ICMA AMIC response to

IOSCO's Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management- Consultation paper

Response deadline: 15 August

The International Capital Market Association (ICMA) welcomes the opportunity to comment on *IOSCO's Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management* report. Our Asset Management and Investors Council (AMIC), the buy side voice of ICMA, was the key group in preparing the drafting of this response and would like to share a few preliminary remarks (1) before giving high level responses to the CP's questions (2).

1. Preliminary remarks

We have read with interest the report and have identified **recommendation 4** as the most urgent priority. We indeed fully agree with IOSCO that there is a risk of fragmentation caused by potentially divergent regulatory approaches and that this needs to be tackled at an international level given the global nature of the asset management industry.

Addressing the risk for market fragmentation

The creation of local labels, taxonomies and rules have certainly helped structure the uptake of ESG and sustainable investment solutions; this was viable when these strategies were still relatively niche. But given that these strategies are becoming more mainstream and as we are witnessing new expectations from both asset owners and regulators across the globe we are now reaching a stage where ensuring international coordination is crucially needed.

Adding further mandatory frameworks, definitions and interpretations related to sustainable finance and on a unilateral basis could hinder cross-border distribution of funds and limit options available to investors. In the EU, we are already seeing worrying signs of potential fragmentation. SFDR was meant to provide a common set of rules to enhance ESG transparency of products and those who manufacture them and provide greater protection to end investors. But some national regulators have or are considering setting local expectations for ESG/sustainable products either in the context of the application of EU rules (SFDR, MiFID) or seating along side them. Here are a few examples of local developments:

- In France, Article 8 and 9 products as defined under the SFDR Regulation must meet the minimum standards defined by the AMF position-recommendation DOC-2020-03 (e.g. minimum 20% reduction of the investment universe; average rating of the product must be higher than the average of the investment universe after reduction; non-financial coverage must be greater than 90%).
- In Spain, the National Securities Market Commission (CNMV) published on 1 June a document with "criteria on the application of new European regulations on sustainability in financial services". It says that in order to market a product as an SRI product, more than 50% of the fund needs to follow an SRI strategy.

- In Germany, the Bafin is consulting on the possibility to require among others that funds labelled as or marketed as a sustainable investment fund be at least 75% invested in "sustainable assets".

These uncoordinated and unilateral approaches are particularly problematic for our buy-side members as when they want to sell a product on a cross-border basis they will have to comply with each of these local requirements. There may be times where this is not possible as some local requirements may contradict each other, and asset managers may have to tailor products according to local legal requirements thus preventing end-investors from benefiting from economies of scale.

Favour globally recognised framework

Global alignment is thus critical to minimise some of these issues and ensure consistent transparency across the entity and product level disclosures across jurisdictions.

The TCFD framework is the globally recognised standard where jurisdictions such as the UK, New Zealand, Hong Kong, Switzerland, and Japan have already expressed that they will require TCFD disclosures. The EU also put in place voluntary climate-related guidelines largely inspired by TCFD.

We would thus welcome that IOSCO incentivises all jurisdictions mandating climate-related financial disclosures to refer to TCFD recommendations.

When it comes to other environmental and social/governance aspects, standards and practices are understandably more fragmented as they are subject to interpretation and refined as citizens' expectations evolve. Unlike for climate-related topics it makes it hard to refer to one single future proof standard or list of KPIs. We hope that these aspects will be addressed in the future sustainability reporting standard developed by the newly established ISSB.

Until this work is finalised we would recommend focusing on climate related disclosures and, to cover social and governance aspects, referring (on a voluntary basis) to the SASB and the GRI frameworks, which have served as credible references for both issuers and asset managers in the recent years.

Recognise and mitigate data gap challenges

The last important point we would like to highlight is that recent regulatory developments are for the most part strictly focusing on the buy-side and their products and rarely involves similar disclosure requirements for issuers.

This leaves investors in a vulnerable position, as they need to report against mandatory sustainability KPIs at either product or entity level (e.g. SFC, FCA, EU) but cannot rely on audited data published by issuers.

But there are currently important discrepancies between assessments performed by ESG data providers precisely due to the absence of mandatory, standardised, and audited reporting for issuers.

This heterogeneity of information already forces asset managers to work with several ESG data providers in order to work out the credible average performance of an issuer against the KPIs recommended by supervisors (such as carbon emissions, UNGC violators) and new mandatory reporting requirements will accentuate this problem. From an investor's perspective, this sequencing proposed by supervisors is far from ideal as it is both costly, approximate and leaves them exposed to litigation risk.

Many asset managers have started reporting GHG emissions in their TCFD reports and have noted that they do not have sufficient CO2 data coverage to support GHG emissions data reporting for 100% of their funds. Particularly with respect to scope 3 emissions, firms are reporting where possible but the lack of standardised methodologies and data gaps for certain asset classes make it very difficult to measure this category comprehensively.

This data gap issue has a knock-on impact on other climate risk metrics (given that many of them also rely on Scope 1, 2 and 3 emissions for their accurate calculation). Until this data gap is resolved we think it's premature to impose disclosing against any forward looking metrics such as the Climate VaR (e.g. FCA consultation).

