the usefulness of that data in time.

For a consumer to choose to invest outside a public holding, they need to be able to trust the accuracy and impartiality of the ESG data available. But even for sectors where data is available it does not provide sufficient comparison evidence on issues like carbon or social impacts and where that data is available, it comes in a format that is not consumer friendly and is difficult to verify.

Standardised global reporting requirements could strengthen the integrity and accuracy of data. Much effort has been made under initiatives such as the voluntary Sustainable Accounting Standards Board and the Financial Stability Board Task Force on Climate Related Disclosures.

Asset managers have the option to require the holdings they invest in to disclose this data and there are a range of sources that provide data on issues like deforestation, greenhouse gases and water usage but there is still so much more that could be done.

A useful start could be for the finance sector to develop consistency on how data is used and how it can be mapped onto a sustainable portfolio. This could allow consumers and investors better understand which ESG factors are material to their own investments and then how to measure the performance of those factors and get relevant information about them.

One other method could be to devise performance measurements using central ESG metric points and linking benchmarks to the UN Sustainable Development Goals.

The investment connection

Investment strategies factoring ESG in are increasingly available to institutional investors, but it seems there are still not enough high quality products to meet the demand for retail consumers and investors to build their own balanced, diversified and international portfolios that invest across a multi-product range.

Many existing products focus on specific issues such as no fossil fuel but investors increasingly understand sustainability factors and how they are material, and the demand has risen so that it seems more suitable to offer a wider proactive but holistic approach.

Investors are firstly looking for options that incorporate those material ESG risks and opportunities for those issues mentioned above such as water, employee issues and energy, but also on changing consumption trends and production line issues (especially in the context of C19 and various geo-politics fault lines exposed because of it) and do not want to miss out on potential future growth opportunities.

Secondly, there are not as many listed equities or hedge funds, which require deeper due diligence given the risk, complexity and timescales. Private equity is not an option for some asset owners because of minimum investment requirements and illiquidity. So as to get asset owners past the point of having a limited sustainability section, asset managers could offer a wider range of quality sustainable investment strategies over a diversified portfolio of wider asset classes, and advisers could be more active getting research and due diligence for new products and then offering and recommending them to clients with the data to address the specific concerns of specific clients.

**Question 7. Overall, can you identify** **specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?**

Essentially there are two regulatory approaches to meet the transition to a sustainable economy - sustainable finance initiatives or a single market.

Through the sustainable finance initiative it should be possible to integrate the sustainable development principle into business and ﬁnancial market law. Given the degree of interconnectivity in the EU ﬁnancial market law and the level of established and developed legal infrastructure, it should result in changes to regulations such as MiFID can have a high impact.

The Sustainable Finance initiatives are a policy area seeing resources being mobilised by the institutions of the EU and by Member States but it remains unclear of needs of consumers will be met and not get side-lined as a result of corporate sector vested interest lobbying.

The EU and national regulators have taken a range of actions to clarify investors should consider ESG factors in their investment decisions consistent with their financial obligations. However, there remain regulatory, practical and behavioural barriers to ESG investing.

It is not unreasonable these barriers should be addressed in a way to encourage ESG integration but not in a way that would risk prudential standards that shape investor behaviour and the other obligations of institutional investors. Regulatory frameworks are obstacles to ESG integration, but institutional investors could perhaps benefit from greater clarity about the role of ESG integration in prudent governance. Institutional investors have different approaches to ESG and investors might be reluctant to integrate ESG into investment decision making and government because of issues like cost and complexity or concerns about ESG factors being a ‘non-financial’ issue.

Policymakers across different jurisdictions have brought in a range of measures to address these including, requiring institutional investors to provide more transparency on their ESG investment policy and to increase engagement with portfolio firms they hold. It might also be useful to develop plans relating to standardised investment terminology and more consistent corporate ESG reporting, which could make it easier for institutional investors to access ESG data and assess its impact.

There are also technical and operational issues about how to measure the nature and impact of ESG factors on portfolio risks and on returns, and the efficacy of different strategies for tackling ESG risk. As an example, using a ‘best in class’ strategy could see a different sector exposed to divestment to reduce exposure to carbon, using historical data, but this might not be based on future changes expected as a result of improvements made by a company in its operations and carbon output.

The Paris Agreement is a reflection of the consensus reached on the need to take action to reduce the impact of climate change and to help an economic pivot toward a sustainable model, but also seeking to mitigate the upheaval this change will have on the economy in general but also on wider society. The Agreement confirms the financial sector is a crucial partner in meeting its objectives given the amount of investment requirements cannot simply be provided by the public sector.

The contribution of the financial sector will be more than identifying investment opportunities that are ‘green’ and should be singled out as specially deserving of financing, but the financing process will also need to be redesigned to quantify a range of other risks linked to climate change, which a proposed investment seeks to resolve.

The financial sector will likely need to take a regional approach to these issues to reflect economic reality and the development ability of different economies and countries and to set credible standards for green bonds in different regions and consider sustainability and climate risk outside of reputation but rather as a factor point in risk analysis and management decision-making.

It is worth asking if financial markets are internalising climate risk or have reviewed initiatives carried out in the private and public sectors over recent years to improve how to evaluate climate risk in financial and risk decision-making. So far it seems they have when you consider issuers and the range of financial instruments that take climate-change into account has risen so much, as reflected in the volume of green bond and equity indices and how it is now possible to make an evidence based case that this has not been at the expense of investment growth.

Bank lending for renewable energy has increased and all manner of public authorities in divergent economies are promoting green financing with support from Central Banks more actively.

The international consensus to tackle climate change is evident and the G20 and EU have actively fostered initiatives that will strengthen the role of the financial system to provide financing in a way that is compatible for increasing levels of sustainable economic development.

Although, even with this progress in a relatively short timescale, there are still a few issues that need firm focus; including a lack of disclosure by companies, the lack of an agreed taxonomy to classify what exactly is ‘green’, although progress is being made on what is not green, but also a lack of experience in how quantify climate risks and opportunities more consistently.

But regulators also need to include climate risk as a risk factor that will impact on financial stability as much as it does for risk or liquidity issues. To embed climate risk into stress tests, the linked governmental climate change strategy needs to be understood in detail as it allows for the time scales in which losses during the transition to a decarbonised economy can be identified. The

Financial sector has contributed to the development of common standards and the creation of green financial instruments, these are high value efforts and have facilitated the valuation of climate risk.

However, there are still areas for improvement, such as in addressing risk and involving risk staff in climate-change innovation to expand how financial instruments can facilitate and encourage more sustainable investments. It will be via greater coordination among all stakeholders that a successful outcome will be achieved. By anticipating the challenge openly and taking difficult measures quickly and effectively it should be the case that the worse outcomes are avoided.

**Question 8. The transition towards a climate neutral economy might have socio-economic impacts, arising either from economic restructuring related to industrial decarbonisation, because of increased climate change-related effects, or a combination thereof. For instance, persons in vulnerable situations or at risk of social exclusion and in need of access to essential services including water, sanitation, energy or transport, may be particularly affected, as well as workers in sectors that are particularly affected by the decarbonisation agenda.  
  
How could the EU ensure that the financial tools developed to increase sustainable investment flows and manage climate and environmental risks have, to the extent possible, no or limited negative socio-economic impacts?**

Sustainable development is contested as a concept. There are theories influenced by people and organisations differing views of the issue and its impact, and this in turn impacted on the solutions that are put forward.

The issue is generally seen as a connection between environment, society and the economy on the basis they are each separate even though they are interlinked. It is not unreasonable to argue these are not themselves single units but are instead multi‐layered and can be considered from a range of spatial views.

The economy is often given priority and the environment is viewed as separate to mankind. But they are interconnected with the economy dependent on society, just as the environment exists at the mercy of mankind and how it uses it, with our society dependent on a stable healthy environment. The separation of environment, society and economy can lead to a marrow techno‐scientific approach, meaning issues about society that would challenge the prevailing accumulation economic model are usually side-lined especially as they relate to community sustainability or diversity and we see this with various social movements in the Covid world we are navigating through at the moment.

In the first instance, it is essential for an immediate co-ordinated health response to the pandemic. Such a response should scale up capacity to test, trace and treat with proportionate measures for restricting movement of people.

It means a response that will deliver universal access to treatment and vaccines as and when they become available and are safe. It will be vital that developed economies help less developed economies to build up their health systems and be able to respond quickly to their needs. If for no reason other than it serves our own interest to ensure the pandemic cannot spread again and in an interconnected world this risk remains high.

Secondly, it is right to tackle head on the social and economic damage from this crisis with a focus on those most impacted which will likely be women, the elderly, young people, low wage earners and SMEs, but also the casual work sector and vulnerable sectors.

This will mean devising a financial and monetary recovery plan that is able to support the direct provision of resources that support workers and households, along with the provision of health and unemployment insurance, an increase in social welfare safety nets and more support to businesses that will prevent bankruptcies and massive job losses.

What is needed will be a large-scale and co-ordinated but comprehensive multilateral response amounting to well over 10% of global GDP. The argument from governments, of whatever political leaning, that they cannot afford, or have no mandate, is not something that can be accepted now given that those governments have shown how fast they can, and have, taken steps already.

Developed countries have the resources to help themselves but the resources for other countries must be made available and this can be possible if the capacity of existing institutions like the International Monetary Fund are drawn on by issuing special drawing rights, and the other international financial institutions to rapidly provide resources for those countries that need it.

Coordinated swaps among central banks can also bring liquidity to developing economies and debt elimination must be a top priority and include waiving interest during 2020 at least. The UN system is prepared and has been providing guidance for global efforts by its support for country responses and placing its supply chains at the disposal of those who need it.

