Paving the way for Sustainable Finance in Europe

STRENGTHENING THE EU’S AGENDA

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About Eurosif

Eurosif is the leading pan-European Sustainable and Responsible Investment (SRI) membership organisation whose mission is to promote sustainability through European financial markets.

Eurosif works as a partnership of Europe-based national Sustainable Investment Fora (SIFs) with the direct support of their network which spans over 400 Europe-based organisations drawn from the sustainable investment industry value chain. These organisations include institutional investors, asset managers, financial services, index providers and ESG research and analysis firms totalling over €8 trillion in total assets.

Eurosif is also a founding member of the Global Sustainable Investment Alliance, the alliance of the largest SIFs around the world.

The main activities of Eurosif are public policy, research and creating platforms for nurturing sustainable investing best practices.

Eurosif’s purpose is to:

- Promote best practice in SRI on behalf of its members
- Lobby for European regulation and legislation that supports the development of SRI
- Support its members in developing their SRI business
- Promote the development of, and collaboration between SIFs across Europe
- Provide research and analysis on the development of, and trends within the SRI market across Europe
- Raise awareness of and increase demand for SRI throughout the European capital markets

Eurosif’s Members
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The global financial crises and responses to them led to a transformation of the financial landscape, which changed the behaviour of the banking sector and very much hampered the willingness of banks to take on long-term financing in connection with global de-risking.

The last crisis brought a sense of great urgency around the need for further regulation and additional vigilance in the financial markets. The need for international coordination to back such actions pushed the G20 to establish a framework to define a regulatory path in this sense. What was needed was ensuring the alignment between incentives and risk-taking on the side of market operators. Banks needed to improve their risk management and revise their compensation system. The competent authorities, in this respect, needed to define the regulation that assesses the appropriate level of incentives. This, in turn, had implications linked to the definition of the prudential framework for banks. Such frameworks needed to be reworked to further strengthen the base capital of banks and introduce rules to ensure sufficient liquidity.

The wave of regulations which followed in Europe further empowered central banks by strengthening their supervisory role and introducing a set of mechanisms, stress tests, which had the ambition of preventing future crises and focused on reducing the risk of insolvency for banks. Transparency, or the lack of thereof, was also tackled to a certain extent in the industry, but with a large emphasis on products, leaving much to be done regarding a crucial part of the equation: short-termism.

Short-termism and a lack of transparency were the underlying sources of the financial crisis. The strong misalignment in terms of time horizons and risk management represented fatal triggers of the crisis, which clearly pointed to an ill that went beyond a regulatory fix. Speculation, the byword for short-term investments, has mined the fibre of our financial system, strongly eroding its ability to contribute to long-term oriented goals.

Long-term investments are key to the financial system of tomorrow, provided they help address today’s pressing needs around climate change and social challenges.

Global energy infrastructure needs and the increasingly pressing challenges and risks associated with climate change present the world with an unprecedented investment opportunity related to the transition to a low-carbon climate resilient (LCR) economy. Making sure that the investment capital is reallocated from high-carbon to low-carbon will involve strategies for closing the financing gap which need to consider a policy regime that establishes price incentives, policy coherence and the significant regulatory constraints faced by traditional sources of financing for green infrastructure (involving governments and corporate actors).

Meeting Juncker’s Energy Union’s low-carbon investment requirements represents a colossal challenge which calls upon a regulatory restructuring to ensure that the right synergies - underlining the realization of the Capital Markets Union’s process and the Energy Union concept - fuse together to achieve sustainability and a long-term vision.

The High-Level Group on Sustainable Finance (HLEG), set up by DG FISMA at the European Commission, is looking into whether and how the financial system can enable capital reallocation consistent with the “green” transition and for the long run (by providing financing for companies and industries that protect and improve the environment and shifting financing away from fossil fuel
industries and environmentally harmful activities). It is only through such a reallocation that the infrastructural foundations of the global economy can be rewired to be consistent with keeping the global temperature increase to well below 2°C Celsius, as called for under the Paris Agreement.

On the 13th of July, Eurosif hosted a roundtable to mark the launch of the HLEG’s Interim Report. This Report identified two imperatives for Europe’s financial system:

- The first is to strengthen financial stability and asset pricing, by improving the assessment and management of long-term material risks and intangible factors of value creation, including those related to environmental, social and governance (ESG) issues.

