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High-Expert Group on Sustainable Finance Final Report

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High-Level Expert Group on Sustainable Finance

- Established December 2016, final report published on 31 January 2018.
- Independent group, but with support of Commission staff.
- The pensions sector is represented by Claudia Kruse (APG) and Magnus Billing (Alecta).
- European Commission poised to publish follow-up Action Plan this March.

Some observations about the report

* Context provided by Paris Accord, therefore a focus on environmental and climate issues.
* The overarching challenges identified is to address short-termism in the financial system.
* There is strong political support and commitments by the European Commission and the European Parliament for the recommendations.
* Comprehensive approach going beyond ESG issues alone, looking at all sectors and processes in the financial system.
* Policy may affect pension funds directly (e.g. revision IORP II Directive) or indirectly (e.g. relationship with asset managers, choice of investable instruments, information availability)

Observations about pension funds

* Pension funds are seen as the ‘purest’ long-term investors that are most exposed to long-term risks.
* However, incorporating these sustainability risks is far from practice (only 5% of funds would consider climate risk).
* There is a disconnect between preferences of members and investment decisions.
* Pension funds sector is invited to explore initiatives to improve ESG integration beyond regulatory requirements.

Key recommendations

1. **Sustainable finance taxonomy** to ensure market consistency and clarity, starting with climate change
2. Clarify fiduciary duty or '**investor duties**'
3. Upgrade Europe's **disclosure rules** for financials and non-financials to make climate change risks more transparent.
4. Improving **access to information on sustainability performance for retail clients** and promoting financial literacy.
5. Develop official European sustainable finance standards, starting with one on **green bonds**.
6. Establish a 'Sustainable Infrastructure Europe' facility, for technical assistance and match-making
7. Reform **governance and leadership** through amended 'fit and proper' tests for financial institutions (though not pension funds), extending stewardship principles, and strengthen director duties.
8. Enlarge the role and capabilities of the **ESAs** to promote sustainable finance as part of their mandates and extend the horizon of risk monitoring.

Investor Duty

* Perception that fiduciary duty is still a hurdle for ESG incorporation
* Proposal: clarify 'investor duties' in through an Omnibus Directive targeting IORP, PEPP, MiFID, Solvency, UCITS, AIFMD.
* Principles:
  * Asset owners and investment intermediaries should examine ESG risks and act upon these risks consistent with best interest and investment timeframe of members/clients.
  * Pension funds should understand broad range of interests and preferences of members and beneficiaries.
  * Pension funds should disclose how ESG factors are incorporated.
  * Whether financially material or not, the preferences of members and beneficiaries shall be pro-actively sought and incorporated into investors' investment decision-making (and translated to asset management mandates)

Role of the ESAs

* ESA Review already gives a narrow mandate (monitoring incorporation of ESG risks and providing advice on legislation)
* Proposals:
  * **Supervise how regulated entities consult their beneficiaries and reflect nonfinancial preferences into investment strategies.**
  * Extend the horizon of risk monitoring of the financial sector, as it is currently too short to capture ESG risks. Therefore the ESAs need to build expertise on climate scenario analysis and other non-cyclical, non-linear risks that may get mispriced by financial markets. Explicit reference to IORP stress tests in interim report were removed.
  * Support research on nonfinancial preferences of beneficiaries.
  * The ESAs should explicitly require sustainability-related skills in stakeholder groups.