29.10.2018

NORDIC SECURITIES ASSOCIATION

Nordic Securities Association's (NSA)[1] views regarding the proposal for a Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

Disclosures relating to sustainable investments and sustainability risks should be harmonised, not overregulated

- Disclosures on sustainability are developing fast in the market. The NSA supports the idea to harmonise these practices, but this should be done without hampering companies' own improvements and the market's evolution.
- Financial companies have a range of ways to integrate sustainability considerations into their investment strategies. However, measuring performance and impact is more difficult. Especially for small financial market participants, the requirement for quantitative metrics is impossible to deliver within the 12-month transitional period. Before demanding the usage of harmonised indicators, these indicators must first be created.
- This regulation is meant to regulate disclosure in investment practices. Topics such as remuneration, due diligence and lending deserve their own discussion, impact assessment and process for incorporating new proposals into already existing regulations and market practices.

1 Getting the concept right: 'sustainability risks'

One of this regulation's most fundamental concepts is 'sustainability risks'. The industry has applied this term to indicate a risk that stems from ESG externalities and threatens a company's or product's financial performance or long-term success.

This understanding is in line with the definition the European Commission uses in its request to EIOPA and ESMA for technical advice on potential amendments to UCITS, AIFMD, IDD, Solvency II and MiFID II[2] regulations, which states that sustainability risks are:

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[1] The Nordic Securities Association (NSA) is a Nordic cooperation that works to promote a sound securities market primarily in the Nordic region. The NSA consists of the Danish Securities Dealers Association, Finance Finland, the Norwegian Securities Dealers Association and the Swedish Securities Dealers Association. NSA's public ID number in the Transparency Register is: 622921012417-15

[2] FISMA C4 SG/acg(2018)4365900

> *"[…] environmental, social and governance risks in the investment decision or advisory processes as part of duties towards policy-holders, customers and/or beneficiaries." (page 3)*

Although understanding sustainability risks only in terms of potential financial losses may seem very technical, in practice this leads companies to consider all negative material consequences that their operations might have on the wider society. Financial market participants report on issues that are relevant to their business operations. Requiring them to disclose all possible effects that might occur in their surroundings is disproportionate and would impose impossible liabilities on them.

We highlight the importance of differentiating between the concepts of 'sustainability risks' and 'sustainability impacts', which seem to get confused with each other in some amendments.

→ We strongly support amendment 114, which aligns with the Commission's definition

2 Finance sector can only disclose information that is available to it

2.1 The European Commission's intention in the proposal is for financial market participants to provide information, in a harmonised way, to their potential clients on how they integrate sustainability risks into their investment decisions and/or investment advice. This is something that many, but not all, companies already do. It is important to get all financial companies to consider sustainability risks as part of their day-to-day business.

→ We support the Commission's original phrasing of Article 4(1) and 4(2), and amendments 122, 124, 135, 135 and 147 which convey the same idea.

2.2 Some amendments propose that the financial sector should report on the *sustainability performance* of companies and products, financial as well as *non-financial performance*, and that this should be done *whether or not they have sustainability targets*.

→ At the moment, companies do not have the resources or means to provide this level of information about all their financial products, especially about the ones that do not have sustainability targets. We oppose and advise to vote against amendments 86, 120, 121, 131, 132, 150, 169, 183, 187 and 204.

2.3 The NSA supports the idea of developing *a harmonised set of indicators to measure 'sustainable investment performance'.* We are also positive towards investigating the possibility of reviewing the *Directive 2013/34/EU* on companies' accounting and reporting requirements, as long as it is done in a synchronised way with requirements in Directive on Non-Financial Reporting. Financial market participants need sustainability data from their investee companies before they can provide it to their clients.

→ We support amendments 49, 58, 68, 75, 77 and 83, which bring forth these ideas in recitals.

However, as the work for creating harmonised indicators has not officially even begun, it is not realistic to expect financial companies to be able to provide the data within 12 months, which is the proposed implementation period for this regulation. The right way to proceed is to first create these indicators, and only then apply them to the financial sector's disclosures.