- The second is to improve the contribution of the financial sector to sustainable and inclusive growth, notably by financing long-term needs such as innovation and infrastructure, and accelerating the shift to a low-carbon and resource-efficient economy.

At the event, the HLEG Chair, Christian Thimann, introduced the most salient points of the Interim Report and explained the core concept, which underlines the mandate of the members. The discussion that followed set the frame for the key recommendations and their implications for the stakeholders present. Key representatives were in attendance, including the heads of EFAMA, PensionsEurope and Invest Europe, who were invited to contribute in order to capture their vision and their reflections.

Their input formed the basis of this report, which was expanded to include the views of other industry players and which will be used to feed the work of the HLEG in view of the publication of the final report, as another way to add to the consultation.

Flavia Micilotta, Executive Director, Eurosif
As the last stage of the investment and lending chain before capital enters the markets, asset managers are uniquely placed to help capital flow towards more sustainable investments. Embedding sustainability into stewardship codes and asset management agreements, and requiring asset managers to disclose how they integrate ESG factors into their strategy and vote on ESG issues, are all part of the measures that could be pursued to strengthen the ownership chain.

Interview with Peter De Proft, EFAMA

_Eurosif:_ What do you think are the main challenges already highlighted in this Interim Report?

**Peter De Proft:** Firstly, it is worth highlighting the prominent role for asset managers in the sustainability debate. In listening to clients and providing them with investment solutions to achieve their objectives, the asset management industry contributes to a more sustainable economy by:

- Mainstreaming the integration of ESG in the investment process;
- Reporting to clients, including on ESG-related challenges;
- Engaging with companies in their portfolios to influence their management of ESG challenges.

EFAMA believes that a future EU strategy on sustainable finance agenda should focus on a balance of the three E, S and G pillars.

- The ‘E’: environmental issues, which does not just include climate-related risk.
- The ‘S’: equal importance of social challenges such as labour conditions, human rights, the development of successful governance frameworks.
- Finally, the ‘G’ is a tool to achieve ‘E’ and ‘S’ objectives. Active ownership or engagement has many advantages in driving corporate responsibility on all these issues forward.

We are particularly focused on the following three issues of the HLEG’s report: _fiduciary duty, time horizon and disclosure-standardisation._

- Fiduciary duty: As asset managers, we are required to act in the best interest of
our clients and we believe that it is our duty to integrate ESG in the investment analysis when these considerations have a financial impact on the company. EFAMA believes the concept of fiduciary duty in the EU is clear and is not an impediment to responsible investment. As intermediaries in the investment chain, asset managers’ work and products on ESG-related challenges rely on clients’ goals, values and ESG objectives. Asset owners need to be clear in identifying their ESG wishes and strategies, and setting their expectations as part of mandates or choosing ESG products.

- **Time horizon:** Working to invest in long-term growth is fundamental for asset managers and their clients, most of who are actually saving for retirement and other long-term goals. Asset managers have a fiduciary duty to act in the long-term best interest of their clients, both retail and institutional, irrespective of whether their mandate is short-term or long-term. We are supporters of long-term investments such as pension products and the PEPP project.

- **Disclosure-standardisation:** Further standardisation of disclosure frameworks is essential to ensure asset managers’ access to reliable and accurate reporting on ESG issues by companies. This would facilitate the investment decision-making process but also enable asset managers to quantify the impact of their investments on their portfolios. Continued development and harmonisation of disclosure practice globally is therefore of utmost importance.

  There would therefore be an opportunity for the EU to pave the way for implementation of the recommendations of the Financial Stability Board’s Task Force on Climate-related Financial Disclosures. Such work could be expanded beyond climate change to cover all areas of E, S and G issues. It is also our view that all sectors need sector-specific comparable metrics, not only carbon footprinting.

We are very positive about the work of the HLEG which has ignited a real debate and a lot of momentum in the sustainable finance policy space. Once the HLEG’s final report is published at the end of the year, it will be important for the European Commission to consider which proposals best foster a market-led approach to the sustainability question.

**Eurosif:** What is your main ask from the HLEG report which comes out later this year?

**PDP:** From an asset management operational point of view, further standardisation of disclosure frameworks is essential. This will ensure asset managers’ access to reliable and accurate reporting on ESG issues by companies. This would facilitate the investment decision-making process but also enable asset managers to quantify the impact of their investments on their portfolios. Continued development and harmonisation of disclosure practice globally is therefore of utmost importance.

