ShareAction
the movement for Responsible Investment

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Public consultation on the capital markets union mid-term review 2017

ShareAction is a UK registered charity established to promote transparency and Responsible Investment practices by pension funds and other institutional investors. As well as working in the UK, we coordinate the European Responsible Investment Network and engage with European policymakers through our Brussels-based work. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 35,000 individual supporters.

Since 2007, ShareAction have a solid history of conducting benchmarking surveys on Responsible Investment (RI) practices within the investment industry. Our newly published 2016/17 report 'Lifting the Lid: Responsible Investment Performance of European Asset Managers' covers 10 different European countries with the examination and ranking of the transparency and Responsible Investment (RI) practices of 40 of the largest asset managers in Europe[i].

These surveys remain the only independent benchmark of the asset management industry's RI performance covering issues such as integration of environmental, social and governance (ESG) factors into investment processes, stewardship of companies, shareholder voting and transparency and reporting. They are intended as a practical operational tool to:

- Identify and spread industry best practice under existing rules and voluntary codes.
- Identify room for improvement through dialogue with fund managers and areas of potential 'free riding'.
- Aid clients of these firms in their evaluation and selection of providers.
- These practical benchmarking surveys help us to identify regulatory gaps and to provide evidence based proposals for changes in market regulation, addressing ESG issues in order to better manage risk.

3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

Question:

Are there additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

The Commission's Mid-term Review consultation paper reiterates the strategic importance the EU is placing on the need for long term investment through the mobilisation of "institutional investors with long term liabilities, such as insurance companies and pension funds." What must remain clear is that it is the savings of millions of **European citizens** which underpin capital markets through their pension funds, insurance and retail savings

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products. It is estimated that €12 trillion is held by the EU's pensions and insurance sector alone[ii].
The European Commission has previously acknowledged that European "households are the main source of funds to finance investment". Therefore the interests of European retail savers and beneficiaries of institutional investors must be placed at the centre of the CMU. It remains a point – economic and political - worth restating. This means that the laws and regulations shaping and managing capital markets directly affect how the savings of everyday pension fund or retail savers are invested.

ShareAction's vision for a CMU that serves savers, society and the environment

It is against this background that ShareAction have assessed the progress of CMU and looked to how it can be further refined to deliver sustainable finance[1] as the underpinning characteristic of the capital markets of the EU and something which can be promoted internationally. We welcome Commission Vice-President Dombrovski's desire for the EU to push for a global transition towards a more sustainable economy and the desire for an ambitious programme at the forefront of innovation.

To this effect we believe the mid-term review arrives at a significant time of change in the capital markets and believe that if developed adeptly it could take a major step forward in internationalising an economic system that works for savers and long-term, environmentally sustainable economic growth instead of the enrichment of financial intermediaries and fuelling bubbles, crashes and hugely destabilising episodes of mis-selling financial products[2].

Trust

Before saving and retirement capital can be safely mobilised, trust must be restored.
The Commission recognises that restoring the trust of investors is a key responsibility and challenge for the financial sector and it must be made easier for consumers to choose and compare *financial products*. It is right to recognise that:

"Retail investor confidence should be strengthened, but it will be difficult to catalyse the necessary improvements without transparency around costs and fees, given their impact on the net performance of financial products. In particular, the new product disclosure rules under MiFID II, PRIIPS and IDD need to be put to work and effectively support retail investors in their investment choices[iii]. (CMU Mid-term review- Chapter 4 Fostering retail Investment and Innovation).

ShareAction has argued that this will be insufficient to promote trust in a sustainable financial market. Overall, pre-contractual disclosure is just one of the pieces in the jigsaw puzzle of investor protection.

Retail savers and beneficiaries of institutional investors, such as pension savers, should have the right to know:

- Where their money is being invested;
- How ownership rights are being exercised on their behalf;

[1] According to the Commission "Sustainable investment is broadly understood as encompassing environment, social and governance considerations in the investment process." HLEG official minutes.
[2] That this problem has not gone away has been painfully illustrated by the recent case of Monte dei Paschi mis-selling its own risky bonds to naïve citizens. See http://eur-lex.europa.eu/legal content/EN/TXT/PDF/?uri=CELEX:52017SC0077&from=EN
Brussels, 22.2.2017 SWD(2017) 77 final COMMISSION STAFF WORKING DOCUMENT Country Report Italy 2017 p.35

- Their scheme's investment policy, including any policies on responsible ownership or ethical investment, and how the policy is being implemented;
- How the scheme is managing long-term risks to their money, including ESG risks.

They should have the right to participate by:

- Being consulted on investment and voting policies;
- Attending annual meetings where they can question the board of their pension fund or other investment provider, as shareholders can attend the annual general meetings of listed companies;
- Receiving a substantive response to queries about specific decisions.

