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Submission in Response to the Questionnaire of the High Level Expert Group on Sustainable Finance

Question 1. From your constituency's point of view, what is the most important issue that needs to be addressed to move towards sustainable finance? (sustainable finance being understood as improving the contribution of finance to long-term sustainable and inclusive growth, as well as strengthening financial stability by considering material environmental, social and governance factors).

ShareAction believes that providing clarification of fiduciary duty at EU level should be a priority. An EU roadmap on fiduciary duty should incorporate the following elements:

(1) expansion of the prudent person rule, to ensure that it incorporates the consideration by institutional investors and other financial professionals of the long-term financial and non-financial interests of end investors, including pension scheme beneficiaries, and its subsequent application to different EU Directives influencing financial regulation – the upcoming review of the AIFMD being an important immediate opportunity;

(2) specification that short-term profit maximization is not consistent with the protection of investor interests, including pension scheme beneficiaries;

(3) development of best practices for beneficiary engagement, consultation and participation in decisions about their assets, as well as access to relevant information by end investors and beneficiaries;

(4) clarification that satisfactory financial conduct includes incorporation of ESG factors and end investor/beneficiary ethical preferences;

(5) creation of accountability mechanisms through which Member States can hold market actors to account, in accordance to the principle of proportionality, in case of failure to undertake appropriate long-term risk management of assets;

(6) resolution of conflicts of interest in the interests of the end-investor/beneficiary.

An immediate opportunity in respect of the above issues is the transposition workshops of the IORP II Directive, for which we encourage the Commission to release guidelines clarifying the fiduciary duties of IORPs.

Question 2. What do you think such an EU taxonomy for sustainable assets and financial products should include?

We do not have a strong opinion as to the types of sustainable assets and financial products that should be included under an EU taxonomy.

Nonetheless, we believe that such a taxonomy should be based on a definition of what ESG factors entail that is standardized at EU level. Whether such a definition be standardized at the level of processes or at the level of content remains to be determined; indeed some combination is likely to deliver the best results.

In terms of content, it should be informed by relevant international treaties in the area of human rights, and in terms of processes, it should reflect the following principles:

(1) E: an investee entity will not contribute to climate change and harm to biodiversity,

(2) S: an investee entity will not breach of human rights and core labour rights,

(3) G: an investee entity will not engage in corruption & fraud, tax avoidance, mis-selling and providing false information, and will report actively and comprehensively on how ESG factors are taken into account.

In case of breach of the above, an investee entity should be obliged to mitigate damage caused and disclose a course of action for avoiding such breaches in the future.

An EU taxonomy for sustainable assets and financial products should ensure that products not respecting the principles above are not classified as sustainable.

Question 3. What considerations should the EU keep in mind when establishing a European standard and label for green bonds and other sustainable assets? How can the EU ensure high-quality standards and labels that avoid misuse/green-washing?

The EU should focus on both a content and process-oriented approach to labelling sustainable assets. It is not the high-quality standards and labels that by themselves will avoid misuse and green-washing, but rather the accountability and tracing mechanisms that will accompany them. An ecosystem of processes to accompany the content, mainly on the four areas focused on by the Green Bond Principles (use of proceeds, process for project evaluation and selection, management of proceeds and reporting – the work of the FSB TCFD being instrumental in the latter) should be created and made mandatory at EU level. In terms of content, we point to the taxonomy created by the Climate Bonds Initiative. Accountability and transparency in the investor-issuer relationship should form the backbone of this process. A clarification of the role of long-term "green" and other factors in fiduciary duty would aid the transition to a transparent green bond market and sustainable assets.

Question 4. What key services do you think an entity like “Sustainable Infrastructure Europe” should provide, more specifically in terms of advisory services and connecting public authorities with private investors?

We do not have a strong opinion on financing for infrastructure. Nonetheless, we underline the importance of ensuring accountability to the citizens whose money underpins the funding of Private Public Partnerships (PPPs). Research has shown that Private Public Partnerships can result in costs borne by ordinary citizens as part of the return expected by the project company. The Commission needs to ensure that proper legal and regulatory safeguards are in place to mitigate this risk, as well as other well-documented problems associated with PPPs, such as misuse of funds, tax evasion and lack of democratic oversight. A lack of proper oversight of these privatized projects can have a counterproductive effect to the goals that sustainable finance is trying to achieve.

Question 5. It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement?

Yes

Question 5.1. If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to resolve or attenuate this conflict?

We believe that the following are significant key measures to mitigate the 'mismatch of time horizons", focused primarily on corporate and fund governance. The suggestion of developing an EU Stewardship Code would be an important opportunity to address these gaps.

(1) Reporting frameworks must be reviewed to ensure that quarterly returns and the short-term elevation of share prices do not put pressure on companies and asset managers to operate on a short-term horizon;

(2) Clarification of legal duties (include those of directors and advisers) to ensure the integration of long-term ESG risks;

(3) More research on the integration of incentives for long-term investors in corporate governance codes, many of which were rejected as part of the revised Shareholder Rights Directive (loyalty shares, tax incentives, dividends and more);

(4) Improving financial literacy of clients/beneficiaries on long-term risk and opportunities, and
determination of best practices for engagement across the investment chain.