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**Main Takeaways**

- Further standardisation of disclosure frameworks through continued development and harmonisation of disclosure practice;

- A more balanced disclosure approach, also to the S and G pillars of ESG.
Views on the ground - Degroof Petercam

- Interview with Ophélie Mortier, Responsible Investment Strategist, Degroof Petercam Asset Management

As a European asset manager, we welcome the preliminary report of the High-Level Expert Group on Sustainable Finance published last July. We are pleased that Europe aims to be in the vanguard of sustainable finance and that sustainable finance is a top priority in the action plan of the capital markets association.

Ambitious programme

The report presents an ambitious programme, which is needed, given the challenges we are facing. The European 2030 Sustainable Development programme is ambitious and will require sizeable investments (close to €180 billion annually). Undeniably, the financial sector has a key role to play here.

First and foremost, given the lack of a uniform definition, the group recommends that sustainable assets be categorised. This poses a major challenge for the sector but it would give investors greater visibility, more transparency and greater confidence in the products they are being offered.

Secondly, green bonds are once again being hailed as a key instrument to finance the low-carbon economy, resulting in a more sustainable financial system. The experts’ suggestion of obtaining a European label and standard for green bonds to reduce the risk of controversies and to increase transparency is also a key feature of the proposals.

Finally, ensuring that sustainable development becomes an intrinsic part of the fiduciary tasks of institutional investors, in tune with the example of the French model and Article 173 of the French law on energy transition, is a major recommendation of the HLEG. It would require institutional investors to report on their risk management relating to climate issues and to include environmental, social and governance criteria in their investment policies.

Main barriers have been identified

Next to the ambitious recommendations, we welcome that the report identifies the main barriers to development of sustainable assets we are facing. To us, the main ones are:

- Lack of common definitions and sustainability parameters;
- Lack of effective policy signals steering the financial system;
• Disconnect between the financial system and the real economy in transition;
• Conflict between market short-termism and regulatory pressures and medium-term sustainable challenges;
• Tackling these issues in a tangible and concrete way is the prerequisite to paving the way for a sustainable economy.

The benchmarks dictatorship

The maturity mismatches between regulatory pressures and sustainable investment could be easily solved, as soon as the supervisory authorities are fully aware of these mismatches and take the appropriate and required regulatory measures to facilitate long-term investment approaches. In this regard, we support some critics stating that the report is a collection of good intentions and lacks regulatory recommendations to move ahead faster; particularly as scientists and other experts share the view on the urgency to act. “The most pressing economic, social and environmental challenges”¹ are NOT long-term.

While green bonds are essential to the low-carbon economy transition, their share of the traditional fixed income benchmarks used by institutional investors remains limited. To illustrate this, the majority of the asset owners for whom we are managing portfolios use a European corporate bonds benchmark which holds less than 1.5% in green bonds!

We confirm the report’s statement: benchmarks and market indices are the cornerstones of global capital markets.

Financing the real economy – Credit rating agencies aligned with sustainable development objectives

Some critics mentioned the report’s failure to define what sustainable finance is. To some, this lack of a definition is a major obstacle to adopting effective policies which could get the financial sector back in touch with society and ensure that it is geared towards the long term.

Nevertheless, the report attempts to define sustainable finance as “funding the real economy, society, new technologies, infrastructure and inclusive growth”.² However, as mentioned, these are generally more related to SMEs, small cap indices, private equity and real assets. These asset classes are typically underrepresented in medium-sized institutional investment portfolios as they are considered too illiquid, too risky and without any reference. A change of attitude is required here, but should be encouraged – if not dictated – by appropriate regulation.

Furthermore, these asset classes require specific non-financial information. We are unable to compare the corporate governance best practices of a large multinational with those of a small start-up whose founder and CFO are in its board of directors. Non-listed companies face an even greater challenge as they do not report on a regular basis. Even if we know which indicators or data we are looking for, we may not find the reports we need.

This big challenge – notably for fixed income, which still represents the bulk of institutional investment portfolios – is recognized by the HLEG and the chapter on credit ratings. Indeed, we should not take for granted that institutional asset owners ask their asset managers to fully integrate ESG factors in their

¹ P.19 of the report
² P.15 of the report
investment processes whilst credit ratings continue to approach sustainability challenges differently. None of these are able to provide a real integrated report on issuers. Credit rating agencies should take the lead; how should one define clearly “brown penalizing” versus “green supportive” investments?