Although the public may not understand fully how the investment system works and are put off by the jargon, they care deeply about the key issues raised by the way in which companies operate and their impact on society, for example pay inequality, climate change, human rights and labour rights abuses in company supply chains.

When beneficiaries are given a voice or when institutional investors feel more accountable to them, a clearer and more rounded view of beneficiaries' best interests emerges, which drives demand for responsible investment or finance which proves sustainable over the longer term.

The European Commission has not previously had a broad legislative action programme in the area of responsible or sustainable investing, but since 2010 it has put forward an agenda to modernise company law and the framework of corporate governance in Europe. While these initiatives do not relate directly to responsible investing, they do have a material impact in the way institutional investors and asset managers interact with the companies they invest in. Fostering the consideration of environmental, social and corporate governance (ESG) criteria by institutional investors in relation to their investment decisions and strategies has the potential to improve risk management and the ability of investors to direct their funds, as expressed by their investment mandates, into more sustainable long-term finance in the real economy.

What the EU has the option of now doing, as part of the CMU, is to draw together a number of elements which can help the way public social and/or environmental objectives are translated into specific products or specific asset classes.

What is missing from the CMU?

In our previous communications to the Commission on the subject of CMU we sought to outline what we believed was missing from the original CMU Action Plan.
In particular we recognised that insufficient attention was being paid to the increasing maturity (the cultural and financial significance) of the Responsible Investment (RI) market and the active role the EU could play in helping shape and grow the sector through smart interventions which are within its remit.

Responsible Investment (RI)

Responsible Investment is an investment approach which takes account of environmental, social and corporate governance (ESG) factors, recognising that they can have a financially material impact on company and investment portfolio performance, particularly over the long-term. Responsible investors monitor and engage with investee companies, seeking to improve their performance rather than trading speculatively and basing decisions on the

behaviour of other market participants. RI is rapidly gaining general industry acceptance; signatories to the UN led Principles for Responsible Investment (PRI) manage assets worth $59 trillion[iv].

Recent research from the Global Sustainable Investment Alliance (GSIA)[v] suggests that sustainable investing strategies now represent more than 60% of professionally managed assets for EU investors.

ESG and the EU

We recognise that, perhaps somewhat belatedly, the Commission has moved to identify just how prevalent the analysis of ESG factors has become in the investment community. Far from being seen as a "nice to have" layer of intelligence, they increasingly lie at the heart of the process of identifying long term value and sustainability. This 'journey' has been reflected in the sequence of EU its policy papers;

18.2.2015 GREEN PAPER Building a Capital Markets Union[vi]
ShareAction registered our disappointment that the 2015 Green Paper only mentioned ESG factors briefly, in question 7, and implied that they were some type of investment category or product, such as Green Bonds. Mainstream thinking had moved beyond this and understood ESG integration as a practical investment approach that considers all potentially financially material risks and opportunities to investment portfolios; numerous studies[vii] have shown that an RI approach is financially beneficial; the investors managing $45 trillion assets globally have publicly declared climate and Responsible Investment commitments, including being signatories to the PRI[viii].

30.09.2015 Action Plan on Building a Capital Markets Union[ix]
The Action Plan continued this tentative approach towards ESG practices and took a "wait and see" approach to market developments including the monitoring of "the need for EU green bond standards, to help investors benefit from a more long term sustainable approach to investment decisions."

18.12.2015 (until 31 March 2016) DG Justice - long-term and sustainable investment[x]
An important intervention by DG Just to bring a corporate governance perspective through a public consultation on long-term and sustainable investment. This process sought to gather information on how institutional investors, asset managers and other service providers in the investment chain factor in sustainability (ESG) information and performance of companies or assets into investment decisions. The consultation also gathered information about possible obstacles to long-term, sustainable investment.

A feedback document outlining the overall results of the consultation was published[xi] in October 2016.

14.09.2016 Communication from the Commission: 'Capital Markets Union - Accelerating Reform'[xii]
This appears to have indicated a step change which ShareAction wishes to support through the Mid-term review. The Commission acknowledged that ESG was becoming part of the regulatory process.

"*Point 12: More broadly, in respect of environmental, social and governance issues (ESG), the EU has adopted mandatory disclosure requirements for certain large companies and will also adopt non-binding guidelines on the methodology for reporting such information to investors and consumers. It is also assessing the follow-up to the recent consultation on long-term and sustainable investment which emphasised the importance of ESG issues for the longer-term performance of companies and investors.*"

As part of this growing attention the Commission announced the establishment of the High-Level Expert Group (HLEG) on sustainable finance.

24/25 January 2017 First meeting High-Level Expert Group (HLEG) on sustainable finance[xiii]*.*
The objective of the HLEG is to provide, by the end of 2017, policy recommendations for a comprehensive EU strategy on sustainable finance as part of the Capital Markets Union. The Commission will draw on these recommendations to determine how to integrate sustainability considerations into the EU's rules for the financial sector. This marks an important step in the follow-up to the EU's 2030 Agenda for sustainable development as well as the Paris Agreement on climate change.