When this crisis passes, as it will, there will be a choice to face. Should the world try to recreate what was considered ‘normal’ at the start of 2020, or has something changed so that returning to that past is not possible or desirable and can the world deal effectively with the issues that made us so unnecessarily vulnerable to this crises and to others.

The UN roadmap is its 2030 Agenda and its 17 Sustainable Development Goals. (SDGs) and the response after C19 must result in a different world economy. The action taken to get past this point should be based on a strong emphasis to creating more inclusive, equal and sustainable economic models and on a society that is more able to withstand pandemics, climate change, and the other global challenges we face.

In very different times this has been achieved and with far fewer resources after WW2 when the Marshall Plan helped rebuild the European economy and national governments stepped up to implement a range of policies creating the modern welfare states we rely on to underpin our standard of living to this day.

**Question 11 Corporates, investors, and financial institutions are becoming increasingly aware of the correlation between biodiversity loss and climate change and the negative impacts of biodiversity loss in particular on corporates who are dependent on ecosystem services, such as in sectors like agriculture, extractives, fisheries, forestry and construction. The importance of biodiversity and ecosystem services is already acknowledged in the EU Taxonomy.**  
**However, in light of the growing negative impact of biodiversity loss on companies’ profitability and long-term prospects (see for instance** [**The Nature of Risk - A Framework for Understanding Nature-Related Risk to Business**](https://ec.europa.eu/eusurvey/runner/XXXX)**, WWF, 2019), as well as its strong connection with climate change, do you think the EU’s sustainable finance agenda should better reflect growing importance of biodiversity loss?**

**Yes**

**Question 11.1 If yes, please specify potential actions the EU could take:**

Biodiversity has been high on the agenda of policy makers, environmental organisations and consumers and there have been many different initiatives launched with the objective to save and protect vulnerable species and habitats and to promote the recovery of those at increased risk.

Aside from the success stories there are still challenges arising from the issues that need to be confronted relating to climate change.

2020 is the end of the UN Decade on Biodiversity and during that time all types of groups have bene working to implement a Strategic Plan for Biodiversity and promote its vision of living in harmony with nature. However, research date still indicates that biodiversity and ecosystems are still declining in quality due to human activity at an unsustainable level.

The financial sector is growing more aware of the need for it to contribute to steps being taken for biodiversity preservation and restoration. Not just because more loss of biodiversity is a material risk for financial institutions, but because humans are more and more aware of our impact on biodiversity, both for good and ill.

There is a need to understand what works, what does not and especially, what are the agreed causes of biodiversity loss along with identified barriers to improvements in biodiversity that can particularly address issues of governance rather than particular on-the ground management measures as those issues are so wide ranging and diverse it would not be possible for a top-down approach to devise solutions, which should instead be local lead.

Governance for biodiversity issues could reasonably be understood as the process through which rules and procedures applying to a defined project have been made, then implemented and reviewed or modified, with the aim to influence motivations and behaviours. It should comprise structures and processes that can be implementable at government level but also more likely through non-government stakeholders with an interest in the issue and at community or company level.

It is worth looking at perceptions and values in relation to people and biodiversity and how these underline different understandings of a problem and in turn the suitable governance solutions that will lead to an improvement in biodiversity. Values are important as they determine what can be achieved and what can be conserved as it may be innovation and new ways are required to achieve a longer-term stability and prosperity. we are trying to conserve and as there may be trade-offs between the values of different groups. Appealing to certain kinds of values can be part of governance mechanisms (we all want clean water and a litter or pollution free environment) and it can be important to understand the implications of applying a range of values and understandings to promote biodiversity that can be respectful of local sensitivities and expertise.

A healthy degree of biodiversity is crucial from how the society and economy function, to the impact on our health and safety. For example, there is a general view that perhaps as much as 75% of the global food crop, including coffee and important fruits and vegetables depend on animals for pollination but also, marine and terrestrial biota are significant carbon sinks and could potentially remove over 50% of global emissions, which means they play a critical role in mitigating climate change. (Díaz et al., 2019).

Risk and return in the financial sector have an impact on biodiversity through investments, insurance and loans to companies and households, and especially investments in companies that have a high degree of exposure to biodiversity through their supply chain and the risk this poses. Those potential losses do not need to materialise and supportive sustainable and biodiversity business models can offer opportunities for business and is expected to lead to longer-term viability of business models, a larger market share, new business models and better relationships with stakeholders (OECD, 2019).

The financial sector can play an important role to realise this and stem the decline of biodiversity. The Convention on Biological Diversity (CBD) estimated that annual investment of US$150 billion plus was needed to achieve the goals set within the 2020 Aichi Targets. Those twenty targets were created in 2010 and signed up to by 194 countries, with the objective to align the world community in the fight against the loss of biodiversity.

By pivoting our investments toward more sustainable biodiversity it is possible to reach those goals. Financial institutions affect biodiversity while also being exposed to the financial risks associated with biodiversity loss. A first step to manage the impact is to understand what the impact could be.

Financial institutions can contribute to a reduction in biodiversity loss if they take action to monitor the impact of their own activity on a reduction in biodiversity and they can integrate biodiversity criteria in investment processes and in loan agreements. They can also contribute to pushing biodiversity policies up the corporate agenda by being more transparent with regard to company biodiversity data, designing suitable investment instruments along with consistent methodological measurements, and make more effort to finance pro-biodiversity projects.

**Question 17. Do you have concerns on the level of concentration in the market for ESG ratings and data?**

As per PIMFA’s submission to the recent ESMA Benchmark Consultation, the RTS set out in that consultation are a set of imposes systems and controls, which are required. The main focus is rightly on the physical and operational separation of data submitters and other staff but within a supervised unit. ESMA has helpfully clarified there should be a separation where there is a conflict of interest between the data input to the benchmark and other actions by that contributor which is not standard.

It is helpful too that the RTS’ clarified the relationships between the remuneration of those submitting and building data used in the benchmark and that it rightly will not be linked to the benchmark itself or any of the values submitted and is a separate yardstick.

PIMFA does agree there is a need to have clear and defined governance arrangements, and a robust conflict of interest policy otherwise the integrity of benchmark operators could be compromised and if a benchmark market can be created, it will require a degree of consistency.

It is important administrators of a benchmark have procedures in place for the composition and structure of governance committees and it is reasonable that they include:

* Roles and responsibilities clearly documented
* Accountability and traceability for decision-making

But that there is also a business relationship between the various individuals across the management function and inputting committees along with the reporting lines

* Proactively identifying and managing conflicts of interest within the benchmark administration organisation, the overall group structure and externally
* Clear and transparent processes on what constitutes discretion and expert judgement
* Independence of the governance arrangements

The addition of this final point plays importance on the expectation that administrators ought to have active and effective governance arrangements. We believe it provides the opportunity to put in place more effective review of the benchmark calculation activity by governance rather than just having it to meet a regulatory requirements.

It may be that firms find implementing the RTS is a challenge especially in cases where members of a governance committee have a number of different roles in an organisation (for example for daily controls while also being part of the oversight function) and this could lead to conflicts of interest. A lot of investment will be required for benchmark administrators to make sure that suitable frameworks are in place for these functions to be effective.

Training and the control culture in a firm will be vital to ensure governance arrangements are effective and it would be useful for more emphasis to be placed on this and the importance of ongoing reviews in this area. Those who administer benchmarks could reasonably benefit from a review of the relevant governance arrangements by a compliance or audit function so as to ensure they remain effective and suitable for the size of the business.

**Question 38. In your view, which recommendation(s) made in the ESAs’ reports have the highest potential to effectively tackle short-termism?**

1. promoting a single set of international ESG disclosure standards;
2. monitoring the application of the Shareholder Rights Directive (SRD II)

**Question 38.1 Please specify what other recommendation(s) have the highest potential to effectively tackle short-termism:**

In particular senior management should take seriously their statutory duties and the benefits of addressing short term risks and impacts of systemic shocks (such as Covid) to the businesses they are charged to manage effectively.

As well as specific obligations under financial services regulation or health and safety requirements, more awareness of the duty of management under Section 172 of the Companies Act 2006 would be welcome.

It requires management to act in good faith to promote the success of the company and have regard to factors that impact on long-term decision making and the interests of staff and they are required to exercise ‘reasonable, care, skill and diligence’. Properly discharging the aims of S172 would certainly align with more generally prudent decision making, and while there may be some short-term implications, the goal is to make better long-term decisions. It is interesting to wonder if management could face claims for breaching this duty in the current Covid context if a poor management response resulted in a company loss or risk to staff.

S172 is a ‘good faith’ duty so a legal case would have challenges if decisions were taken honestly with the intention to save a business for the long term, especially decisions made in a fast-moving event. On the other hand were the burden is not shared evenly and sacrifices are not first targeted at those most able to make them, there may be a different case to argue and it will be interesting to see how firms balance seeking government help, and the issue of remuneration and dividends in the coming year or two.

Covid has impacted cash flows hard and this is likely to increase over the coming months. It could be the case that previously financially stable companies are faced with the real prospect of insolvency. If the solvency of a going concern looks unsteady, the duty of the management moves from promoting the success of the company to acting in the best interests of the creditors of the company as a whole, as its equity value is eliminated.

This is a point where the role of management exposes those personal to risk that their recent decisions will be used in a negative way if it is shown the risk the company was exposed to was avoidable (ie too much was allocated to dividends or management remuneration instead ensuring the firm could withstand a reasonable disruption to its business).