**Extra financial rating agencies have also a responsibility to assume**

Credit rating agencies could also work closely with extra financial rating agencies, which play an increasing role in global capital markets but are not always fully aware of this issue or do not take up their responsibility.

For the sake of transparency and greater visibility, we see the emergence of systems to assess the sustainability of existing products, such as Morningstar ratings, MSCI ESG ratings or the World Benchmarking Alliance. They all rely on the research from extra-financial rating agencies and inadvertently force asset managers to increasingly rely on the same providers. The coherence of their research and approach, the credibility of their ratings, the appropriateness and relevancy of their information are therefore crucial as financial institutions increasingly use them to invest in certain issuers, or exclude them instead. These matters impact what economic activity or enterprise will be financed.

**Excessive reporting kills transparency**

We can only encourage more transparency and better disclosure from companies, from asset managers to all players across the value chain. But as the group experts warned: be careful and do not get trapped in a continuous reporting cycle!

Furthermore, we need to keep an eye on the challenge of reporting. Nowadays, although the Article 173 of the French law does not impose any reporting template, there is a clear trend to report on the carbon footprint of the institutional investment portfolios. The HLEG recommends similar requirements for reporting whilst it confirms that, today, only 45% of the 6300 largest firms provide quantitative information on carbon emissions.

An additional issue with more disclosure from green bonds issuers: it would also incur a cost for issuers on a market which could be quite lucrative to credit and labelling agencies.

Transparency and reporting are often confused. The HLEG needs to strike the right balance in order to avoid striking the right balance in order to avoid favouring big companies and major asset managers capable of paying for ratings, reporting, measures, etc. In that way, the objective of sustainable finance will be foregone. This will be the sustainability test for the final report, highly anticipated by the end of the year.
Views on the ground – Aberdeen Standard Investments

- Interview with Cindy Rose, Head of Responsible Investing – Stewardship, Aberdeen Standard Investments

Taxonomy: an acronym soup that needs to be sorted

The market is awash in terms of nomenclature for ESG. There are too many acronyms which mean too many different things and this is helpful to neither the market nor to investors. We desperately need leadership in defining the terminology which allows for the many approaches and many application techniques within the market but which sets out black and white parameters on what is being done. Without some form of homogenous naming system, it will be virtually impossible (or at least much, much more difficult) to move forward. The market is increasingly interested in ESG and SRI and deserves to have a platform which better defines these areas.

At Aberdeen Asset Management, we define ESG as any material risk or opportunity to an asset that helps define its inherent, longer-term quality. SRI, in contrast, is any additional consideration or application of a concern or desire from an investor, such as involvement in tobacco or the need for best practice in supply chains. While there may be overlap in these areas - i.e. a material risk to an asset may also happen to be a concern to a client - we still separate the two for practical reasons. The risks and opportunities that an asset faces change independently of what investors deem to be important in their investment decisions. In some ways, this distinction can be described in the difference between top down (SRI screens) and ESG holistic risk assessment (bottom up.) Nevertheless, that is also an over-simplification of the difference.

A good example of the naming problem is with impact investing. In the Eurosif 2016 SRI Study, it was noted that impact investing is the fastest growing area within the space. But sometimes there is no real delineation between impact investing and positive screening, as they both can essentially use a box ticking / positive screening approach.

Also, the term “Responsible Investing” probably needs to change, especially as ESG risk assessment is integrated more fully into the mainstream. If there is a subset of funds that falls under “Responsible Investing” does that mean that everything else is irresponsible? The ESG part is not responsible – it is necessary.

Separating ESG and SRI & make ESG more core to the investment process

We would clearly welcome more segregation between ESG and SRI. As mentioned, we
see ESG as anything fundamental to the investment process that focuses on an asset’s own risks and opportunities. SRI would be anything that is client-driven, including screening, best in class, thematic, norms based, etc. The reason for this is because the concerns and themes that the market or investors focus on change over time. Currently, we see a huge focus on climate change and low-carbon approaches. But two years from now, it could (will) be something different – perhaps supply chain or cyber security. SRI reflects those changes – it is the concerns that investors have when they make investments. However, the risks and opportunities for any particular asset will always be unique to that asset. Risks are dynamic and should be managed dynamically – but these will always be the issues to be dealt with by the asset itself. Those assets that manage risks well should be better performers over the longer term. This is why many managers see the value in integrating ESG along with financial considerations into their investment decisions. We should be looking at ways to get asset managers to make ESG more central, or core, to the investment process. Many are incorporating actual risks and opportunities of the individual asset, but many others are still simply using negative screening and calling it ESG integration (which goes back to the naming problem).