Recommendations

1. **The gateway provision - fiduciary duty**

We believe a crucial enabling action is needed before investment funds can properly take advantage of the opportunities posed by RI.

The European Commission should end the debate on environmental, social and governance (ESG) risk in the context of fiduciary duty as soon as possible.

It should provide guidance to the competent Member State authorities on how they should interpret fiduciary duty in the national legal context.

The debate around fiduciary duty and ESG issues has been a barrier to the adoption of greater RI practices by institutional investors. ShareAction has been working on this area for a number of years and produced key research about the strangle-hold misconceptions about the law has had on asset owners, in particular, investing responsibly[xiv]. In part as a result of our evidence based submissions, the UK Law Commission examined the role of ESG issues in fiduciary duties and clarified that fiduciary duty poses no barrier to taking account of ESG issues[xv]. On the contrary, where ESG factors pose material financial risks, they should be taken into account. Furthermore, wider concerns such as ethical preferences of savers may also be taken into account by pension trustees. The UN PRI has also worked extensively on this area, looking also at the European angle in its review of fiduciary duty across different Member States[xvi]. However, this remains an issue which is not clearly resolved at Member State level.

Guidance from the Commission should clarify that asset owners have a duty to pay attention to long term factors including ESG factors where they are likely to be financially material. Authorities should also clarify that assets owners and managers are permitted, and indeed encouraged, to take other ESG issues linked to beneficiaries' quality of life or ethical views into account if doing so would not pose a risk of significant financial detriment to investments[xvii].

Guidance would build on the recent IORPs II legislation (discussed further below). It would also build upon the findings of the recent consultation on long-term and sustainable investment which emphasised the importance of ESG issues for the longer-term performance of companies and investors[xviii]. The executive summary concluded that:

"*The large majority of contributors, in particular institutional investors and NGOs, argued that* ***fiduciary duty*** *i.e. the duty of investors and asset managers to act in the best interest of the beneficiary (i.e. future pensioners) or the client (i.e. retail or institutional investors) was not clear enough and could therefore be used as an excuse for not considering ESG matters in investment decisions."*

In addition, DG FISMA should cooperate with DG ENV and DG CLIMA in relation to their study of fiduciary duties and efficient resource use across Europe[xix]. Where European Directives and Regulations refer to investors' duties to invest in beneficiaries' best interests, for example in Article 20 of the IORPs Directive, it must be clarified that this means their long-term best interests and that financially material ESG factors must be taken into account. (This is explored further in the section on fostering retail investment- see IORP II below).

2. ESG factors

The treatment of ESG factors in the original Green Paper was confused. The focus was on ESG as a product class. Although investment products and vehicles with a strong focus on environmental, social or corporate governance issues such as green bonds exist and this is to be welcomed, ESG must be understood as part of a Responsible Investment approach which is appropriate, and increasingly common, <u>for all asset classes</u>. This approach is based on the understanding that ESG factors can be financially material to investments, particularly over the long-term and therefore should be considered in investment decisions. As such the Commission must ensure that ESG considerations become a strategic component of all investment practices covering all asset classes.

The Commission should play a leading role in defining standardised definitions and measures, in collaboration with other globally recognised initiatives.

Robust definitions and requirements in relation to ESG factors will ensure that disclosure requirements for investors, corporations and other projects seeking investment are meaningful, useful and comparable.

ShareAction's benchmarking studies of the Responsible Investment performance of the UK's largest pension funds, asset managers and insurance companies have found that when disclosure requirements are vaguely defined by policymakers or regulators the result is often correspondingly vague disclosures that have limited value[xx].

For asset owners seeking to appoint investment managers, or for investment managers making investment decisions, it remains far too difficult to judge which organisations are genuinely doing a good job of integrating ESG considerations. There is a danger that positive public statements on RI and ESG are merely greenwashing or marketing initiatives with little impact on actual processes and decisions. As such markets are not working as efficiently as they could be by rewarding organisations that do make investments in ESG related capabilities. This has been recognised in the recent work carried out by the Joint ESA committee on PRIIPS[xxi](see next section on fostering retail investment.)

There needs to be a clear, robust and widely accepted definition of what is meant by "ESG". There are examples of references to ESG issues in legislative texts which could be used as a basis for defining "ESG" factors. For example, in the Non-Financial Reporting Directive ("as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters") and in IORPS II, Recital 58, which refers to the UN PRI, thus incorporating a broad range of environmental, human rights and governance issues.

The Commission could also draw on definitions used in Member States' law, such as Article 173 of the French law on "energy transition for green growth", with its implementing decree setting out the requirements in greater detail.[xxii] Further inspiration could be taken from the existing body of human rights law, including soft law standards (such as the UN Guiding Principles on Business and Human Rights, the UN Sustainable Development Goals and the UN PRI) and hard law standards (such as the eight core International Labour Organization (ILO) conventions).These are relatively more developed and sophisticated and give a clearer idea of how legislators can capture issues around social and human rights concerns.