We appreciate the need to look into intermediaries (such as the buy-side and ESG data providers) but until the question of issuer reporting is addressed the ability to prevent greenwashing and to transition towards a more sustainable economy will be hindered.

We welcome the fact the IFRS is already working toward a global sustainability reporting standard, but until this work is finalised and adopted locally we suggest for supervisors to acknowledge the data challenges (gaps, approximations) that asset managers are currently facing, to limit mandatory reporting requirements (focus on climate-related aspects as a priority) and allow them to perform these new disclosures on a voluntary basis or at least on a reasonable efforts basis (bearing in mind that data challenges will only partially be addressed with a global standard: e.g. challenges to measure upstream and downstream emissions will remain).

AMIC high-level response to the questions

Question 1: Will the recommendations outlined below sufficiently improve sustainability-related practices, policies, procedures and disclosure in the asset management industry and address the issue of greenwashing? Are there other areas of sustainability-related practices, policies, procedures and disclosure in the asset management industry not mentioned in this consultation report that should be addressed as separate recommendations?

AMIC response to Q1: The key role that we see in these recommendations is not so much their ability to improve practices (which are constantly improving and developing) but rather their ability to bring different regulatory frameworks closer together and make them more aligned, thus helping to promote one global standard for the purpose of achieving a large and liquid sustainable investment market.

Recommendation 1: Asset Manager Practices, Policies, Procedures and Disclosure. Securities regulators and/or policymakers, as applicable, should consider setting regulatory and supervisory expectations for asset managers in respect of the: (a) development and implementation of practices, policies and procedures relating to sustainability-related risks and opportunities; and (b) related disclosure.

Question 2: The key areas identified are based on the key pillars of the TCFD Framework. Do you agree with this approach?

AMIC response to Q2: Yes we would be in favour for asset managers and supervisors to refer to the TCFD framework bearing in mind challenges around data/metrics as explained under our introductory remarks (cf. *Recognise and mitigate data gap challenges*).

Question 3: Should the scope of this recommendation cover all asset managers or be limited to only those asset managers that take sustainability-related risks and opportunities into consideration in their investment process?

AMIC response to Q3: We believe that it should apply to all asset managers for the purpose of ensuring a level playing field but also on the basis that sustainability risks are relevant for investment value independently of the nature of the business or products.

Recommendation 2: Product Disclosure. Securities regulators and/or policymakers, as applicable, should consider clarifying and/or expanding on existing regulatory requirements or guidance or, if necessary, creating new regulatory requirements or guidance, to improve product-level disclosure in order to help investors better understand: (a) sustainability-related products; and (b) material sustainability-related risks for all products.

Question 4: Should securities regulators and/or policymakers, as applicable, consider setting out different disclosure requirements for products with sustainability-related investment objectives as compared to products that promote sustainability-related characteristics? If so, for which of the different areas of disclosure listed above should the requirements vary, and how should they vary? In addition, if so, should securities regulators and/or policymakers, as applicable, consider specifying thresholds or other criteria for determining whether a product has sustainability-related investment objectives as compared to sustainability-related characteristics, and what should those thresholds or criteria be?

AMIC response to Q4: No, we would prefer high-level requirements applicable to both types of products. It would ease comparability. Also distinguishing these two categories of products has proven to be difficult under SFDR as similar strategies could both qualify as article 8 and 9 (e.g. Best in class approach). Cf. Morningstar survey: "*SFDR: Four Months After Its Introduction. Article 8 and 9 Funds in Review*". A better approach, in our view, would be one that does not place artificial distinctions between characteristics and objectives but rather recognises that there are different ways and means to achieve sustainability and focusses on how to make this clear to clients. Ultimately, clients should be in a position where they can understand the nature of a product and what it is trying to achieve. Any disclosure requirements should prioritise this.

Question 5: Should naming parameters permit the product name to reference sustainability only if the investment objectives refer to sustainability?

AMIC response to Q5: Yes, we would agree with that proposal. But one needs to consider the need to have a dedicated bucket of assets to manage liquidity or for hedging purposes. Not all the assets in the portfolio can contribute to the sustainability objectives of the fund. For instance a green bond funds will hold a portion of sovereign or cash-like instruments to manage liquidity. The proportion of sustainable assets vs assets held for liquidity/hedging purposes can be estimated and disclosed, but should not be prescribed by regulators (unless in the context of a label).

Question 6: Should a product need to have an ESG, SRI or similar label in order to be marketed as a sustainability-related product?

AMIC response to Q6: No, given that labels are not yet available in all jurisdictions and generally speaking we think getting a label should remain a voluntary process. Some members have faced difficulties selling funds with a national label on a cross border basis (not recognised by host regulators).

That is not to say that labels are not useful at all. Labels can work in a supplementary way and be helpful to investors if they are designed carefully. But we don't consider that they should be a precondition for marketing a product on the basis of its sustainability features. Indeed we believe that a glossary of sustainability terms (as discussed under Question 13) could be more helpful and effective than a mandatory label and thus labels should remain a voluntary process.