**ESG ratings and reporting transparency**

There is the problem of the reliability of data provided by third-party research providers. These groups do not own shares themselves but use questionnaires to data mine on a gamut of topics. They do not reliably distinguish between SRI information (for screening purposes) and actual risks to the underlying company (risks that are actually material to the business). Third-party research providers have become quite powerful in their assessment of data – many investors (and asset managers) depend on the information they provide – and they assume it is accurate information. ESG and SRI are not well-formulated yet in certain parts of the world and trying to answer questions in a survey of this type can be challenging for asset managers and owners from those areas. Also, there is the problem that the SRI community has created itself – that of pushing companies to publish “CSR” or “Sustainability” reports which focus more on marketing material (or information on the company’s practices in “hot topics” rather than, necessarily, on a group’s key risks and opportunities). Now there is confusion over what is material. In terms of mandatory ESG disclosure (as developed by legislation), while it is always helpful to understand more about a company’s activities, requiring information on certain topics can end up being a box ticking approach. The danger is that investors see the data and do not understand the importance (or irrelevance) of the required information. A huge obstacle for us is the inability of companies to do meaningful risk assessment themselves. There seems to be a huge learning curve on this with companies, investors and asset managers.

The issue of transparency also greatly affects green bonds. The definition of what is a green bond and the guidelines that determine what a green bond is, need to be further addressed and clarified. We fear that the work done by third parties in terms of verification is not necessarily sound, as in most cases, a third party would not necessarily be in a position to understand the risks and opportunities for the particular bond from a holistic perspective.
The report underlines the extent to which mobilising capital for a sustainable economy requires action on two fronts. Namely, shifting the current capital allocation from an unsustainable pathway to a sustainable one; and filling the investment gap to ensure that objectives are achieved on time.

The need for green investment is substantial and pension funds, amongst other institutional investors, have a big role to play. Yet, their asset allocation remains generally low; this is partly due to a lack of environmental policy support, a lack of investment vehicles and market liquidity, regulatory disincentives and scale issues.

Interview with Matti Leppälä, PensionsEurope

_Eurosif_: What do you think could be done to lower some of these barriers? How do you think the French Article 173 and the integration of IORP can really represent a game changer for the investors and what do you foresee to be the long-term implications for pension funds?

_Matti Leppälä_: I was happy to see that the occupational pension and insurance sector are both tackled in the report. Together with EFAMA, Trade Unions, BUSINESSEUROPE, AEIP and other stakeholders, we have lobbied against the notion that pension funds should be treated as institutions with short-term time horizons, and be submitted to Solvency II kind of regulations. The IORP II directive that was passed in December 2016 really focuses on giving pension funds the ability to invest more freely in private
equity and infrastructure, whereas market-based valuation methods of liabilities would not support this. Policymakers should be all the more cautious in setting solvency and funding regulations so as to provide sufficient flexibility for pension funds. The market rate based valuation rules don’t rightly fit long-term liabilities, which pension funds and insurers have to manage. This is a serious problem and there is a need for a paradigm shift in this respect. Luckily, the pension funds do not have a harmonised framework, as they have different national prudential framework and they are very diverse.

The bigger pension funds, in the Netherlands and the UK for example, are very much in favour of sustainability and they have pushed greatly in this direction. There is a true belief, especially in countries where there is the notion that pension funds are so big that they cannot shy away from these considerations as being integral part of their responsibilities. In countries where pension funds are small, the issues are somewhat different. The French Article 173 and the Dutch regulatory framework are very good and ambitious examples but I do not think they are, at the present time, possible for all pension funds. Pension funds have to be in charge of their own destiny. We have a lot of new regulation for pension funds coming from the European Parliament and there are many provisions for issues around climate change and ESG. Although those are not obligations, they push pension funds to take them into consideration in their risk management, in investment policies, and in the reporting. A number of policies and a number of issues could still be tackled. Firstly, it is important to enable pension funds to make these investments in the future as well and this relates to the previously mentioned risk-based solvency requirements.

As far as being able to capitalise on infrastructure investments, only the big pension funds have the internal expertise and the size to match the size of the project. The Pension Infrastructure Platform (PiP), launched in the UK, where the smaller pension funds are able to invest in infrastructure where ESG issues are taken into consideration, represents the type of projects, which should be further supported by public policy as well. Pension funds have their duties first and foremost to members and beneficiaries and they have already taken ESG into account in their fiduciary duty, but we need to look at their ambitions and understand the reality of the different pension funds in the different jurisdictions and traditions. We need to guide them in this sense but not force them too fiercely and thus enable them.