Short-termism sees too much focus of decision-making on short-term goals at the expense of longer-term objectives. It can have negative outcomes and there is concern that corporate management in particular would delay or give up projects that could create durable value in order not to miss short-term reporting deadlines, which means those immediate gains of meeting a short-term target are a huge incentive for poor behaviour at the highest decision making levels and reward those who postpone or cancel long-term focused decisions and spending.

Thinking in the short-term is a concern too given the evidence of a gap in long-term investments in Europe especially. Evidence from the European Parliament indicates that investment in infrastructure in the EU has decreased since 2009 and there is a large divergence between research and development spending and this is a challenge given the decisions required for the EU to meet its climate related objectives.

Measures already taken at EU level include its 2017 requirement for insurers and pension funds to provide more transparency and disclosure on their investment strategies, the European ‘long-term investment funds’, and the abolition of mandatory quarterly financial reports, which were creating conditions for poor short term behaviour.

Action can be taken:

Firstly, take action to prioritise allocating assets and profits into investment opportunities that create sustainable, long-term value striking the right balance between reinvestment and short-term requirements such as remuneration or debt payments. Institutional investors could make long term investment decisions by diversifying portfolio toward infrastructure and investment tools like private equity that aims to meet the needs of certain SMEs.

Business can secondly embed ESG factors into strategies, processes and valuations. This would require them to take account of the impact on the well-being of all stakeholders, a role in the society and develop a purpose, a vision and in the long term become sustainable. This approach should also include initiatives for the local community and see an empowerment of human resources by the provision of ongoing training and an inclusive and merit-based culture. Firms increasingly retain or attract staff based on perceptions of its sustainability factors rather than just financial issues.

Thirdly, a company can show long-term focus and influence its external stakeholders if it regularly and transparently discloses its long-term strategy, vision and sustainable objective actions in its financial reporting.

In the wider view, the way society (personal and corporate) invests its resources and impact on environment and society, while embedded proper governance into decision making and openly communicating with stakeholders is essential for long-term investments to nurture sustainable and inclusive economic growth.

**Question 41. Do you think that a defined set of EU companies should be required to include carbon emission reductions, where applicable, in their lists of ESG factors affecting directors’ variable remuneration?**

**Yes**

**Question 45: Do you think that passive index investing, if it does not take into account ESG factors, could have an impact on the interests of long-term shareholders?**

**Yes**

**Question 45.1 If yes, in your view, what do you think this impact is, do you think that the EU should address it and how?**

Passive investing and sustainability integration might arguably be irreconcilable investment strategies.

Among the largest recent investment trends has been the move from active to passive investment, which may be explained why uncertainty from consumers over charging or the sheer range of options and an increasingly pool of capital to be invested, certainly in the UK given the ability of consumers to invest their own pensions.

The argument for passive investing is that active management is not worth it when you factor in costs, when there is an option to simply follow a portfolio at minimal cost with the reasonable expectation it will lead to better than average performance. The other trend is to seriously integrate sustainability factors like ESG, into the investment process. However, these two aims to passively invest but also integrate sustainable factors might be a circle that can’t be squared as the nature of each is specific to the consumer investing, so will require direct and specific choices from that investor or their adviser based on the their circumstances.

It can seem sustainability considerations could be integrated reasonably effectively into a passive investment approach and active voting and engagement are examples of that, as could be excluding the stocks that don’t meet sustainability aims, or passively following an ESG index.

Given proper sustainability integration require making active decisions, it results in a need for an active investment portfolio management including active risk management and assessing a range of valuations. In the end this means investors end up in the active management arena whether that was the intention or not. Separately passive investing and sustainability are strong investment options, but hard to practice at the same time.

Passive managers can try influence corporate policy with active voting and engagement, but they will be unable to sell a holding if it is the mandate to just follow an index closely. It could be possible to exclude a small range of holdings, but comprehensive sustainability integration must reasonably go past just negative screening. If the weight of each holding can change due to evolving ESG factors, then the investor is an active manager either themselves or via their adviser or asset manager.

This in turn raises concerns that consumers do not have the skill or knowledge to understand the risk profile they need to follow to meet their objectives. If consumers are managing their investments directly the emotional urge to minimise lost is strong and there is a difficult in getting accurate comparable data to show that the long term investment comparison is the target they need to focus on.

Increasing consumer financial education and skills is one factor but so is making accessible and comparable ESG date an answer so consumers are able to make fair comparisons over variable time scales to understand the value of taking long term views of investments especially in volatile markets.

However, providing a robust, trusted and well-regulated advice model will address most of the concerns of consumers especially where consumer protection is very strong, even if that comes at the expense of a slight reduction in innovation as higher risk products are not facilitated.

**Question 46. Due regard for a range of ’stakeholder interests’, such as the interests of employees, customers, etc., has long been a social expectation vis-a-vis companies. In recent years, the number of such interests have expanded to include issues such as human rights violations, environmental pollution and climate change. Do you think companies and their directors should take account of these interests in corporate decisions alongside financial interests of shareholders, beyond what is currently required by EU law?**

**Yes**

**Question 49. In order to ensure that retail investors are asked about their sustainability preferences in a simple, adequate and sufficiently granular way, would detailed guidance for financial advisers be useful when they ask questions to retail investors seeking financial advice?**

**No**

**Question 49.1 If necessary, please explain your answer to question 49:**

However, it is reasonable that questions about non-financial values and the requirements of the consumer could be built-into the client on-boarding and review process because the regulatory frameworks around sustainable finance are already sufficiently clear that the consumer’s values should be taken into account.

The European Commission has been clear it prefers a consistent approach for firms to integrate ESG considerations into suitability requirements to avoid confusing consumers. It seems more reasonable that the on-boarding process is the more suitable point for those conversations. If a harmonised approach was laid down it will take time to devise and is likely to just become a box-ticking exercise.

In the same way an adviser assesses their consumer’s attitude to risk and builds a savings and investment plan around that, a similar approach could be as suitable for building in sustainability preferences into the suitability assessment from the start.

Investment firms providing investment advice and portfolio management should reasonably consider each consumer’s specific and individual ESG preferences on a case-by-case basis and on that basis then offer products or services that match the consumer’s preferences and requirements.

It is helpful for firms to provide clients with documents that describe their potential ESG preferences clearly and simply and clarification on the language used may be helpful.

Investment firms may need to explain how ESG preferences inform the selection of financial product. However, it seems more likely that asset allocation is determined by the entire portfolio and that ESG preferences can just as reasonably be applied to the whole portfolio rather than product by product.

**Question 50. Do you think that retail investors should be systematically offered sustainable investment products as one of the default options, when the provider has them available, at a comparable cost and if those products meet the suitability test?**

**No**

**Question 51. Should the EU support the development of more structured actions in the area of financial literacy and sustainability, in order to raise awareness and knowledge of sustainable finance among citizens and finance professionals?**

**Yes**

**Question 52. In your view, is it important to better measure the impact of financial products on sustainability factors?**

**Yes**

**Question 52.1 What actions should the EU take in your view?**

Stakeholders increasingly want sustainable strategies and an increase in sustainability reports from their investments. However, the assessment and measurement of corporate performance now extends past just measuring financial data and it is important for companies to also be able to measure its non-financial impact but also its non-financial contribution.

But there is no common agreed methodology to assess this and it will important to develop a framework to understand and measure corporate sustainability across the financial sector.

In theory it would be possible to design a framework that integrates sustainability but also includes an economic, environmental and a social dimension. Those three groups could have various data points and be based on annual reporting and act as a benchmark a firm over a certain period. A key tool would be being able to analyse corporate performance and this can give firms in the sector a competitive advantage.

The concept of corporate sustainability has gradually evolved into a more holistic issue and firms are integrating the three aspects of sustainability into strategic planning. The construction of an index would provide quantitative data and an appraisal of performance over time and can have direct management consequences in terms of comparing performance to assess how firms have incorporated environmental and societal aspects of sustainability into their business operations.

Benchmarking corporate efficiency is useful but the best policy is an ongoing process that takes into account new data and revised experiences and can meet the needs of internal and external stakeholders and some suggestions include:

The capital requirements (Basel III and the EU CRD II which require banks to set aside a minimum percentage of capital to cover defaults, could be changed to ensure banks have thoroughly integrated sustainability factors into lending and financing processes. Sustainability risk should be an important data point to draw a difference in weighting factors for sectors and types of companies, while not altering the overall capital requirement.

Credit rating agencies are important but should also integrate sustainability criteria into their ratings and be required to explain its capacity to do so as a licence requirement to operate the business.

Supervisors should be allocated to supervise how banks deal with sustainability risk and they should have professional knowledge on the issue, but not be required to prescribe sustainability criteria but ensure they have a sufficient level of expertise that they can develop a clear process.

National regulators should have standard functions that banks are required to be able to carry out in order to meet knowledge and assessment capacity for sustainability risk and a key requirement for approved persons should involve a degree of knowledge and capability in the area of sustainability risk. Supervisors could require sustainability factors to be part of remuneration and bonus processes.

**Question 53: Do you think that all financial products / instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities.**

**No**

**Question 53.1 If no, please explain what you would consider to be the most impactful products/instruments to reallocate capital in this way:**

A huge reallocation of capital from emission-intensive investments into low-carbon options across all locations and asset classes will require the right products that incentivise renewable technology and sustainable practices. We also need better institutional practices to build the capacity to generate a green financial product development pipeline.

We need to ask how to ensure sustainable finance products are ambitious enough and are aligned with the Paris Agreement and UNSDGs to a level that will change the direction of portfolio investments toward sustainable options, and what are challenges and opportunities to scaling up new sustainable and blended finance products.

