18 September 2017

ecoDa's reaction to the 2017 HLEG Interim report on Sustainable Finance

Transparency Register Number : 37854527418-86

Question 1. From your constituency 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)
1500 characters maximum (spaces included)

The European Confederation of Directors' Associations (ecoDa) is a not-for-profit association representing the views of company directors from EU member states to corporate governance policy makers at EU level. ecoDa's member organisations (20) represent 55.000 board directors from the largest public companies to the smallest private firms, both listed and unlisted. ecoDa welcomes the opportunity to comment on this report and to bring a Corporate Governance perspective. First, ecoDa would like to congratulate the High-level expert group on Sustainable finance for its interim report, his in-depth reflection and the very valuable recommendations already put forth. However, we also want to express some fears after carefully analysing the report:

1. ecoDa has doubts as to the reliability and usefulness of integrating the approach for analysing governance with the development of environmental and social criteria into the ESG concept. While there is a scientific approach for environmental targets and an overall EU background on social criteria, the EC should not try to standardize the investors' views on corporate governance. The fact that the EU clearly abandoned the historic route of harmonising governance recommendations into a pan-EU code proves that this domain is far too heterogeneous across countries. Moreover, the choice for the comply or explain approach to regulate governance practices is in itself a proof that a one size fits all approach is infeasible even within Member States. Any new EU guidelines for investors on how to assess corporate governance would end up with a box-ticking exercise which would be detrimental to the general perception that corporate governance should be tailored-made in order to fit with each company's strategy. ecoDa would encourage the High-level expert group to refer its sustainability approach to environmental and social aspects.
2. We note that the group does not sufficiently take into consideration the multitude of bodies that already exist. The European Commission should make optimal use of what exists, and should not create additional layers.

3. Any legislation should be carefully examined for its impact on sustainability, its respect of social and environmental objectives, and possible unintended consequences in terms of short-termism. For that, we support the proposed «Sustainability tests». In addition, whatever new initiative will be taken that might incur costs for society should be subject to a cost-benefit analysis, integrating its sustainability impact.

In terms of priorities, the most important issues that need to be addressed to move towards sustainable finance are:

1. Change in time perspective. The fifth barrier you identify in your intermediary report is the key to financing a sustainable economy. There is a political responsibility to promote a long-term perspective and overcome the "tragedy of the short-term horizon", which needs to be addressed if any of the other measures suggested are to succeed. The EU must acknowledge that stock exchanges and their business model are at the heart of this time horizon challenge. Their business model is based on trading, with the pursuit of liquidity as a key driver.
2. Identifying categories of shareholders, based on their investment horizons, is key to stimulate a long-term horizon as a result of our point 1. These different categories of shareholders do not all need the same focus when stimulating sustainability. If sustainability is the goal, than companies and their board need to be protected from shareholders whose short-term objectives hamper the respect of long-term perspectives. Complementary to that, one could develop incentives to encourage long term and stable investors and promote them to invest in sustainability (eg. the benefit corporation, as introduced in Italy 1.5 years ago).
3. Introduce 'Sustainability tests' of all future EU financial regulations and policies, and align the different reporting approaches that exist.
4. Clarify that fiduciary duty encompasses sustainability.

Develop a classification system for sustainable assets and financial products

Question 2. What do you think such an EU taxonomy for sustainable assets and financial products should include?
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If the EU adopts a taxonomy for sustainable assets and financial products, it should:

- Not lose sight of the goal, which is sustainable finance.
- Keep things simple. It should make sure the taxonomy is not too detailed and that it does not hurt competition (eg. avoid the detailed, exclusionary logic of Islamic finance). The EU should not black-list some specific products without a worldwide approach. Companies do not operate indeed on an isle protected from competition.
- Look at what exists today in terms of existing standards and taxonomies, and build on it. For example, it could suggest (but not require) identifying a financial product's contribution to each of the UN's 2020 SDGs1. Companies already try to do this, though it is quite difficult for them for the moment. The problem with a new taxonomy is that

[1] http://www.un.org/sustainabledevelopment/sustainable-development-goals/

it needs to be dynamic, which would require a new body to update this taxonomy. As noted above, we are weary of the multiplication of bodies.