Overall, we believe that the mismatch of time horizons can be dealt with through ensuring an expanded understanding of risk across the investment chain - as one including ESG factors. We believe that the clarification of fiduciary duty as outlined in Question 1 is an important first step in ensuring that risk assessments by institutional investors and companies includes ESG factors.

Question 6. What key levers do you think the EU could use to best align the investment and analyst community with long-term sustainability considerations in the real economy?

Please refer to our answers in Questions 1 and 5.1. We believe that standardizing best practices on ascertaining beneficiaries' views and on beneficiary engagement, while encouraging long-term investment, is necessary to ensure that responsible investment serves the real economy, in addition to a review of the comply-or-explain principle so as to ensure this does not contribute to poor reporting and transparency standards. In terms of reporting, investors should be provided with high-quality, harmonized data that reflects real-world effects of corporate activity. We encourage a first step in this direction to be the integration of the TCFD Task Force's guidelines in the upcoming review of the Non-Financial Reporting Directive.

Question 7. How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?

We do not hold a strong opinion on this question. We would, nonetheless, like to emphasize that when projects are funded by private sector funds they nevertheless need to be subjected to the high standards of public scrutiny, transparency and accountability (see Question 4).

Question 8. What are some of the most effective ways to encourage credit rating agencies to take into consideration ESG factors and/or long-term risk factors?

We do not hold strong opinions on the topic. Nonetheless, we believe that while an independent EU credit rating agency focused on ESG would be able to operate with a certain level of independence, it is important to ensure that ESG ratings would not be silo-ed in a separate entity, but rather be incorporated into the mainstream work of existing credit rating agencies. We would like to reiterate the importance of action to clarify fiduciary duty (Question 1) as a way to encourage investors to create the correct pressure for the integration of ESG factors in the work of credit rating agencies. The incorporation of ESG factors in investor decision-making processes, alongside strong disclosure and reporting requirements, would ensure that investors do their part to ensure credit rating agencies respond to long-term investor needs, such as sophisticated quantification of ESG factors (including social and governance indicators).

We consider that our answer to Question 1 would be an important step in ensuring that investors, companies, credit rating agencies and other actors be incentivized to develop a holistic approach to defining ESG.

Question 9. What would be the best way to involve banks more strongly on sustainability, particularly through long-term lending and project finance?

As a general framework, we believe that the separation of retail and investment banks is a significant step in ensuring the goals of a sustainable financial system by ensuring that banks act to serve the real economy and its participants, not the financial sector. We support the work of the Global Alliance for Banking on Values, which has connected serving the real economy with sustainable and inclusive economic growth, which the HLEG has adopted as an important element of its expanded definition of sustainable finance.

We would like to reiterate the centrality of transparency and accountability in this process, as per our answer to Question 7.

Question 10. What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?

In the short-term, we believe that the creation of the Pan European Personal Pension Product is an important tool through which to engage insurers in the transition to sustainable finance. As providers of Pillar III contract-based pensions, insurance companies should be bound by the highest duties of care to their clients, in particular when considering the increased risk to the beneficiary in contract-based defined contribution schemes, as opposed to trust-based schemes. The prudent person rule, which is included in both the PEPP and Solvency II texts, should be expanded as to include principles such as due diligence, care, skill and delegation, duty to monitor, duty to protect policyholders' and beneficiaries' interests as per EIOPA's accompanying guidelines to Solvency II. Impact assessments of the PEPP should include sustainability criteria.

Question 11. What do you think should be the priority when mobilizing private capital for social dimensions of sustainable development?

Please see the answer to Questions 4 and 13.

Question 12. Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?

We would like to emphasize that the involvement of society should be a priority in the transition to sustainable finance. We support an increase in funding in both the H2020 and Life budgets towards projects that would determine best practices not just in the fields of green and sustainable finance as such, but into the structural barriers that a wide range of civil society actors and retail investors face in ensuring their interests are heard in the making of EU financial regulation. This should be a priority for the Commission when considering the scope and reach of the financial lobby. The ten-year anniversary of the crisis should serve as a significant point of reflection here - sustainable finance should be viewed as a vehicle through which the trust of ordinary citizens in the financial system can be restored. The Commission's response to the work of the HLEG will be crucial in ensuring this outcome.

Question 13. In your view, is there any other area that the expert group should cover in their work?

We regret the lack of an explicit mention to the centrality of the respect of human rights as identified in the Universal Declaration of Human Rights and other international human rights instruments as a key component of the resilient societies that will form the basis of a transition to a sustainable financial system. The lack of sophisticated social metrics and integration of social issues (such as labour standards) in investment decision-making, as well a lack of clear understanding of the systemic risk posed by inequality and the violations of both socio-economic and political rights that underpin it, are important barriers in ensuring a closer integration of human rights in the financial system. The Doughnut Economics model is a useful concept for this understanding. We recommend the development of a formalized Human Rights-Based Approach (HRBA) to Sustainable Finance based on the best practices in the UN's HRBA programming (http://hrbaportal.org/), which would necessitate the inclusion of human rights expertise in the work of the HLEG.

Sustainable finance should expand to include a review of core activities of the financial sector, such as derivatives trading, and assess the suitability of reliance on shadow banking as part of the Capital Markets Union as a force in the development of a sustainable financial system.

Finally, the HLEG should consider the sustainability and the influence of EU financial activities beyond the EU's borders. A close examination of the Commission's External Investment Plan would be an important first step.

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