Lessons learnt and best practice will need to be shared between commercial institutions to help develop capacity to build up sustainable investments (e.g. standards, internal tracking and generate a pipeline of investment.

Knowing what can be learn from the finance and commercial stakeholders will be vital to creating the incentives and culture that leads to long-term, low-carbon investment solutions. Also, our sector will have to improve on the process of assigning ‘matchmaking’ platforms or regular tenders to accelerate effectiveness, transparency and lower transaction costs)?

Even if limited success was needed to address global warming and mitigating the impact of climate change, it will still require substantial changes in the real economy if we are to reach a goal of net zero emissions by 2050. To meet this goal we will need to green the energy system, decarbonise heavy industries including in cement and steel, as well as retrofit millions of buildings, transport systems and communications network and completely overhauling how we produce and consumer food and clothing, while still facilitating business as usual innovation and improvements.

The scale of change will need strong and coordinated political leadership, a reworking of our consumption patterns away from an accumulation economic model and toward new economic norms where added value is sustainable.

But this won’t happen until the transition is complete across the financial sector and it will require a monumental reallocation of capital from emission intensive options into low carbon options for asset classes.

There is growing momentum and countless new initiatives for ‘greening’ the system but they are not happening fast enough or at sufficient depth. For example, despite all the efforts on renewable power spending has fallen to about $332 billion per annum, which compares to €2 trillion invested in fossil fuels in the same period. Even banks who claim to not finance new coal projects have not taken steps to disinvest from fossil fuel related advice, insurance and corporate finance.

To meet a target of net zero emissions by 2050, more capital has to move to a new sustainable economy that is low carbon and captures and monitises external issues like high-emissions from coal or animal production sectors and then can create value from circular and sustainable economic activities.

But significant reductions in the cost of clean technology and more innovative financial products like green mortgages that incentivise energy efficiency in buildings, show that there is potential to change capital flows. By taking a lifecycle-approach we can better understand the costs and benefits of an asset, including the impact of maintenance and the cost of human health and the environment.

Blended finance solutions using development capital to mitigate investor risks can play a crucial role for this transition. Development finance institutions could help largescale capital access small scale investments and philanthropic funds can be particularly useful to bed in entrepreneurs and scale technology innovation, especially in harder locations or higher impact sectors.

Investments in line with the Paris Agreement do not have to lower returns and in fact there is more data to show building in environmental and social considerations can reduce financial risk and is aligns with institutional investors’ fiduciary duty to act responsibly on behalf of others.

So moving the financial system to be more sustainable will reasonably be in line with the long-term fiduciary duties of asset owners and meets the objectives of wider society.

After a rise in green bonds that were pioneered by the development banks, there are new trends for green and sustainable labelled products and there are not ETFs for passive holdings and transition bonds (for firms moving from brown to green), sustainability-linked loans linking to environmental performance), climate-related insurance and resilience bonds.

Steps required might include:

* Amend regulations and capital weighting to support investing in emerging Clarifying fiduciary duty to consider ESG risks
* Review asset allocations toward infrastructure
* Improve the taxonomy and quality of green products (brown, grey, blue, green etc).
* More data and transparency relating to climate risk exposure and less information gaps

The response of government (left or right) to the Covid pandemic shows government can act fast and cover a large canvass. Even though there are systemic barriers preventing capital shifts the pressure to act is more likely to increase, leading to more innovation and incentives for investors to invest in low-carbon investment pathways and this can include:

* Challenge asset owners, asset managers and investment advisers to stop obsessing on quarterly data, the past and look to the future and longer-term climate and risk projections.
* Work with finance ministers on macro-fiscal frameworks and include the insurance sector industry and IMF to embed climate in its consultations
* Increase public awareness of the power they hold in their own personal finances to push for change in their products and savings

The finance sector and manufacturers cannot do it all by themselves and will need regulatory and policy support. The issue of short-termism in the markets is a problem but firms need to change that culture internally and requires a full and honest discussion on the mandates provided by their clients but the evidence that following sustainable returns does not lessen alpha should make that an easier conversation.

**Question 54. Do you think that green securitisation has a role to play to increase the capital allocated to sustainable projects and activities?**

**Yes**

**Question 54.1 If necessary, please explain your answer to question 54:**

Securitisation will improve access to capital and should reasonably reduce the costs of raising capital. In particular loans to smaller projects could be aggregated and securitised to reach an suitable deal size that will appeal to the bond market; capital from the sale of asset-backed securities by loan originators could be used to develop a new portfolio of re-jigged loans and labelling the securitisation as ‘green’ can facilitate issuers who want to engage more with the increasing demand for securities that have environmental benefits and use that label as a selling point for its risk decision making and assessment processes.

**Question 56. Do you see the need for a dedicated regulatory and prudential framework for ‘green securitisation’?**

**Yes**

**If yes, what regulatory and/or prudential measures should the dedicated framework contain and how would they interact with the existing general rules for all securitisations and specific rule for STS securitisations?**

A clear definition of green securitisation would be useful for encouraging the market to develop faster but more effort will be needed to reporting capacity too and an ability to keep track of underlying data as consumers and investors need to be able to identify the holdings they have. Improved regulatory capital standards for green bonds along with tax incentives could help increase the attraction of green securitisations across the sector not only for those with a specific green mandate.

Better definition of green eligibility criteria to avoid greenwashing and a review of any green labels if they do not still meet the requirements so that those who do not have any green label removed.

There are still areas for improvement especially regarding institutional investor awareness of the securitisation regulation and its wider impacts in particular its reach regarding exposure in the risk retention rules section and how this applies to AIFMs, but having the principles in operation has had the reasonable consequence that it requires EU institutional investors to be aware of and to be more effective at managing the securitisations they hold and it will be easier to adjust the requirements as the market evolves that try to implement a new set of rules from scratch under time pressure.

**Question 60. What do you consider to be the key market and key regulatory obstacles that prevent an increase in the pipeline of sustainable projects?**

A circular economy enables participants to address a range of challenges posed by climate change and evolution to a sustainable model.

Evolving to a circular economy is complicated and there are challenges at firm and value chain levels and at EU and national level in terms of policy. Some of the challenges include financing new business models, taxation, resistance to change and a perceived lack of consumer demand.

The EU Action Plan for the Circular Economy, as the Plastics Strategy and funding availability are important enablers to support businesses to pursue a circular ambition and this can also be encouraged at state level with more consumer engagement and awareness, along with multi-stakeholder platforms and the government making it a priority to development strategies.

But policy obstacles like tax and regulation for how to use secondary raw materials, along with a need for harmonisation of recycling plans, unsuitable waste management laws and public procurement issues remain.

Solutions should focus on ensuring safe areas to innovate and tender more green procurement but making sure to properly understand the challenges and the opportunities to implement circular economic models and how that leads to delivering a circular Economy. It will only be by understanding all the elements that help or hinder the transition will firm and policy planning be effective and successful.

Committed leadership and the engagement of senior management along with clear legislation will be required to promote the scale of transition needed to achieve a circular economy model. This will require top down support but more relevantly it will need stronger local government support that sets the quality standards needed for recycled and reused materials, and to support innovative initiatives. But meeting the bottom line properly is of course crucial and steps are required to adjust taxation on labour and raw materials.

For a circularity model to work those barriers need to be tackled and there are many levers available to do that. Connecting with a firms’ sustainability policy and its corporate social responsibility strategies and devising favourable taxation systems (reduced VAT on reused goods etc) will encourage the chances needed. More work is needed to make a circular model the best option and the challenges have a framework to be addressed through the EU Action Plan on the Circular Economy from 2015 but barriers remains and need to be addressed more actively.

**Question 64. In particular, would you consider it useful to have a category for R&I in the EU Taxonomy?**

**Yes**

**Question 76. Do you think the current level of global coordination between public actors for sustainable finance is sufficient to promote sustainable finance globally as well as to ensure coherent frameworks and action to deliver on the Paris Agreement and/or the UN Sustainable Development Goals (SDGs)?**

Nationally determined contributions (NDCs) under the Paris Agreement are statements of the actions a country aims to take so it can reduce its greenhouse gas emissions, but they can also map out other priorities and ambitions that will make a definitive contribution to meeting wider sustainable development objectives.

The new NDC and SDG connection tool can identify important overlaps and potential synergies between the NDCs and the 2030 Agenda for Sustainable Development and it seems the most likely results will show overlaps in the areas of water, food and energy.

But not every environmental SDG will be reflected in the NDC commitments. The social SDGs are under-represented in NDC commitments if compared to environmental and economic goals especially relating to health, education and gender equality. The NDCs will reinforce the connected character of sustainable development and several of the SDG themes are covered by a range of climate actions that show there are a few potential synergies and opportunities for policy linkages.

While the UN’s SDG 2030 Agenda is global and universally applicable it remains the case that it is left to each state to decide the best way to implement it, and which goals to prioritise based on local needs. Countries can set up their own national and subnational implementation structures and plans but they are encouraged to work together too.

Even though the NDCs are linked to implementing the Paris Agreement, they were first drafted before it. The Paris Agreement will be judged on those documents though and its 192 signatories have committed to go well above proposals to reduce greenhouse gas emissions to mitigate climate change, but they aim to meet a range of objectives to promote sustainable development.

The Paris Agreement takes a bottom-up approach, with countries setting their own climate targets as written in the NDC and they are asked to submit an updated NDC every five years. As NDCs are different and SDGs were developed after, the links are not clear and the new NDC-SDG connection tool seeks to bridge that gap.

It will be useful for policymakers as they can use the connections to plan better and co-ordinate the implementation of the SDGs with climate actions and the links will provide opportunities for more ambitious implementation of both agendas. Countries could strengthen the links in the next round of NDC though.