- Focus on impact. The preoccupation of sustainable finance is no longer only on disclosure and process, but increasingly on impact in terms of sustainability. It is not sufficient to label and report processes. The taxonomy should also focus on products and how they have a sustainable impact.
- The taxonomy should not only address sustainability impact, but also risk and return of the financial asset, moving away from the unidimensional market return and volatility measure of risk, and towards multi-dimensional measures of risk.

Establish a European standard and label for green bonds and other sustainable assets

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?

1500 characters maximum (spaces included)

No opinion. However, it requires a verification body with power to incentivize and penalize. This aggravates the proliferation of bodies. We recommend capitalizing on what is in existence already. Rather than create a new body, recognize existing labels, for example with an "approved by EU" stamp for the existing label.

Create "Sustainable Infrastructure Europe" to channel finance into sustainable projects

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?

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- The EU should focus on sustainability impact, not on complexifying things. We are not convinced that it is the role of public authorities to provide "match-making" services, and suggest this may rather be a private initiate, rather than an issue for the EU to tackle.
- Should the infrastructure be set up, it must facilitate coordination and collaboration among the many initiatives for sustainable finance that are all attempting to promote a common objective (UNEP.financial initiative, Equator principles, Sustainable. Exchanges Initiative of UNCTAD, etc co-exist with investor-driven initiatives such as SASB, Delphi project, etc). Listed companies are confronted to the expectations of all these initiatives, and would benefit greatly from coordination and a certain level of standardization.

The report also touches upon areas for further analysis. The following questions focus on a selection of these, which the group would appreciate your feedback on:

Mismatched time horizons and short-termism versus long-term orientation

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 / No / Don't know

The temporal mismatch not only affects investment decisions, but all strategic decisions. In financial markets moving at the speed of daily quotes and increasingly computerized transactions, there is no time to ponder on the implications of decisions – only time to make and implement them, possibly aggravating the frequency of ethical breeches by corporate executives. The high speed of finance conflicts with the temporality of environmental issues, of democracy, of multi-stakeholder initiatives. These domains share characteristics with sustainable finance, such as a long-term perspectives, attention to stakeholders and to non-financial factors. ESG investing is therefore an activity particularly prone to temporal tensions.

We see a strong correlation between temporal tensions and shareholder structure of a company. We must hence look at shareholders' horizon above all. For example, pharmaceuticals or telecom need stable shareholders to go with them through the tides of R&D. As a result, they have different profiles of long-term shareholders. We argue that many listed companies may need long-term shareholders to cope with their long-term strategy. The stock exchange's business model is short-term oriented, whether we like it or not. Liquidity is a key value, and the authorities must understand that if you pursue liquidity, you provoke short-termism. This puzzle requires further attention.

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?
1500 characters maximum (spaces included)

- The mismatch is most flagrant in Pharmaceuticals, Transport (aircraft, trains,…), Energy, Health, Insurance, and Infrastructure. These happen to be the biggest sectors, with long cycles. They are also worldwide sectors.
- Metrics play an essential role in this as they shape what is being taken into account and what is considered to matter (what is "material" or not).

Measures must address the development of tools to measure and assess environmental, social and governance (ESG) performance, which must go beyond the uniform temporal yardstick imported from financial markets:

- **Remuneration**. Rewarding executives for short-term results can incentivise them to take excessive risks. Further, excessive short-termism may affect the corporate governance practices of listed companies. Remuneration policies should include non-financial criteria when evaluating the performance of executives. A meaningful proportion of executive remuneration should be based on long-term performance measures, avoiding excessive weighting of short-term remuneration.
- **Shareholder rights**. As the turnover of shareholdings increases, it becomes more difficult for companies to know and understand their shareholders. It may also undermine the traditional role of shareholders in monitoring companies because short-

term shareholders are generally less concerned about stewardship, and less likely to engage with boards and management. Methods can be developed to incentivize long-term shareholders (loyalty dividends, loyalty voting rights, etc. to stimulate long-term shareholders).

- **Shareholder engagement**. Enhance stewardship and engagement (look at the FRC's initiative in this area).
- **Reporting**. Discourage reporting practices that disclose short-term performance in the context of medium and long-term goals and strategies. Supplement or replace short-term earnings guidance (such as quarterly earnings guidance) with more meaningful disclosures (for example, narratives that combine long-term strategy narratives, health metrics and integrated reporting).