Question 7: Do you agree with the specified areas of investment strategies disclosure?

AMIC response to Q7: Yes, we would agree with that proposal. If a fund has a sustainability-related strategy then it should make clear what is its investment universe, selection process, any ESG indices or ratings used etc.

Question 8: Should the disclosures address how past proxy voting and shareholder engagement records align with the investment objectives or characteristics of a sustainability-related product?

AMIC response to Q8: Proxy voting and shareholder engagement is often done at firm level rather than product level. Furthermore some of the engagement activities required are not always feasible: AGM voting process and filing of resolutions on a cross-border basis can be very cumbersome in some jurisdictions. We would therefore suggest leaving this type of disclosure at the discretion of the fund manager unless the product follows an engagement strategy.

Question 9: Should securities regulators and/or policymakers, as applicable, also address the format and presentation of marketing materials and website disclosure for sustainability-related products?

AMIC response to Q9: Some voluntary guidelines for a standardised format of presentation could be helpful for clients and investors when they compare different products and services, as long as the financial market participants can tailor the recommended format to suit their strategy or have the freedom to choose their own presentation format if they deem the recommended one unsuitable.

Question 10: Should securities regulators and/or policymakers, as applicable, encourage the use of specific metrics or key performance indicators to assess, measure and monitor the sustainability-related product's compliance with its investment objectives and/or characteristics? Should these metrics be subject to self-selection, or should there be a standardised approach?

AMIC response to Q10: Standardised metrics do not always suit all types of sustainable/ESG strategy and asset classes. Furthermore issuers are currently not required to disclose against any KPI. Until this is resolved (locally and internationally) we believe it's better for the buy-side to work on the basis of a small set of core metrics on a voluntary basis or at least on a reasonable efforts basis. Please refer to our introductory remarks (cf. *Recognise and mitigate data gap challenges*).

Question 11: Should periodic reporting include both quantitative and qualitative information about whether a sustainability-related product is meeting its sustainability-related investment objectives and/or characteristics?

AMIC response to Q11: We would suggest focusing on qualitative information at this stage (see our response to question 10).

Recommendation 3: Supervision and Enforcement. Securities regulators and/or policymakers, as applicable, should have supervisory tools to ensure that asset managers and sustainability-related products are in compliance with regulatory requirements and enforcement tools to address any breaches of such requirements.

Recommendation 4: Terminology. Securities regulators and/or policymakers, as applicable, should consider encouraging industry participants to develop common sustainable finance-related terms and definitions to ensure consistency throughout the global asset management industry.

Question 12: Do you agree that securities regulators and/or policymakers, as applicable, should encourage industry participants to coalesce around a set of consistent sustainability-related terms?

AMIC response to Q12: Yes, we would favour a common approach on key concepts and potential expectations associated with it to overcome the risk of fragmentation described in our introductory remarks. This workstream around sustainability related-terms should not try to change the nature of strategies currently available but rather facilitate their understanding by end-investors and allow them to make informed decision. In the meantime, we encourage regulators to embrace readily available and recognised international frameworks such for both issuers (TCFD, SASB) and investors (PRI).

Question 13: Are there any sets of standardized sustainability-related terms being developed by international organisations that should be considered by securities regulators and/or policymakers, as applicable?

AMIC response to Q13: Regulators in various jurisdictions, such as the EU, UK, Singapore, China, Malaysia etc. either already have or are currently working on taxonomies (ICMA's *Overview and Recommendations for Sustainable Finance Taxonomies)*. These taxonomies, however, tend to focus on the actual economic activities rather than the investment approaches to sustainability an asset manager may take. We consider these to be more helpful for clients and investors to understand what a product tries to achieve and how. One helpful and comprehensive framework is the PRI glossary of commonly used terms in the PRI Reporting Framework.

Recommendation 5: Financial and Investor Education. Securities regulators and/or policymakers, as applicable, should consider promoting financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives.

Question 14: Do you agree that securities regulators and/or policymakers, as applicable, should promote financial and investor education initiatives relating to sustainability, or, where applicable, enhance existing sustainability-related financial and investor education initiatives?

AMIC response to Q14: For retail investors specifically, we see a great need for education. This is not specific to sustainability products but to investing altogether. We would consider a much broader effort is necessary; one that uses education to engage and empower people to consider investment as a possible solution to real-life problems and understand how different investment strategies can match their values and goals. Sustainable investing and its nuances would inevitably be part of this but it is not the only part that is needed when we look at investor education as a theme altogether.

Question 15: Are there any specific sustainability-related financial and investor education initiatives not mentioned in this consultation report that could be considered by securities regulators and/or policymakers, as applicable?

AMIC response to Q15: ICMA Education offers an introductory course on Green, Social and Sustainability Bonds in both live and online self-study formats and is in the process of developing an advanced course covering regulatory and market topics within sustainable bonds which is launching in 2022. We would be more than happy to collaborate with IOSCO members regarding their investor education initiatives and encourage you to contact us education@icmagroup.org

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Contact: regulatoryhelpdesk@icmagroup.org | Telephone +44 20 7213 0339