The connections identified by the NDC-SDG Connections tool shows there is a need to consider the SDGs and climate action under the NDCs and link them in an integrated approach. By factoring in SDG aims, countries can also be better prepared to ensure their climate related actions are capable of promoting wider social, economic and environmental ambitions and climate actions and SDG targets reviewed together can reduce duplication and identify more opportunities for an effective process of budget allocation to achieve objectives.

**Question 78. In your view, what are the main barriers private investors face when financing sustainable projects and activities in emerging markets and developing economies?**

Given the requirement for a transition period to keep global average temperatures under 2 degrees above pre-industrial levels there is still a challenge to reduce the stress on ecological pressures but also to address an increasing population, which places more pressure on resources as needs are addressed and poverty issues tackled.

Unlocking private finance is regarded as among the solutions most essential to meeting this challenge but implementing the political, regulatory and economic conditions to redirect private sector investment is as big a task as ever.

Discussions often mention the vast amounts of capital available for funding a move to a sustainable economic model but the evidence of these amounts is rare. There are many factors that are needed to achieve climate and sustainable development ambitions, there are a number of specific commitments and international agreements there are steps that have helped reorient attention and they include the Paris Agreement, biodiversity targets and the UN Sustainable Development Goals.

There is still a gap between global commitments and our capacity to implement the scale of change required. The finance options that will support climate action and sustainable development have been expanding across different funding sources such as the World Bank’s BioCarbon Fund the Global Environment Facility and the Clean Development Mechanism, Funding is also accessible through local and national sources both public and private. But new funding structures and more innovative partnerships are an important step in the financial sector that will foster more solution options and the scale up of finance at government level should be followed by a focus on the private sector lending capacity too.

There is a general consensus that public funding alone will not be enough but the scope of operations and responsibility of financial institutions has changed given the risks presented now by environmental forces like climate change. Environmental, social and political conflicts can result in business disruption and we are currently in the middle of such a period and it’s not clear what systemic changes will result from Covid. Business continuity is essential for private sector operations to mitigate risk and the risk needs to be clearly integrated for financial institutions, governments, and private stakeholders in order to highlight the need for a holistic framework aligned with regulations and policies to mitigate risk and meet a common goal.

Understanding financial flows for the environment and sustainable development is complicated because of a range of definitions and a lack of mandatory reporting requirements. So there is a lack of empirical data or a systematic understanding of financing directed towards environmental and developmental sustainability action that would include climate mitigation and adaptation.

The issue is further affected by the range of understanding on what is green or sustainable finance and that it means building secure data is difficult.

It will be essential to have reliable and integrated data relating to the status of financial flows to be able to properly assess the current state of financing and make informed decisions on which strategies and financial decisions are needed to fill gaps and know where to allocate limited resources most efficiently.

**Question 79. In your opinion, in the context of European international cooperation and development policy, how can the EU best support the mobilisation of international and domestic private investors to finance sustainable projects and activities in emerging markets and developing countries, whilst avoiding market distortions?**

The transition to a green economy needs to unlock finance to facilitate sustainable development. It will need government and policy reform that enables an investment environment that is more than voluntary commitments and can better value natural resources and environmental degradation.

Designing incentives to scale up private investment and align subsidies with financial measures will add to risk mitigation, but it is also important to address any political risks too and that includes implementing regulatory reporting requirements that will improve transparency.

Developing an international informational body can be helpful to build consumer confidence and make it easier to identify suitable investment options, and such a resource can be useful in the current situation in coordinating efforts to highlight projects and works that need to be actioned and which can be a route to redirect employment reductions from other sections of the economy.

An improvement in the awareness of initiatives and funding sources for projects and increasing financial literacy will improve the financial system and can increase network and other opportunities. Bridging finance gaps and enhancing cost effectiveness of projects by better monitoring, reporting and impact assessments is crucial.

Centralising information, at local, national or international level can have the benefit of building coordination and communication between a range of stakeholders and can be a tool to develop a strong resource for sustainable development projects and provide financial information including projects and investments through DFI options too.

**Question 80. How can EU sustainable finance tools (e.g. taxonomy, benchmarks, disclosure requirements) be used to help scale up the financing of sustainable projects and activities in emerging markets and/or developing economies?**

Recent years have increased a focus on international challenges like climate change and sustainable development. The Paris Agreement and the SDGs provide a framework for the finance sector to better engage to meet the objectives of the transition to a sustainable economy.

But this raises the issue of how to achieve and finance these objectives and a solution can include unlocking private finance to meet sustainable development commitments. Although there are a number of blocks to achieving this link, such as a reliance on voluntary commitments, market failures, information gaps and short-termism but also concerns with undervaluing natural capital along with inconsistent and counterintuitive policies that may have provided a disincentive to the scale of private investment required to meet sustainable development goals.

Progress has been made regarding cross sectorial commitments in particular and initiatives are being undertaken to support that. Leveraging voluntary commitments and innovative partnerships and collaborating on DFI and public private partnerships all offer potential.

Given the current momentum and ongoing environmental concerns there is a sense of urgency to establish an understanding of the outcomes and implications of sustainable investing that would ensure investment decision making can be well-informed. Long-term sustainability and being able to access funding is crucial, but so to is showing sustainable investment can help companies achieve goals will help ensure a flow of capital but also profitability which is vital for emerging markets to build scale.

**Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of**

The proposed criteria for economic activities for the Taxonomy are a valuable data source unprecedented by its granularity. The classification and the metrics and thresholds that follow is already a reference used in finance activities.

The Taxonomy excludes a large portion of firms and facilities within high emitting sectors and it is a challenge because this is where the large chunk of GHG emissions come from and where serious deductions can be made. It is vital to engage with all stakeholders and understand that it is not the case that not being dark green does not mean an activity is brown. It is also important when looking at some green activities to note there are degrees of green and it is reasonable that a brown (and blue and grey) taxonomy may also be warranted and quickly.

The transition is not binary and requires shade. Managing transitional risks requires gradually moving away from high emissions. A shaded brown taxonomy could enable signals to decarbonize our economy at a lowest economic and social cost and minimise a glut of stranded assets.

Shades could have a range of benefits including for risk-weighted adjustments and collateral requirements from central banks. Those who advocate a brown taxonomy include the Network for Greening the Financial System (NGFS) and the European Insurance and Occupational Pensions Authority (EIOPA). It would be reasonable to hope the European Parliament would review extending the Taxonomy to non-green activities. A shadedtaxonomy can help with transition pathways and balance sheets by targeting where to invest or divest and the brown element is the stick element while the degree of shade can be a carrot.

**Question 84. Climate change will impact financial stability through two main channels: physical risks, related to damages from climate-related events, and transition risks, related to the effect of mitigation strategies, especially if these are adopted late and abruptly. In addition, second-order effects (for instance the impact of climate change on real estate prices) can further weaken the whole financial system.**  
**What are in your view the most important channels through which climate change will affect your industry?**

The necessary transition to a low-carbon economy requires considerable investment and if the pace of investment is too slow, a sharper adjustment will be required, and that could pose macroeconomic and financial stability risks. In response to the 2015 Paris Agreement, the EU has committed to a 40% reduction in emissions by 2030 when compared to 1990 levels and to meet net carbon neutrality by 2050.

Meeting this goal will be crucial to the international effort to reduce global warming, and reports of the Intergovernmental Panel on Climate Change (IPCC) set out the consequences of a sustained increase in global temperatures. As part of a comprehensive policy, carbon taxes have to play a central role to guide the energy transition and facilitate economic incentives that foster moving to a zero-carbon model.

The economic and societal challenges posed by climate change mean it is inevitable the financial system has a major role in financing the carbon transition. On that basis the strategic plans of financial firms to address climate change and central banks and regulators have a leading role to embed climate change as a strategic priority for the financial system. After the shock to the financial system from the financial crisis the central bank forum is better placed to make the scale of change required to transition to a sustainable system.

Addressing the implications of climate change for the financial system is essential to make progress on three important issues: resilience, consumer protection and engagement and influence. Without action the long-term resilience of the financial system is unstable as balance sheets are left exposed to avoidable climate risk and resilience is integral to the stability of the wider financial system and growth of the economy.

The consumer protection frameworks must help households understand the financial choices they face due to climate change, both for general financial goals but also in how it will impact on housing and transportation. The multi-dimensional nature of carbon transitioning means it can only be completed with the joint effort of consumers but also firms, government and the financial sector to make sure policy and regulation developments are correctly addressing the right issues.

**Copy from the PIMFA response to Financial Conduct Authority (FCA) Climate Change and Green Finance Discussion Paper (DP18/8)**

In 2019 PIMFA had the opportunity to reply to the Financial Conduct Authority (FCA) Climate Change and Green Finance Discussion Paper (DP18/8) and it is worth reiterating some of the comments we made then, now in this submission and to share our responses to the questions that were asked them, which I would argue have relevance for this consultation.

Regardless of the future regulatory framework applicable in the UK and in the EU and elsewhere, tackling the impact of climate change will require a more proactive policy response and the design of those policies will be filtered through regulatory requirements that must meet national, supranational and international realities, as well as respond to public opinion. But not only will the financial sector be required and expected to respond and change it can also be a catalyst for controlling some of the change it will be expected to implement.

In 2015, The Bank of England governor Mark Carney called for action on climate change and he argued for action from the financial services sector before climate change became a ‘clear and present danger’ to financial stability. As there is more experience of weather damaging property and disrupting trade and more active political involvement to tackle carbon emissions and increase the use of green technology and recycling there is a greater awareness of the potential for these events to impact on asset prices.