Governance of the investment and analyst community

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?
1500 characters maximum (spaces included)

- Governance is much more than shareholder focus, particularly if we want to cope with all the new challenges. We appreciate that the report recognizes this.
- The adoption of material metrics, which favour long-term focus and highlight sustainability impact is a necessary tool to align the investment and analyst community with long-term sustainability considerations. These metrics would be used for reporting, but also for rewarding. They must be characterized by:
  - **Simplicity:** using simple metrics enables communication with a broader audience.
  - **Comparability**: investors are interested in measuring outcomes at a portfolio level, making it important to use metrics that are comparable across sectors.
  - **Relevance**: the desire for comparison should not outweigh the specific aspects of each sector and the need to use metrics that are relevant for a particular industry or region.
  - **Aggregation**: We are weary of too much rigidity in the reporting, and insist that they should not require too much detail. Companies tend to report performance metrics at the project level. But for impacts to reach scale, metrics should be consolidated at company and portfolio levels.

A strong pipeline of sustainable projects for investment

Question 7. How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?
1500 characters maximum (spaces included)

No opinion.

There already are institution active in this area, such as the European Investment Bank and its regional fund (which, incidentally, is working on the sectors we identified as key). We urge you not too create too many new bodies or reinvent the wheel.

Integrating sustainability and long-term perspectives into credit ratings

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?

Please choose 1 option from the list below

- Create a European credit rating agency designed to track long-term sustainability risks
- Require all credit rating agencies to disclose whether and how they consider TCFD-related information in their credit ratings
- Require all credit rating agencies to include ESG factors as part of their rating
- All of the above
- Other

Above all, we believe the EU should not create a new body. We also note the following points:

- Mainstreaming sustainability means including it at all levels, not as an add-on.
- Asset managers are more likely to consider information from a same source, rather than multiple sources and report.
- But this requires additional supervision of credit rating agencies and rethinking the business model underlying rating agencies (including the alleged conflicts of interests flowing from their income model), to determine how to make it more valid for sustainable financial markets.

Role of banks

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

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The capital requirement directive is key for banks and insurers. These actors need additional risk capital to invest in long term projects, aimed at stimulating sustainability. The solution might be that governments deliver a guarantee to 'neutralise' the additional risk of sustainable projects. Or another suggestion may be to differentiate the capital requirements for stimulating investment with sustainability at its core.

Role of insurers

Question 10. What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?
1500 characters maximum (spaces included)

See comment to question 9.

Social dimensions

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

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- As long as companies contribute to society, investors remain ready to invest (that is typically the case with the pharmaceutical sector where investors still believe in the societal and long-term purpose notwithstanding negative cash flows over the shorter term).
- Once again, this shows the importance of having relevant, multi-dimensional metrics that encourage a long-term focus and asses the sustainability performance of investments in terms of societal impact.

Other

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?
1500 characters maximum (spaces included)

We wish to insist on the categorisation of shareholders. The “all shareholders” focus should be rethought, considering the many different types of shareholders, with different investment horizons.

- We can’t ignore that the EU authorities show a decreasing trust in boards; they tend to give more power to shareholders even if these meet only once a year and even if their agenda is already full (ex: shareholder rights directive). But boards are well equipped and motivated to focus on the long-term, which cannot be said of all shareholders. So why focus on shareholders when you want to promote sustainability? There is much more alignment between long-term investors and boards than between short-term shareholders and boards. A categorization of shareholders could acknowledge this and nuance recommendations.
- Beside boards and shareholders, one should not neglect the third pillar: the top management. We see more and more developments on what managers’ responsibility should be concerning stakeholders’ interest, for example by including non-financial targets in their remuneration. We see this as a positive development, to be encouraged.
- Regulators also tend to neglect the different existing shareholder models in Europe (controlling shareholders model where independent directors have a key role to play versus dispersed share-ownership where long-term sustainability is not really the priority).

Question 13. In your view, is there any other area that the expert group should cover in their work?
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About the European Confederation of Directors Associations (ecoDa)

The European Confederation of Directors Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Through its national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa's member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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