**Eurofis:** Do you think that the most relevant issues are covered?

**ML:** Yes.

**Eurofis:** What is your main ask from the HLEG report which comes out later this year?

**ML:** That the autonomy of pension funds as institutional investors is respected and that the diversity of the pension fund landscape is understood. And with that, the fact that this is not the time to propose prescriptive obligations or EU-level harmonisation on the level of the member states that are the most advanced.

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**Key Takeaways**

- Ensure respect for a pension funds authority in its capacity as an institutional investor.
- Avoid a prescriptive approach which could hamper pension funds’ ability to invest long-term.
Interview with Pietro Negri, ANIA (Associazione Nazionale per le imprese assicuratrici) and FFS (Forum per la Finanza Sostenibile)

The insurance sector is particularly suited to supporting sustainability and it is the largest institutional investor in Europe, accounting for nearly €10 trillion in assets. The Interim Report has recognized the extent to which some regulations have hampered the ability of the industry to properly capitalise in the long term.

**Eurosif:** What do you see as the most strategic blocking elements at policy level today?

**Pietro Negri:** Like others before me, first of all I would like to express my congratulations to the group for producing in such a short space of time such an impressive and wide-ranging piece of work. The proposals made by the HLEG are very important and, if they were accepted, would allow a generalised transition to a sustainable economy with a medium-long horizon in Europe.

In this regard, I believe that the Interim Report (IR) should first emphasize the strategic importance of ensuring stability and certainty to the European legislation and, consequently, to domestic policies. This aspect is a fundamental prerequisite for fostering medium to long-term investments.

The other fundamental aspect is related to tax interventions promoting green and social oriented goods and services, because a level playing field should be guaranteed at an EU level in order to avoid competitive distortions.

To this end, IR should highlight the importance of including the so-called “negative externalities” as an essential part of the financial investment and, more generally, in the definition of the final price of goods and services.

We still pay insufficient attention to the ‘intangible’ component of the investment: disclosure can favour more conscious choices and consumption, also affecting the industry’s ability to orient itself towards a circular economy. Co2 saved, for example, can become an essential parameter for measuring any investment project (GHG scope 1,2 and 3).

Currently there is a latent, unexpressed demand for SRI products which underpins a general lack of knowledge on the retail side around SRI in general. Much could be done to improve this knowledge gap and distributors should be part of the equation. The challenges in delivering a sustainable financial system represent a moving target for the EU to address. What is needed is systemic change to address these very concrete challenges.

The need to have a greater disclosure can be observed mostly in institutional investors’ investments (i.e. insurers, pension funds, etc.) oriented towards the sovereign debt in which negative externalities are less evident and measurable.

The third general aspect which should be increasingly developed in the IR refers to the “social” variable as integrating part of the sustainable development of the economy. At present, the IR is slightly biased towards topics such as climate change. It is important not to lose sight of the other dimensions of ESG.

In particular, the role and full involvement of employees of 4.0 companies in the production change process is clearly important for the transition to a low-carbon economy, encouraging a circular economy, also thanks to a widespread use of technology (Fintech and Insurtech).
The IR stresses that physical, transitional and liability risks are the most important in the shift to a low-carbon economy. However, social and reputational risks should be added too.

**Eurosif:** What are the elements you would like to see further explored in the final HLEG report?

**PN:** The IR may further stress the importance of integrating the welfare benefit plans and remuneration systems of the boards of directors and the top management of companies with non-financial objectives, possibly oriented to the pursuit of SDGs: it could thus be possible to start a top down integration process of strategic plans with the companies’ sustainability plans in the medium to long-term.

Furthermore, it is not clear what role the European Supervisory Authorities are expected to play in defining the transition process towards a sustainable economy. The stress tests which have been launched, with considerable technical and administrative commitment, should provide for an explicit reference to non-financial elements in risk evaluation, in investment choices and in the framework of internal audit systems of supervised companies.

The wide and complex definition of fiduciary duty proposed by the IR should also refer – as previously proposed for example in the ESAs document on the so-called E. or S. PRIIPs of 28 July 2017 – to the Insurance Distribution Directive in order to guarantee an effective level playing field.