It is also important to note that the message should be sent to market participants that each type of factor within the "ESG" umbrella is important and potentially poses risks and opportunities. Anecdotally in our work with institutional investors and their agents, we see a tendancy to focus on one type of factor over another. For example when looking to engage with companies, UK asset managers may tend to focus on "governance" issues like board structures. We also detect a move within policy debates towards looking at risks associated around climate change and environmental factors. Whilst these issues are very important, there are other equally important risks posed by factors which fall under the "social" heading.

This is an important factor that will need to be considered by the Commission if it delegates major policy orientation on sustainable finance to the HLEG. According to the minutes of the first meeting, Vice President Dombrovskis (VP) said that "*the focus should be on environmental aspects due to the ambitious timetable, but that solutions and policy recommendations developed for the environmental side could be applied to encourage sustainable finance more broadly, including its social or governance dimension*[xxiii]."

We would contend that with the implementation of NFR and the adoption of the Shareholder Rights Directive it is imperative to advance, in parallel, work on all aspects of the ESG spectrum.

4. FOSTERING RETAIL INVESTMENT AND INNOVATION

Question:

Are there additional actions that can contribute to fostering retail investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

The EU should continue to progress legislation and regulatory measures that ensure corporate ESG disclosures are comparable, timely and meaningful. This must continue at a number of policy levels.

1. Pensions

ShareAction see this as a critical area for action. This has special significance for CMU as the Commission have identified personal pensions as a new priority area. As this interest reflects the greater shift among the Member States towards encouraging citizens to take out Defined Contribution pensions where members are exposed in full to investment risk:

"As increasingly new members of occupational pension schemes will bear investment risks in the future as a result of the shift from DB to DC pensions, the need for improving information disclosure and transparency with respect to the investment policy becomes even more important to help occupational DC members plan for their retirement, in a context where IORPs will be required to publish the SIPP under the IORPII Directive." EIOPA-BoS-16-170 30 September 2016 Peer Review of the Statement of Investment Policy Principles for IORPs Publication of Outcomes[xxiv]*.*

The recent progress on IORP II provides a possible model for how to incorporate ESG concerns into personal pension products. ShareAction believe that the Commission should seek consistency with IORPs II when considering the law covering personal pensions.

1.1 Institutions for Occupational Retirement Provision (IORP II) Directive

ShareAction were pleased that the legislation states that IORPs must take account of environmental, social and governance (ESG) factors in their investment decisions (we refer in particular to Articles 19, 21, 25 and 30 of the Directive). This constitutes a significant contribution to the Capital Market Union (CMU) priority of supporting the development of a sustainable finance system. However, we feel greater clarity is needed on how ESG relates to the fiduciary duties of investors. We also refer to our response to Q.3 above (see section headed "**The gateway provision - fiduciary duty").**

We believe the Commission is well placed to issue guidance on this matter as a matter of urgency, drawing upon work already carried out within the Commission services. The Directorate-General for the Environment's 2015 report, Resource Efficiency and Fiduciary Duties of Investors (the DG Environment report)[xxv] explored the extent to which financial risks associated with ESG factors are incorporated into investment strategies. The report found that despite most institutional investors claiming to apply sustainable and responsible investment strategies, the final impact on investment decisions is rarely disclosed and the actual investment decisions do not seem to result in widespread long-term sustainable investment behaviour.

The report made a number of recommendations for addressing this issue, and we would like to know how the Commission is planning to take these forward, particularly in the context of the mid-term review of the CMU, which aims to increase the flow of capital to sustainable investments.

The two-year period for Member States to transpose the IORP II Directive is underway. This would form an important element in accelerating the implementation of the sustainability aspects of CMU.

In particular, Article 19 of the IORP II Directive states as follows: *Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors*[xxvi].

This clause does not make it clear that ESG factors can carry financial risks which may impact on investment returns. Secondly, it is not sufficiently clear, given the use of the phrase "shall allow", that IORPS should consider the financial impact of ESG factors on investments. However, articles 21, 25, 29 and 30 do specify that IORPs should consider ESG risks that can impact on their investments. Given the depth and persistence of confusion on this topic, and the detrimental effect this could have on savers' long-term outcomes and on the environment and human rights, we strongly recommend issuing guidance to dispel the misconceptions that remain. The DG Environment report highlights confusion amongst investors on the extent to which their fiduciary duties allow them to consider ESG factors in investment decisions.