For the financial services sector the transition risks are more serious. Loan books can be impacted by costal erosion, weather events or government decisions relating to climate and proposals for new energy efficient standards can result in stranded assets, which impacts the industry sector using those assets as collateral.

More recently[[1]](#footnote-1) the Bank of England stated banking institutions will need to set up board-level engagement and responsibility for managing climate change risk, which means senior executives will be held personally responsible. In October 2018 central banks who are members of the Network for Greening the Financial System (NGFS) committed to a declaration that climate change related risks come under their mandate and within their previous remit on the basis that it is reasonable central banks should take note of any material risk that could impact capital requirements.

The learning point for the industry is that this reflects a cultural shift given most risk is based on assessing historical data, while climate change risk is about the potential for risk in the future without the benefit of historical comparative data to use. A task force of the Financial Stability Board (which Mr Carney chaired ) set out its recommendations to help firms manage this risk. It encourages firms to use scenario analysis to model how businesses need to alter their operations if governments take concrete action to meet the Paris Agreement aspiration to limit increases in global average temperatures to less than 2 degrees.

Currently the supervisory focus is on developing risk-management tools. But proponents of regulatory change could reasonably be confident more will be done - not just relating to climate-related risk but also for green investment choices across the full ESG spectrum. The ECB already applies ethical criteria to the asset portfolios its staff pension scheme invests through and is considering extending this to its paid-up capital and general reserves, which may have implications for the interest rate setting process.

However, it is a balancing act because targeting green assets could be counter-productive if taxing assets weakens the market or limits the evolution of green finance products.

In the event of rating agencies accurately factoring in climate change risk and applying genuine disclosure it could see capital move toward sustainable investments. Climate risk responses could have an impact on monetary policy for how austerity or quantitative policies are applied to targeted green finance related outcomes.

The financial services sector needs to be aware of potential implications if governments did include climate change objectives to central bank remits as a secondary objective or issues clarity on what it considered sustainable investment to be.

The paper touched on the increase in consumer demand for ‘green’ financial services but the FCA should remain aware if new or targeted regulation and rules stifle innovation. The impact of climate change is a material fact the FCA must be aware of and prepare to quantify as it could affect the value of some investments. It is important to make sure that disclosures relating to climate change are a help to those making investment decisions.

Part of the policy process for disclosing important information in green finance is to have some minimum standards, which will also help develop investor and market trust. The FCA has focused on:

* The Law Commission recommendation[[2]](#footnote-2) (on Pension Funds and Social Investment) concerning climate change and pensions;
* Boosting innovation in the evolution of green products;
* Assessing if more support is needed to provide for appropriate information for investors and disclosures on the issuing of securities.
* The option of a new requirement for financial services to report publicly on how they are managing climate change risk

Additional input from firms would be required to manage the effects and risks from climate change and the transition to a low carbon economy for consumers and how the impacts of climate change could affect appropriateness of certain products or asset allocations.

**DISCLOSURES IN CAPITAL MARKETS**

**We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally. If so, what framework would be most useful?**

In our view having comparability of disclosures can help. Retail financial services rely on this information and most of time it is difficult to determine as the features of various financial transactions vary widely across the product range. They each use different screening processes and criteria so some consistency in approach could be beneficial.

**Would exploring a ‘comply or explain’ approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?**

Comply or explain is intended as a process to let the market decide if standards remain appropriate and it is not compatible with a one size fits all regulatory approach. For comply or explain to be relevant and an effective tool, it needs an agreed and consistent base against which data from the industry is mapped, and from which investors can obtain reputable data to use when making investment decisions.

Subject to an agreed framework being applied consistently for corporate environmental reporting it could strengthen the relationship between climate matters and strategy and evidence of the firm’s ability to build value.

Although climate factors can be a significant business risk, they are not always reflected in key performance indicators firms’ management use to monitor a firm progress and firms will need to communicate this data more effectively. Consider too the characteristics and purpose of performance indicators.

Strategies and targets relating to a firm’s own assessment are by their nature unique to that firm, while the consistency and comparability of disclosures could be improved by developing performance indicators with common characteristics that still link to the objective of disclosure and the circumstances of the organisation. The common data characteristics that could be built on to encourage conformity could include:

* Traceable financial information
* Consistency over successive periods and mapped to internal indicators
* Focus on substantive material data
* Data should be available together with qualitative information for context
* Matching consistency to accepted industry benchmarks

Directive 2014/95/EU[[3]](#footnote-3) sets out the rules on disclosure of non-financial and diversity information by large companies, who are required to include non-financial statements in annual reports from 2018 on. It may be that as data becomes available from 2018 onwards public opinion creates an expectation on firms to explain why they are not making this data available.

**PUBLIC REPORTING REQUIREMENTS**

**Do you think that a requirement for firms to report on climate risks would be a valuable measure?**

We welcome the FCA’s approach in building up the work of the Task Force on Climate-Related Financial Disclosures (TCFD) and the concept of climate risks reporting. It is important to build on existing work and progress to encourage firms to consider the impact of climate change.

Reporting on climate risks would be a valuable measure especially as retail providers rely on institutional investors for their information. An important part of this would be to agree on a harmonised and consistent approach to what needs to be included in this report. Such reports should be based on a ‘comply or explain’ approach and should not discourage firms using ESG considerations, which are relatively consistent with a history of application across a range of product classes.

In the majority of G20 countries there is a requirement for companies with public debt or equity to disclose material information (including climate-related) information. Disclosure in accounts should foster engagement from shareholders (both personal and institutional) and lead to a more informed understanding of the risks and opportunities presented to firms by climate-related factors.

**Do you have any suggestions for what information could be included in a climate risks report?**

The TCFD structures its recommendations around four thematic areas: governance, strategy, risk management and also metrics and targets. The Environmental Audit Committee (EAC) does mention in its conclusions[[4]](#footnote-4) (page 42) relating to climate risk reporting – it’s not only listed companies but also investment managers who should help ensure climate risks are considered at every point in the investment chain.

We do not disagree with those conclusions.

Understanding best practice in corporate environmental reporting can strengthen the relationship between climate-related matters and overall corporate strategy, performance and prospects.

**Do you have any views on which regulated firms should be required to compile a climate risks report?**

According to the EAC report it is not just listed companies but also investment managers who are relevant stakeholders. It is important compiling such reports are not a burden to them or discourages them to use ESG considerations and ESG products.

At this stage we have no additional comment on public reporting, but we note Section 5.27 mentions the Financial Stability Board (FSB) recommendations on disclosures and how they should apply to financial service firms. Particularly, if we look at page 18 of the FSB Report, it stated ‘disclosures should be comparable among companies within a sector, industry or portfolio’. It further noted (page 34 fig 10) that more detailed reporting might include exposure to green revenue and changes over time and insight into portfolio positioning under different climate scenarios.

Our member firms need to be able accurately compare information.

**ADDITIONAL QUESTIONS**

**How can authorities, including the FCA, most effectively work with industry to meet investor demand for green investment opportunities and encourage those raising capital and investing in it to pursue sustainable outcomes?**

The FCA can play a key role in providing more structure and protection to consumers for green finance products and ensuring that the market develops in an orderly and fair way to meet users’ needs to:

* Build from emerging practice: There is an overlap between the UK Strategic Report[[5]](#footnote-5) requirements and the International Integrated Reporting (IR) Framework[[6]](#footnote-6), as they both require firms to report on strategy, business model, risks and key performance indicators. Regulators could add to the quality of reporting by agreeing on shared definitions for terms (such as the business model) that are common to both types of reporting and by drawing reference to guides to supports compliance with both the UK Strategic Report requirements and IR. As an example, the International Financial Reporting Standards Practice Statement on Management Commentary gives international guidance on content for Strategic and Integrated Reporting purposes, meaning it encourages reporting on the same content to develop consistently across different jurisdictions.
* Balance consistency, comparability and flexibility: firms all have a different narrative, and communication adds value when it takes place within a common, shared framework. There is a lot of variation in reporting practice across sectors that is not just about the features of one or other firm. More guidance describing the expectations of reporting companies might help give support to greater consistency and comparability in reporting practice.
* Establish and build up some mandatory reporting requirements: this is important but it should depend on the type of information. If information can be measured and is demonstrably objective, auditable, is capable of standardisation across companies and can be widely used for decision-making the case for the mandatory reporting of material activities is stronger. At the same time firms benefit from clear definitions of what information should be captured and how to disclose and present it.
* Understand the international landscape and opportunities for alignment: the UK Companies Act 2006 - Strategic Report and Directors’ Report – (Regulations 2013) provide a clear structure and platform for the implementation of the EU Non-Financial Reporting Directive. That report explains from a regulatory perspective how the UK is in a good position to lead the development of non-financial reporting and the implementation of this Directive.

**Do you agree with the extent of the FCA’s proposed interventions on climate change-related financial disclosures? Is there a specific need for us to intervene further in the interests of market integrity or consumer interests?**

Financial institutions and investors will be required to assess, monitor and disclose the sustainability of their investments. Regulatory intervention is increasing in the UK but within the existing supervisory frameworks. Even though this is likely to represent an increased cost to businesses (due to the extra assessment, disclosure, monitoring and reporting obligations), the changes could also be an opportunity for the development of new products and services.

In meeting the risk from climate-change, the market has the chance to innovate within a suitable framework, which can create value and help advance climate-related risk management and ESG objectives. The sector is already moving to develop sustainable finance focused products and its initiatives include voluntary guidelines that encourages transparency and disclosure, and the development of the green products market, including green loans and green bonds.