The last aspect which could be thoroughly developed concerns the insurance sector in particular. In fact, various and important sections of the IR are devoted to the role that insurers could play in different aspects: underwriting, asset allocation and disaster risk prevention.

The IR often refers to the technical tools available for the sector so as to encourage a better breakdown of particularly serious risks for which there is not sufficient data available in order to define contract tariffs. In particular, risks connected to climate change (floods, storms, etc..) usually have low occurrence frequency. However, when they occur, they have high loss severity due to their destructive effects and the large involvement of directly or indirectly struck subjects.

The 2010 Insurance Block Exemption Regulation n. 267/2010 (IBER) expired in March this year. Those insurers complying with IBER as for tariff calculation and the setting-up of pools for common risk coverage were not submitted to the discipline under art. 101 and 102 of the Treaty on the Functioning of the European Union in the field of competition and therefore enjoyed a safe harbour in the application of the provision. Currently, without a specific regulation, generic reference is usually made to the guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to the EU Commission horizontal cooperation agreements (2011/C 11/01).

Finally, if we want to encourage and foster a stronger intervention of the insurance sector in disaster risk reduction, also through investments in specific infrastructures, we should acknowledge the importance of data and information sharing which characterises the insurance activity, above all concerning new risks connected to the social and environmental changes under way.
INFRASTRUCTURE INVESTMENT

The report underlines the extent to which sustainable infrastructure is essential for delivery on the SDGs and how they will determine the EU’s collective chances of meeting its contribution to limiting global warming to 1.5/2°C. According to the OECD, 60% of greenhouse gas emissions are hard-wired in infrastructure, so the next 15 years are crucial for realigning capital to support a sustainable economy.

Some of the recommendations linked to fostering infrastructure concretely suggested how the EU could create a dedicated organisation responsible for developing and structuring infrastructure projects and matching them with investors. This new entity would be responsible for match-making infrastructure projects with investors, focusing on sustainability projects in particular, and help countries in their efforts to access capital markets to finance their capital-raising plans.

Interview with Michael Collins, Invest Europe

Eurosif: How do you think such a structure could play a useful role in terms of bringing players together, reducing the knowledge gap and fostering investment opportunities?

Michael Collins: Congratulations to the group for producing in such a short space of time such an impressive and wide-ranging piece of work.

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4 OECD, Investing in Climate, Investing in Growth, 2017
Our membership at Invest Europe spans the whole range of venture capital, private equity and infrastructure funds. We have managers and we have the institutional investors - the pension funds, insurance companies, the family offices and the university endowments that are the providers of long-term capital that is then put to work by fund managers.

When I talk to our infrastructure fund members, rarely do I hear them complain that there is a problem with deal-flow. That may be a problem that other infrastructure investors face, but in our sector, that is not really a problem. The complaints that I hear are more around the lack of stability and certainty in domestic policy as it applies to infrastructure.

We had a very stark example of this five years or so ago, following significant investments by our members into the renewable energy sector in one Member State. That Member State declared unilaterally and retroactively that it would change its pricing policy on renewables and the economic case for hundreds, if not billions, of euros of investment into renewables was undermined.

What a case like this drives home is the importance, if you want long-term investors, of certainty and stability in the regulatory and tax environments you’re operating in, and because many of these infrastructure projects and initiatives are state-backed, certainty in pricing.

So, yes, the capital is there and investors are desperate to put it to work, but that misguided, and dare I say short-termist, reaction from the government has effectively closed that Member State off to investment from our members.

And this issue is not new. I was involved with work the OECD did a few years ago when they produced some principles on long-term investment and they very clearly identified the need for long-term certainty and stability in the public policy environment. We’ve still not learnt that lesson but I hope that as the HLEG moves towards its final report, that lesson can be driven home.

The business models put together by an infrastructure fund manager considering making an investment will have a 10, 15, 20, 30-year horizon. There’s already a lot of risk when you’re investing for that length of time but that’s risk that these managers are skilled in calculating, skilled in determining. But there has to be at least some certainty and some assumptions.

The other thing that we’ve touched on already but I think it’s essential to reiterate is the need for us to get the rest of the regulatory and public policy regime right. I would support the tweaks and changes to specific bits of regulation to improve the focus and the emphasis that is placed on sustainability. But there are some pretty fundamental changes that are required to certain bits of public policy.