A global survey mentioned in the report found 9 out of 10 investors recognise that, when there are ESG concerns associated with companies they invest in, it carries a financial risk. Despite this, ESG issues are not comprehensively factored into investment decision-making. For example, when reviewing their investment rules, only 30% of investors 'frequently consider' ESG concerns, with a further 32% saying they 'occasionally consider' them[xxvii].
These findings are of great concern. They suggest some investors believe their fiduciary duty – to act prudently, and in their members' interests – is actually compromised by taking account of ESG factors. However, there is increasing evidence showing that companies that perform well on ESG issues tend to produce better returns for investors, particularly over the long term[xxviii].

This is particularly true of investors with long-term investment horizons, like many pension funds, as these factors are more likely to be financially material over longer time horizons. In

addition, companies that do badly on ESG measures could face negative financial impacts via damage to reputation and/or legal proceedings. Incorporating ESG concerns makes for a robust, risk-adjusted investment strategy that will also benefit wider society and the environment.

Recommendations - proposed complementary policy measures

i. Fiduciary duty

The DG Environment report makes recommendations for clarifying this point. In particular we welcome its suggestion that:
National financial authorities with support from the European Commission provide official guidance and interpretation of fiduciary duties and the extent to which institutional investors may include ESG issues into their investment strategies and decisions[xxix].

The two-year period for Member States to transpose IORP II is underway. In light of this, it is essential that this guidance is published as soon as possible, so that Member States can transpose IORP II effectively and ensure that pension funds across the EU are clear about their duty to incorporate financially material ESG factors in their investment decisions. The current two-year implementation period offers an immediate window of opportunity for the Commission to introduce guidance that would create uniform and smooth application of the ESG provisions across the EU. It should be made clear that asset managers and asset owners have a duty to consider ESG factors where they are likely to be financially material. It should also clarify that assets owners and managers are permitted, and indeed encouraged, to take other ESG issues linked to beneficiaries' quality of life or ethical views into account if doing so would not pose a risk of significant financial detriment to investments[xxx].This would provide necessary clarity for pension funds in making investment decisions. The Commission could look to the work of the UK Law Commission on fiduciary duty and ESG factors in the context of UK pensions[xxxi].

ii. Statement of Investment Principles (SIPs)

Institutional investors and asset managers should be required to produce Statements of Investment Principles (SIPs), this was set out in the original IORP Directive[3]. These SIPs should include meaningful information on how investors are managing long-term risks, including ESG risks, their approach to engagement with investee companies and voting.

Recent work completed by EIOPA as part of the peer review process has highlighted the importance of SIP as a governance and supervisory document that national supervisors can use to verify and monitor the suitability of IORPs' investment policy and proper risk management[xxxii]. The exercise also set out the potential for further enhancement of supervisory practices to facilitate the qualitative assessment of SIPs. Furthermore, this peer review reiterates the challenges of communicating investment matters especially to DC pension plan members who are fully or partially exposed to investment risks.

The review suggested EIOPA should also consider if the new governance and risk management requirements due to be introduced in the IORPII Directive would benefit from some clarification in the context of the SIP content.

ShareAction believes that this should be done as a matter of urgency to ensure that there is a meaningful (and verifiable) link between needs of the retail investor and the operational framework of boundaries to the investment activity of the manufacturer.

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[3] Article 12 of Directive 2003/41/ECon the "Statement of Investment Policy Principles" (SIPP)

However, it is unclear, given that the IORP directive does not provide any derogatory powers for EIOPA to regulate in this area – which party will take this important measure forward. We would urge the Commission to deal with this issue as it has approached the case of guidelines for the Non-financial Reporting Directive.

2. Other retail investments

2.1 PRIIPS - Packaged retail and insurance-based investment products

In order to accelerate CMU for sustainable finance ShareAction believe further action is needed to be taken at the level of the PRIIPs initiative and should not be delayed by the requirements of the formal review timetables set out in the PRIIPS regulation and related measures across EU investment regulation. ESG products are entering the markets of EU member states now and "wait and see" attitude towards their regulation is no longer appropriate.

We focus on PRIIPS because of the ambition the Commission demonstrated in the space it reserved in the Key Information Document (KID) for responsible investment products[xxxiii].
a. It envisages the summary disclosure of the specific environmental, social or governance (ESG) objectives and the means to achieve them (Art. 8.2.b.iii). The Commission recognised that thorough work from regulators and supervisors to make sure ESG branding is not used as a mere marketing tool was needed.
b. The success of PRIIPs could prove to be very influential across the retail investment universe

Alternative investment funds ("AIFs") marketing to retail investors must comply with the PRIIPs Regulation from 31 December 2016.

UCITS are exempted from preparing a KID under the PRIIPs Regulation until 31 December 2019. The European Commission must review the PRIIPs Regulation by 31 December 2018 including a consideration as to whether the exemption for UCITS should be prolonged past December 2019 or whether the existing requirement to produce a Key Investor Information Document (KIID)[4] under the UCITS Directive should be replaced by or considered equivalent to the KID under the PRIIPs Regulation.