The UNPRI has already developed a set of principles, which can be matched to meet the objectives of the relevant supervisory authorities (BOE, PRA, FCA and others) and meet the requirement for consistent regulatory approaches that make the process of embedding climate change related disclosure standards easier.

Institutional investors have a duty to act in the best long-term interests of their clients. In that fiduciary role, environmental, social, and corporate governance (ESG) issues can impact the performance of investment portfolios. But the UNPRI are designed as a means to “better align investors with broader objectives of society”.

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* Developing quantitative and qualitative metrics and tools to monitor financial exposure to climate change.
* Engagement with clients, counterparties and corporates to understand possible current and future impacts of the physical and transition risk factors relevant to risk assessment and management.
* Do Pillar 3[[7]](#footnote-7) and Strategic Report disclosures provide enough transparency about climate-related financial risks, or whether additional disclosures are necessary?

The FCA’s paper is focused on exploring “the impact of climate change on investments, and on all intermediaries in the investment chain”, including potential conduct risks for investors. It proposes measures in:

* Securities admitted to trading on a regulated market: this will give investors information to make risk assessments on their investments and assess the impact of climate change on their securities’ valuation. The FCA will engage on guidance to securities issuers about how the disclosure regime could apply to climate-related risks and it has suggested this might take the form of a “comply or explain” approach.
* Disclosure of climate risk management: aligning with TCFD guidelines and the European Commission’s sustainability risk disclosure, the FCA will ask for views on introducing a new requirement for firms to issue public reports on how they manage climate risks.
* Personal pension schemes: the FCA plans to launch its consultation to require personal pension schemes, including workplace personal pension schemes, consider climate change in their investment decisions. It will evaluate how Independent Governance Committees of workplace personal pension schemes take environmental, social and governance considerations into account, and introduce guidance for providers of workplace pension schemes to take financial and non-financial factors into account when making investment decisions.
* Innovation in specialist green products: focusing on the opportunities from growing demand for green finance, the FCA has launched its Green Fin Tech challenge extending its innovative services, like the sand box, to selected providers of green solutions and services.

Against a backdrop of international and EU initiatives to put climate change onto the financial regulatory agenda, it is reasonable to expect the UK regulators take an active lead.

There is already a good degree of overlap between the approaches taken by the relevant supervisory stakeholders and it will be of value to continue collaborating with each other and the industry through the new joint Climate Financial Risk Forum and explore relevant issues, including data improvement and the potential development of climate-related scenarios.

**What are your biggest concerns and commercial priorities regarding climate change?**

To a degree, climate change is still an issue viewed as one about operational efficiency rather than the creation of long-term sustainable value. A lot of firms focus on actions that give clear and low risk returns, which have modest costs. This is not unusual where substantive action can require significant costs and when actions can commit a firm to a course of action that is difficult to alter.

No doubt this may reflect the uncertainties about climate change policy at the national and international levels, which can be a barrier to firms engaging more about climate change other than relatively short-term costs and benefits. Although there may be concerns among business leaders about the risk inherent in responding to and being seen to respond to green issues, in business terms, responding to climate-change is a long-term structural change.

Firms need to be able to make decisions taking proper account of uncertainty about the longer-term journey of climate change policy formation. But still be robust and flexible enough to be able to respond to the inevitable changes in the market, business and regulatory context they operate within.

In practice this issue could be addressed by firstly, firms rethinking the timescales they use in corporate risk assessment and strategy processes. Secondly, firms need to reconsider and review their capital investment processes and thirdly, firms will need to develop suitable corporate data and expertise on climate change.

Climate change is a strategic issue for the industry and the fact its roots stem from debates on using natural resources do not lessen its importance as its impacts are felt in all areas of the economy. The firms best able to meet the challenge of how climate change can strategically drive additions to value will be those who take a longer-term view of the implications of climate change for that business and who have built that fact into their capital investment decisions.

**What are the biggest barriers to the growth of green financial services in the UK?**

Barriers include standards in the industry, regulation uncertainty (UK, EU or Intl), education for advisers and market data

There is no need to reinvent the wheel and there are already a range of guidelines such as the UNPRI that provide additional ground rules for ESG definitions.

The FCA needs to consider flexibility in the application of green finance disclosures as a one size fits all approach is unlikely to be effective. Investor demand needs to go hand-in-hand with a balanced regulatory regime and obligations for firms and in this respect, common standards would be helpful for both investors and firms. Make sure the process is not too burdensome for firms.

At the same time the FCA needs to ensure that a) suitability obligations under MiFID II incorporate sustainability considerations and b) training on ESG topics is facilitated through approved exam formats. ESG preferences need to become part of the advice process and this in turn can help drive investor demand for their preferences to be taken into account.

Retail financial services rely on institutional bodies for the information they make investment decisions on which means agreed standards and taxonomy is crucial.

Since the UK Green Finance Initiative was set up in 2016 the global policy agenda has advanced with other countries taking leading positions internationally or proceeding with national plans. This creates opportunities and a challenge to the UK not to fall behind.

The European Union published its own Action Plan in March 2018 on Sustainable Finance setting out the strategy it will follow to support a financial system that will meet the EU’s climate-related development plan. It sets out a range of initiatives based on the findings of the High-Level Expert Group (HLEG) and includes reforms the UK will be interested in too.

The UK has advanced regulatory experience in relevant areas including fiduciary duty, reporting and using capital for clean infrastructure and can implement domestic legislation as required. It would be useful to removing future barriers that the UK should align with the EU reforms that best serve the interests of increasing international investment markets in clean growth, using its weight as a leading financial centre to build an international framework for green finance and standards that are not only national based but are used as best practice examples internationally such as the success of expanding the use of English common law for international business contracts.

PIMFA welcomes the opportunity to respond to the FCA’s Climate Change and Green Finance Discussion Paper (DP18/8).

The 2015 Paris Agreement was reached with the participation of 196 countries and parties under the remit of the UN Framework Convention on Climate Change (UNFCCC) and comes into effect from 2020.

Its aim is to lay the foundation for the process to respond to greenhouse gas emissions ‘mitigation, adaption and finance’ and to limit temperature increases to ‘well below’ two degrees Celsius. It is among the most important and consequential efforts undertaken to date to collective design an international framework within which to address the challenges of tackling climate change.

The agreement leaves it to each country to plan and report on its contribution to meeting these goals but it does not set targets or fixed dates for implementation. Although the US government has announced its intention to withdraw that will not come into effect until November 2020, just as this Administration’s current term ends. However, the US is already weakening a range of environmental and financial regulatory policies that will potentially undermine the applicability of any steps taken to meet the aspirations of the agreement.

The Paris Agreement aspirations will shape much of the context within which the financial services industry will operate in the coming years. In December 2018, the UNFCCC conference held in Katowice in Poland met to agree on the rules to implement the 2015 Paris Agreement. Although the specific rules were not all agreed and remain the subject of ongoing

discussions, the direction of travel has been set and the financial services industry, along with other industries, can no longer ignore the risks it faces from the impact of climate change.

Regardless of the future regulatory framework applicable in the UK, tackling the impact of climate change will require a more proactive policy response and the design of those policies will be filtered through regulatory requirements that must meet national, supranational and international realities, as well as respond to public opinion.

But not only will the financial sector be required and expected to respond and change it can also be a catalyst for controlling some of the change it will be expected to implement.

In 2015, The Bank of England governor Mark Carney called for action on climate change and he argued for action from the financial services sector before climate change became a ‘clear and present danger’ to financial stability. As there is more experience of weather damaging property and disrupting trade and more active political involvement to tackle carbon emissions and increase the use of green technology and recycling there is a greater awareness of the potential for these events to impact on asset prices.

For the financial services sector the transaction risks are more serious. Loan books can be impacted by costal erosion, weather events or government decisions relating to climate and proposals for new energy efficient standards can result in stranded assets, which impacts the industry sector using those assets as collateral.

More recently[[8]](#footnote-8) the Bank of England stated banking institutions will need to set up board-level engagement and responsibility for managing climate change risk, which means senior executives will be held personally responsible. In October 2018 central banks who are members of the Network for Greening the Financial System (NGFS) committed to a declaration that climate change related risks come under their mandate and within their previous remit on the basis that it is reasonable central banks should take note of any material risk that could impact capital requirements.

The learning point for the industry is that this reflects a cultural shift given most risk is based on assessing historical data, while climate change risk is about the potential for risk in the future without the benefit of historical comparative data to use.

A task force of the Financial Stability Board (which Mr Carney chairs) set out its recommendations to help firms manage this risk. It encourages firms to use scenario analysis to model how businesses would need to alter their operations if governments take concrete action to meet the Paris Agreement aspiration to limit increases in global average temperatures to less than 2 degrees.

Currently the supervisory focus is on developing risk-management tools. But proponents of regulatory change could reasonably be confident more will be done - not just relating to climate-related risk but also for green investment choices across the full ESG spectrum. The ECB already applies ethical criteria to the asset portfolios its staff pension scheme invests through and is considering extending this to its paid-up capital and general reserves, which may have implications for the interest rate setting process.

However, it’s a balancing act because targeting green assets could be counter-productive if taxing assets weakens the market or limits the evolution of green finance products.

In the event of rating agencies accurately factoring in climate change risk and applying genuine disclosure it could see capital move toward sustainable investments. Climate risk responses could have an impact on monetary policy for how austerity or quantitative policies are applied to targeted green finance related outcomes.

The financial services sector needs to be aware of potential implications if governments did include climate change objectives to central bank remits as a secondary objective or issues clarity on what it considered sustainable investment to be.

The paper touches on the increase in consumer demand for ‘green’ financial services but the FCA should remain aware if new or targeted regulation and rules stifle innovation. The impact of climate change is a material fact the FCA must be aware of and prepare to quantify as it could affect the value of some investments. It is important to make sure that disclosures relating to climate change are a help to those making investment decisions.