Solvency 2 is a classic example I think, as is banking regulation as well. We’re in a perverse world where institutional investors have a massive incentive to invest in government debt because of the way in which it is treated by public policy. That is distorting investment decisions, no doubt about it. We know why governments do it. We know what the incentives are for doing it, but it is going to distort the flows of capital and prevent flows going to the sort of projects that we would like to see.

My final point, broadening it out beyond just the very specifics of financial market regulation is about pricing. If there is one thing that our industry is good at, it is building a business case and making an investment decision. They would be able to do this for climate-proof policies, if the pricing is right. If we can truly make progress in building into the market price of assets their real environmental, social and governance (ESG)
implications, then our members - collectively - have all the expertise required to make sure that investment flows in the right direction. It will flow in the right direction, if we get the pricing right.

I used to work on environment policy issues in a previous life when I worked for the UK Treasury. We were talking about emissions trading, carbon taxation 15 years ago and I look around at the progress that has been made since then and it’s pretty woeful. There are lots of things we can do, lots of specific initiatives that the HLEG have identified, but we do need to tackle some of these fundamental questions. If we do that, get the pricing right in the market, I am confident that my members are more than capable of making sure that these investments flow into the right parts of the economy, rather than the wrong parts.

_Eurosif_: In 2015, Invest Europe published a handbook for the industry in support of the commitment of the different players to deliver 'strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them'. How do you assess the use of the guidelines after two years and in view of the work of the HLEG?

_MC_: One of the functions we have at Invest Europe is to provide guidance and professional standards that our members are expected to abide by. We have a professional standards handbook and when we reviewed it in 2015, we introduced a whole section on responsible investment. The feedback from our members, from managers and investors, is that it’s useful to have some guidance.

If you look at our industry, it’s very, very diverse. Invest Europe represents some of the largest asset managers in the world, with hundreds of billions of assets under management and also some pretty small venture capital firms, with €50-60 million of assets under management. Particularly at the small end, breaking into this whole debate around responsible investment and ESG can be difficult; so the provision of guidance has been really valuable.

Frankly, I would say we’re still in Chapter 1 of this story with some of our industry. They are beginning to appreciate the importance of ESG and responsible investment, but then there are others in the industry - particularly from the institutional investor community (the pension funds most notably), but also some of the big asset managers - who have now really mainstreamed not only our guidance but ESG and responsible investment more broadly into how they operate.

We are constantly reviewing and revising the approach that we take to ESG risks. The most recent development for us was the production of a due diligence questionnaire - a tool that is available for our community when they’re thinking of making an investment into a company, helping them to ask the right questions.

When you think about really concrete ways to help the industry, that kind of practical advice will be really valuable because we definitely sense that there’s a need out there for more and more practical assistance.

_Eurosif_: Do you think that the most relevant issues are covered?

_MC_: The Interim Report is a really important piece of work. It has – understandably – had a focus on the environmental aspects of sustainability. As the HLEG continues its work, and as the EU continues to look at these issues beyond the final report, it will be important that we do not lose sight of the other dimensions of ESG. Sometimes there will be trade-offs between different objectives or goals that have to be made and if we have a broad concept of sustainability and sustainable finance, we can manage those more easily.
In the areas that it does cover, the Interim Report has done an impressive job of identifying both an overall vision for sustainable finance and some very specific policy initiatives.

**Eurosif:** What is your main ask from the HLEG report which comes out later this year?

**MC:** That it marks the beginning of the debate and not the end. I sense that there is now a genuine commitment on the part of the financial sector – and certainly in private equity – to integrate ESG into the way that it works. The interest in Invest Europe’s work on this agenda (for example, the number of times our due diligence questionnaire has been downloaded!) is large and growing. But the challenges in delivering sustainable finance will not be static and the EU’s work needs to reflect this reality. There are, of course, some very concrete changes to financial market policies that can be made to promote more sustainable finance, but we need a ‘whole economy’ approach. If market prices don’t reflect environmental and social externalities because, collectively, we have failed to put in place the tax, regulations, or other policies that internalise such costs, we cannot expect a few tweaks to Solvency II or AIFMD to tackle the problem.

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**Key Takeaways**

- Ensure alignment among the regulatory and the tax environment to guarantee stability in building a market price of assets and their real environment;

- Getting the regulatory and public policy regime right to ensure a stable environment for infrastructure investment;

- Ensure that whatever changes are made to the regulatory regime take due account of the different needs of different financial sector players; whether it be differences in the size of the firm or in the nature of their business, we need to recognise that ‘sustainable finance’ will need to be pursued in a range of ways.
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