There is also the significant possibility that lessons learnt could be read across to other areas such as European Long Term Investment Funds (ELTIF)[xxxiv] and IORP II.

Recommendations for PRIIPS

On 31st May 2016 the European Commission mandated the Joint Committee of the European Supervisor Authorities (ESAs) to provide Technical Advice specifying the details of the procedures used to establish whether a PRIIP targets specific environmental or social objectives, based on Article 8(4) of the Regulation. According to the mandate, where a KID states that a PRIIP targets environmental or social objectives (EOS PRIIP), the manufacturer must be able to demonstrate to stakeholders, and in particular to the potential retail investor, in supporting documentation to the KID, the relevance of these objectives for the whole value chain of the investment process.
The ESA's analysis states that, it is important that PRIIPs manufacturers are transparent about their products, strategies and constraints. This transparency can also translate into/ be

[4] The Key Investor Information Document ('KIID') was introduced by the 2008 recast of the UCITS Directive ('UCITS IV'). It is "a short document containing […] product information about the essential characteristics of the UCITS concerned". The new PRIIPs 'KID' is based on the UCITS 'KIID'; although the two are very similar they are not wholly identical, as the KIID contains some UCITS-specific information. For this reason there will be a five-year transitional period in which the PRIIPs Regulation will not apply to UCITS, which will continue to use the KIID as before.

enabled by the disclosures provided in the KID and additional detailed disclosures (which are referred to in the Mandate as the investment policy statement (IPS)). For successfully establishing an EOS market and to foster the achievement of socially desired objectives, retail investors must be able to have confidence in manufacturers' compliance with stated objectives, strategies and constraints. Limited comprehension of EOS strategies and objectives could lead to potential cases of mis-selling.

The Joint Committee provides a useful analysis of the lack of any current "*bespoke EOS regulatory framework or specific industry standards."* While hedging that this could help stimulate innovation it also recognised that "non-financial objectives should be safeguarded against potential abusive marketing by PRIIPs manufacturers that could 'greenwash' their products by brushing them 'environmental', 'social' or similarly designated[xxxv]*."*

The ESAs concluded that existing governance and other requirements include the relevant principles for achieving these outcomes, including the necessity of information to be fair clear and not misleading, and the general obligations on product oversight and governance were sufficient.

However, the ESAs noted that the European Commission may consider articulating these principles and obligations in the context of EOS PRIIPs through specific measures, to provide greater certainty for retail investors and for PRIIP manufacturers in the context of EOS PRIIPs.

We share this view and believe that the Commission should reflect on why the conclusions of the ESAs are insufficient and why they felt the need to restrict the mandate given to the ESAs which explicitly excluded any approach that might – directly or indirectly – result in any kind of labelling of products as 'E' environmental or social 'S'.

As the ESAs remark "the ESAs refrained from entering into exploration of more elevated standard type of approaches, as such would inevitably lead to de-facto 'labelling'."

Given that products are entering the market and labelling schemes are appearing at national level if trust is to be maintained in the new market and cross border fragmentation is to be avoided, we believe the time for a "wait and see" attitude to the market is no longer realistic.
The ESA analysis usefully clarifies what is missing from permitting a more "elevated" approach.
"*The mandate to avoid a normative labelling approach… is also followed as a reflection of the fact that there are currently no widely accepted definitions of 'environmental or social investments' available in the EU legal framework for financial markets. Thus, specific data in this area is not readily available. That being said, an area that appears to have at least some of the objectives in common with the investments referred to in Art. 8 (4) of the PRIIPs Regulation is the one of 'socially responsible investment' (RI). It can be concluded from RI data, that sustainable and responsible investment strategies are in aggregate continuing to grow, at a faster rate than the broader European asset management market*." (3.2, p9 JC 2017 05 10 February 2017 Joint Consultation Paper on PRIIPs with environmental or social objectives)

ShareAction believe that this highlights the importance for the Commission to integrate ESG definitions into the EU legal framework to reflect the major growth of the responsible investment market. We note that *Recital 19 of the PRIIPs Regulation anticipates that in its review of this Regulation the Commission could consider further developments relating to EOS investment products.*

2.2 Green Bonds

Green bonds are extremely popular[xxxvi]. While predominantly aimed at the institutional investment market, there are increasing moves towards making this asset class available at the retail level[5]. The majority of green bonds issued so far have been oversubscribed due to huge demand from a wide variety of investors. The first $1bn green bond, issued by the International Finance Corporation in March 2013, sold out within an hour of issue and issuance of green bonds tripled from $11billion in 2013 to $36 billion in 2014[xxxvii].