→ Amendments 118, 189, 193, 194, 196, 197, 201, 209, 210, 212, 214, 215 and 219 require too much of companies. Companies will not be able to adhere to these obligations within the intended timeline. We oppose and advise to vote against these amendments.

3 Existing remuneration principles are already aligned with sustainability considerations

Companies' remuneration policies are regulated by e.g. the Shareholders' Rights Directive (2017/828), which states that:

> ”*Directors contribute to the long-term success of the company. The form and structure of directors' remuneration are matters primarily falling within the competence of the company, its relevant boards, shareholders and, where applicable, employee representatives. It is therefore important to respect the diversity of corporate governance systems within the Union, which reflect different Member States' views about the roles of companies and of bodies responsible for the determination of the remuneration policy and of the remuneration of individual directors." (Recital 28)*
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> And:
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> *"The remuneration policy should contribute to the business strategy, long-term interests and sustainability of the company and should not be linked entirely or mainly to short-term objectives. Directors' performance should be assessed using both financial and non-financial performance criteria, including, where appropriate, environmental, social and governance factors." (Recital 29)*

The Shareholders' Rights Directive seeks to promote governance practices that serve the company's business strategy, long-term interests and sustainability. This is well in line with ESG considerations, and we should therefore not view the existing practices as contradictory to the objectives of the sustainable finance agenda.

Incorporating differently worded remuneration provisions into different regulations only confuses companies and creates unnecessary judicial uncertainty. Companies also lack the metrics with which to measure sustainability targets that could serve as remuneration criteria.

For the criteria to correspond to the intention of the legislators, and not being misused, the criteria should be based on some objective and shared understanding of sustainability, which is still a work in progress. We do not think that this sustainability risk disclosure regulation is the right instrument for defining remuneration policies.

→ *We strongly object amendments 64, 66, 159, 174, 180 and 181, which would present new provisions on remuneration policies without any prior impact assessment or explanation of how they align with Directive 2017/828.*

→ *We support amendments 157, 158, 173 and 175, which state that remuneration policies are either excluded from this Regulation or that companies shall report on how their remuneration policies are consistent with Directive 2017/828.*

4 Maintain the focus on investment practices

4.1 Some amendments would require companies to have a mandatory *due diligence framework*, but they do not define it or explain what it would mean for companies' operations in practice. The term usually refers to an extensive investigation of a business in merging and acquisition situations. The process is very expensive and time-consuming, and it is usually conducted by a third party. It is unrealistic to expect that financial market participants could conduct this kind of process every time they consider investing in a company.

It is dangerous and confusing to use the same concept to mean different things, or to impose new obligations on companies without any impact assessment. Also, what would be the contractual obligation of the investment target to disclose more information for financial companies than what is made available for all shareholders?

> → *We strongly object amendments 80, 119, 136, 138, 145, 146, 166 and 167.*

4.2 Banks have a crucial role in the financial sector's impact on sustainability, and we think that the possible contribution or hindrance of all financial activities to achieving climate and energy targets should be evaluated. Credit institutions' lending decisions have a major impact on which projects and activities will be realised and which will not. We consider banks to be natural stakeholders in the sustainable finance agenda.

Lending differs significantly from investing. Companies which seek investors in regulated markets are usually of size and their capabilities to report on their activities is relatively good. On the other hand, lending is practiced in relation to all kinds of stakeholders, from private households to large corporations, whose readiness to provide information for credit institutions differs significantly.

Since they are two completely different activities, a one-size-fits-all approach does not apply to them. We support the idea that banks should disclose sustainability risks also in their lending activities in the future, but this merits discussion about the methods and means of doing it. This is also the Commission's approach: the EC's action plan separates sustainability considerations in lending as their own acts. They are currently also discussed as part of the CRR/CRD package.

> → *We oppose and advise to vote against amendments 51, 53, 53, 79, 87 and 89 which would extend the scope of this regulation to credit institutions.*

> → *We support the amendment 55 which explicitly states that banks fall within the scope of this Regulation when offering financial products or related advisory services.*

On behalf of the Nordic Securities Association,

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