Part of the policy process for disclosing important information in green finance is to have some minimum standards, which will also help develop investor and market trust. The FCA has focused on:

* The Law Commission recommendation[[9]](#footnote-9) (on Pension Funds and Social Investment) concerning climate change and pensions;
* Boosting innovation in the evolution of green products;
* Assessing if more support is needed to provide for appropriate information for investors and disclosures on the issuing of securities.
* The option of a new requirement for financial services to report publicly on how they are managing climate change risk

Additional input from firms would be required to manage the effects and risks from climate change and the transition to a low carbon economy for consumers and how the impacts of climate change could affect appropriateness of certain products or asset allocations.

Should you have any queries about our response please do not hesitate to contact us: we would be happy to discuss and provide further information.

Yours sincerely



Desmond FitzGerald

Senior Policy Adviser

PIMFA

**Appendix**

**DISCLOSURES IN CAPITAL MARKETS**

**Question 1**

**What, if any, difficulties do issuers \* (of listed securities) face in determining materiality. We are also interested in exploring how investors consider materiality \* (the point where a market movement can be quantified against a starting point) in this context**

No comment.

**Question 2**

**We are interested in understanding whether greater comparability of disclosures would help investors in their decision-making more generally. If so, what framework would be most useful?**

In our view having comparability of disclosures can help. Retail financial services rely on this information and most of time it is difficult to determine as the features of various financial transactions vary widely across the product range. They each use different screening processes and criteria so some consistency in approach could be beneficial.

**Question 3**

**Would exploring a ‘comply or explain’ approach, or other avenues to encourage more consistent disclosures, be an effective way of facilitating more effective markets?**

Comply or explain is intended as a process to let the market decide if standards remain appropriate and it is not compatible with a one size fits all regulatory approach. For comply or explain to be relevant and an effective tool, it needs an agreed and consistent base against which data from the industry is mapped, and from which investors can obtain reputable data to use when making investment decisions.

Subject to an agreed framework being applied consistently for corporate environmental reporting it could strengthen the relationship between climate matters and strategy and evidence of the firm’s ability to build value.

Although climate factors can be a significant business risk, they are not always reflected in key performance indicators firms’ management use to monitor a firm progress and firms will need to communicate this data more effectively. Consider too the characteristics and purpose of performance indicators.

Strategies and targets relating to a firm’s own assessment are by their nature unique to that firm, while the consistency and comparability of disclosures could be improved by developing performance indicators with common characteristics that still link to the objective of disclosure and the circumstances of the organisation. The common data characteristics that could be built on to encourage conformity could include:

* Traceable financial information
* Consistency over successive periods and mapped to internal indicators
* Focus on substantive material data
* Data should be available together with qualitative information for context
* Matching consistency to accepted industry benchmarks

Directive 2014/95/EU[[10]](#footnote-10) sets out the rules on disclosure of non-financial and diversity information by large companies, who are required to include non-financial statements in annual reports from 2018 on. It may be that as data becomes available from 2018 onwards public opinion creates an expectation on firms to explain why they are not making this data available.

**PUBLIC REPORTING REQUIREMENTS**

**Question 1**

**Do you think that a requirement for firms to report on climate risks would be a valuable measure?**

We welcome the FCA’s approach in building up the work of the Task Force on Climate-Related Financial Disclosures (TCFD) and the concept of climate risks reporting. It is important to build on existing work and progress to encourage firms to consider the impact of climate change.

Reporting on climate risks would be a valuable measure especially as retail providers rely on institutional investors for their information. An important part of this would be to agree on a harmonised and consistent approach to what needs to be included in this report. Such reports should be based on a ‘comply or explain’ approach and should not discourage firms using ESG considerations, which are relatively consistent with a history of application across a range of product classes.

In the majority of G20 countries there is a requirement for companies with public debt or equity to disclose material information (including climate-related) information. Disclosure in accounts should foster engagement from shareholders (both personal and institutional) and lead to a more informed understanding of the risks and opportunities presented to firms by climate-related factors.

**Question 2**

**Do you have any suggestions for what information could be included in a climate risks report?**

The TCFD structures its recommendations around four thematic areas: governance, strategy, risk management and also metrics and targets. The Environmental Audit Committee (EAC) does mention in its conclusions[[11]](#footnote-11) (page 42) relating to climate risk reporting – it’s not only listed companies but also investment managers who should help ensure climate risks are considered at every point in the investment chain.

We do not disagree with those conclusions.

Understanding best practice in corporate environmental reporting can strengthen the relationship between climate-related matters and overall corporate strategy, performance and prospects.

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**Do you have any views on which regulated firms should be required to compile a climate risks report?**

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The FCA’s paper is focused on exploring “the impact of climate change on investments, and on all intermediaries in the investment chain”, including potential conduct risks for investors. It proposes measures in:

* Securities admitted to trading on a regulated market: this will give investors information to make risk assessments on their investments and assess the impact of climate change on their securities’ valuation. The FCA will engage on guidance to securities issuers about how the disclosure regime could apply to climate-related risks and it has suggested this might take the form of a “comply or explain” approach.
* Disclosure of climate risk management: aligning with TCFD guidelines and the European Commission’s sustainability risk disclosure, the FCA will ask for views on introducing a new requirement for firms to issue public reports on how they manage climate risks.
* Personal pension schemes: the FCA plans to launch its consultation to require personal pension schemes, including workplace personal pension schemes, consider climate change in their investment decisions. It will evaluate how Independent Governance Committees of workplace personal pension schemes take environmental, social and governance considerations into account, and introduce guidance for providers of workplace pension schemes to take financial and non-financial factors into account when making investment decisions.
* Innovation in specialist green products: focusing on the opportunities from growing demand for green finance, the FCA has launched its Green Fin Tech challenge extending its innovative services, like the sand box, to selected providers of green solutions and services.

Against a backdrop of international and EU initiatives to put climate change onto the financial regulatory agenda, it is reasonable to expect the UK regulators take an active lead.

There is already a good degree of overlap between the approaches taken by the relevant supervisory stakeholders and it will be of value to continue collaborating with each other and the industry through the new joint Climate Financial Risk Forum and explore relevant issues, including data improvement and the potential development of climate-related scenarios.

**Question 5**

**What are your biggest concerns and commercial priorities regarding climate change?**

To a degree, climate change is still an issue viewed as one about operational efficiency rather than the creation of long-term sustainable value. A lot of firms focus on actions that give clear and low risk returns, which have modest costs. This is not unusual where substantive action can require significant costs and when actions can commit a firm to a course of action that is difficult to alter.

No doubt this may reflect the uncertainties about climate change policy at the national and international levels, which can be a barrier to firms engaging more about climate change other than relatively short-term costs and benefits. Although there may be concerns among business leaders about the risk inherent in responding to and being seen to respond to green issues, in business terms, responding to climate-change is a long-term structural change.

Firms need to be able to make decisions taking proper account of uncertainty about the longer-term journey of climate change policy formation. But still be robust and flexible enough to be able to respond to the inevitable changes in the market, business and regulatory context they operate within.

In practice this issue could be addressed by firstly, firms rethinking the timescales they use in corporate risk assessment and strategy processes. Secondly, firms need to reconsider and review their capital investment processes and thirdly, firms will need to develop suitable corporate data and expertise on climate change.

Climate change is a strategic issue for the industry and the fact its roots stem from debates on using natural resources do not lessen its importance as its impacts are felt in all areas of the economy. The firms best able to meet the challenge of how climate change can strategically drive additions to value will be those who take a longer-term view of the implications of climate change for that business and who have built that fact into their capital investment decisions.

**Question 6**

**What are the biggest barriers to the growth of green financial services in the UK?**

Barriers include standards in the industry, regulation uncertainty (UK, EU or Intl), education for advisers and market data

There is no need to reinvent the wheel and there are already a range of guidelines such as the UNPRI that provide additional ground rules for ESG definitions.

The FCA needs to consider flexibility in the application of green finance disclosures as a one size fits all approach is unlikely to be effective. Investor demand needs to go hand-in-hand with a balanced regulatory regime and obligations for firms and in this respect, common standards would be helpful for both investors and firms. Make sure the process is not too burdensome for firms.

At the same time the FCA needs to ensure that a) suitability obligations under MiFID II incorporate sustainability considerations and b) training on ESG topics is facilitated through approved exam formats. ESG preferences need to become part of the advice process and this in turn can help drive investor demand for their preferences to be taken into account.

Retail financial services rely on institutional bodies for the information they make investment decisions on which means agreed standards and taxonomy is crucial.

Since the UK Green Finance Initiative was set up in 2016 the global policy agenda has advanced with other countries taking leading positions internationally or proceeding with national plans. This creates opportunities and a challenge to the UK not to fall behind.

The European Union published its own Action Plan in March 2018 on Sustainable Finance setting out the strategy it will follow to support a financial system that will meet the EU’s climate-related development plan. It sets out a range of initiatives based on the findings of the High-Level Expert Group (HLEG) and includes reforms the UK will be interested in too.

The UK has advanced regulatory experience in relevant areas including fiduciary duty, reporting and using capital for clean infrastructure and can implement domestic legislation as required. It would be useful to removing future barriers that the UK should align with the EU reforms that best serve the interests of increasing international investment markets in clean growth, using its weight as a leading financial centre to build an international framework for green finance and standards that are not only national based but are used as best practice examples internationally such as the success of expanding the use of English common law for international business contracts.

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2. https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/ [↑](#footnote-ref-2)
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