ShareAction is concerned that in order to satisfy this investor demand, green bonds could be issued that are not for genuinely green projects. Therefore there is a growing need for better transparency requirements and universal definitions of 'green' in relation to green bonds to counteract to danger of greenwashing and potentially damaging the reputation and credibility of green bonds as a whole. The Green Bond Principles[xxxviii], established by a consortium of investment banks in January 2014 and now managed by an independent secretariat at the International Capital Markets Association (ICMA)[6] highlight the importance of tracking proceeds, allocating funds to eligible projects and providing adequate, regular reporting on the use of proceeds. However, these principles do not provide definitions of 'green' projects and this is left to the issuer to determine.

ShareAction advise the Commission to work with the World Bank, the International Finance Corporation and the Climate Bonds Initiative to develop a robust, sector specific standards and definitions of 'green' projects that can be used to determine if an issuance can be marketed as a green bond. As supply of green bonds is not currently sufficient to meet demand, the Commission could also look at ways to encourage issuance of green bonds by companies, municipalities, governments and EU institutions.

ShareAction welcomes the recognition that the need to support EU green bond standards was highlighted in the CMU Action Plan and that is now being taken forward as a key agenda item for the High Level Expert Group on Sustainable Finance (HLEG).

3. Company law and corporate governance modernisation

We noted earlier that the EU has had no overarching strategy towards building a legal framework for Responsible Investment. We recognise that significant contributions have been made from outside the normal financial services regulatory framework. We welcome the indication given by the agenda of the new HLEG that there is now a concerted effort to "join the dots" across the DGs to bring all of the regulatory levers together to underpin a sustainable finance strategy.

Of particular interest to ShareAction has been to try and capture the benefits made through EU efforts to modernise company law and corporate governance (the G in ESG).

We have shared the persistent concern of the Commission about the problems of short-termism and the need to improve shareholder engagement as a means to address the problem on the part of the asset management industry managing institutional funds.

The gradual moves to increasing shareholder regulation serve the public interest purpose and is a form of regulation of investment practices although it is presented as improving corporate governance standards.

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[5] In terms of investment, the issuance of a Green Growth Bond for Italian retail investors (Italy is the largest retail investment market in Europe) was also a milestone according to the 2016 Commission Study on the potential of green bond finance for resource-efficient investments. (http://ec.europa.eu/environment/enveco/pdf/potential-green-bond.pdf)

[6] ICMA has observer status on the HLEG.

3.1 Shareholder Rights Directive[xxxix]

At the date of writing, the European Parliament has just passed the Shareholder Rights Directive[xl]. We welcome the text of the Directive, in particular the requirement for institutional investors to not only publicly disclose their engagement strategy, but also to disclose annually how their engagement policy has been implemented. The engagement policy needs to describe how investors monitor investee companies on financial and non-financial performance, including social and environmental impact and corporate governance. The Directive will complement and reinforce the Non-Financial Reporting Directive, currently being transposed, as shareholders will have access to the information disclosed by companies which is key to their engagement and stewardship. However, we are concerned about reliance on the "comply or explain" mechanism as a method for shareholders to meet their legal obligations. Experience in the UK shows that this mechanism can lack the necessary enforcement "teeth" to change behaviour amongst less committed shareholders.

3.2 Non-Financial Reporting (NFR)

Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups is at transposition stage. We understand that non-binding guidelines relating to this are being prepared by the Commission. We continue to urge the Commission to take account of the recommendations of the industry-led Task Force on climate-related financial disclosures established by the Financial Stability Board (FSB).

Mandating comprehensive ESG consideration and disclosure by corporations, as well as by investment managers and institutional investors, should not be considered a burden, but a valuable process that results in investors, corporations and projects seeking investment obtaining a better understanding of their own risks and processes. Standardisation will also mitigate the unnecessary burden of needing to comply with multiple different sets of indicators and requirements in different jurisdictions. Furthermore, ESG related material should be published in mainstream financial reports, not as separate reports.

3.3 Prospectus Regulation[xli]

In early December 2016, the European Parliament, the EU Council and the EU Commission reached agreement on revisions to the EU Prospectus Regulation. The EU Prospectus Regulation, which will replace the national EU Prospectus Directive, governs the offer of securities in Europe. Once adopted, the new EU Prospectus Regulation will become effective 24 months after its publication in the Official Journal. Garnering momentum from the inclusion of ESG language in IORPS II, the Shareholder Rights' Directive and the Non-Financial Reporting Directive, we believe that an inclusion of ESG risk factors in the agreed text (under Article 16) would have been a strong signal of the EU's commitment to see consistency in promoting a sustainable financial system in the EU. We note that ESG risks are recognized as specific and material in Recital 48a, proposed by the Council.

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[i] https://shareaction.org/wp-content/uploads/2017/03/Survey-LiftingTheLid.pdf
[ii] European Commission, 'Green Paper: Building a Capital Markets Union /* COM/2015/063 final *', 2015, available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0063
[iii] https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review_en Chapter 4 Fostering retail Investment and Innovation.
[iv] http://www.unpri.org/news/pri-fact-sheet/
[v] The Global Sustainable Investment Review 2014. www.gsi-alliance.org/members-resources/ global-sustainableinvestment-review-2014 written by the Global Sustainable Investment Alliance and the Japan Social Investment Forum
[vi] See i.
[vii] Including a meta study of over 100 studies commissioned by Deutsche Bank: Fulton, M., Kahn, B. M. and Sharples, C., 'Sustainable Investing: Establishing Long-Term Value and Performance', 2012.

[viii] UN PRI, 'PRI Fact Sheet', 2013, http://www.unpri.org/news/pri-fact-sheet/
[ix] *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468*
[x] http://ec.europa.eu/justice/newsroom/civil/opinion/151211_en.htm

[xi] http://ec.europa.eu/information_society/newsroom/image/document/2016-44/feedback_final_pc_30068_en_19173.pdf
[xii] http://ec.europa.eu/finance/capital-markets-union/docs/20160914-com-2016-601_en.pdf Capital Markets Union - Accelerating Reform
[xiii] http://ec.europa.eu/finance/capital-markets-union/index_en.htm
[xiv] http://shareaction.org/wp-content/uploads/2016/01/EnlightenedShareholderReport.pdf
http://shareaction.org/wp-content/uploads/2016/01/ProtectingOurBestInterests.pdf
[xv] http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf
[xvi] http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf
[xvii] OCTOBER 2016 A SUSTAINABLE FINANCE PLAN FOR THE EUROPEAN UNION
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[xviii] http://ec.europa.eu/information_society/newsroom/image/document/2016-44/feedback_final_pc_30068_en_19173.pdf October 2016 SUMMARY OF THE RESPONSES TO THE PUBLIC CONSULTATION ON Long-term and sustainable investment
[xix] http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf
Resource Efficiency and
Fiduciary Duties of Investors, Final Report ENV.F.1/ETU/2014/0002 DG Environment
[xx] Galdiolo, S., and de Ste Croix, C., 'Responsible Investment Performance of UK Asset Managers: The 2015 ShareAction Survey', ShareAction, 2014, available at http://shareaction.org/sites/default/files/uploaded_files/AssetManagerBenchmarkSurvey2015.pdf and 'Lifting the Lid: Responsible Investment Performance of European Asset Managers (2016) https://shareaction.org/wp-content/uploads/2017/03/Survey-LiftingTheLid.pdf
[xxi] PRIIPS https://esas-joint-committee.europa.eu/Publications/Consultations/JC_2017_05_CP_EOS_PRIIPs_final.pdf
[xxii] https://www.ipe.com/countries/france/france-aims-high-with-first-ever-investor-climate-reporting-law/10011722.fullarticle
[xxiii] http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=30183&no=2
[xxiv] https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-16-170_SIPP_Peer_Review_Publication_of_Outcomes.pdf
[xxv] DG Environment (2014). Resource Efficiency and Fiduciary Duties of Investors: Final Report. Available at: http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf [accessed 23.02.2017]

[xxvi] Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs). Available at: http://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=CELEX:32016L2341 [accessed 23.02.2017].

[xxvii] DG Environment (2014). Resource Efficiency and Fiduciary Duties of Investors: Final Report, p 49. Available at: http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf [accessed 23.02.2017]

[xxviii] E.g. Arabesque Partners and University of Oxford (2015). From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance. Available at http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11 [accessed 23.02.2017].

[xxix] DG Environment (2014). Resource Efficiency and Fiduciary Duties of Investors: Final Report, p 49. Available at: http://ec.europa.eu/environment/enveco/resource_efficiency/pdf/FiduciaryDuties.pdf [accessed 23.02.2017]

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[xxxi] http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf
[xxxii] https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-16-170_SIPP_Peer_Review_Publication_of_Outcomes.pdf
REGULATION (EU) No 1286/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)
[xxxiii] http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32014R1286 PRIIPs
[xxxiv] Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R0760
[xxxv] PRIIPs https://esas-joint committee.europa.eu/Publications/Consultations/JC_2017_05_CP_EOS_PRIIPs_final.pdf
[xxxvi] http://europa.eu/rapid/press-release_IP-16-4217_en.htm Green bonds: New study shows extraordinary growth and signals potential in financing Europe's climate and environment goals Brussels, 2 December 2016 - http://ec.europa.eu/environment/enveco/pdf/potential-green-bond.pdf
[xxxvii] ShareAction and Climate Bonds Initiative, 'Green Bonds: Exploring Opportunities for Investment', 2015, available at http://shareaction.org/sites/default/files/uploaded_files/IntroductiontoGreenBonds.pdf
[xxxviii] http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/green-bond-principles/

[xl] http://europa.eu/rapid/press-release_MEMO-17-592_en.htm

[xli] http://data.consilium.europa.eu/doc/document/ST-9801-2016-INIT/en/pdf