| asset management group

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IOSCO consultation report: Sustainable finance in emerging markets and the role of securities regulators

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide comments to the International Organization of Securities Commissions ("**IOSCO**") on the consultation report on *Sustainable Finance on Emerging Markets and the role of securities regulators* (the "**Consultation**")[1].

The AMG is the voice of the buy side within the securities industry and broader financial markets, which serves millions of individual and institutional investors as they save for retirement, education, emergencies, and other investment needs and goals. The AMG's members represent U.S. asset management firms whose combined assets under management exceed $45 trillion.

The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. While our members operate both inside and outside the United States and many are considered to be global enterprises, the background and orientation of our organization is rooted in U.S. laws and regulations.

Our approach

We understand that the Consultation is part of an IOSCO's growth and emerging markets committee ("**GEMC**") project, launched in 2017, with the aim of helping growth and emerging markets regulators better understand the issues and challenges that affect the development of sustainable finance in capital markets. In IOSCO's words "in proposing this set of recommendations, the GEMC believes they will help achieve a degree of international consistency and harmonisation and thereby assist investors and issuers, given the cross-border and global nature of sustainable instruments"[2].

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD621.pdf
[2] https://www.iosco.org/news/pdf/IOSCONEWS522.pdf

In other words, the Consultation's aim is to look at issues and challenges that affect the development of sustainable finance in capital markets, focusing on sustainable assets in emerging markets and measures to facilitate market development in this area.

In this framework, we note the recent IOSCO Statement on disclosure of ESG matters by issuers[3] and the fact that the GEMC Consultation, despite being fairly general, is more prescriptive than the IOSCO Statement, which simply sets out the importance for issuers of considering the inclusion of ESG matters when disclosing information material to investors' decisions, and lists current developments in the ESG area and IOSCO's ongoing efforts.

In general, we would caution IOSCO against issuing diverging sets of recommendations among its member groups/committees. ESG issues are not unique to the GEMC and emerging markets jurisdictions, and there are broad efforts undertaken in numerous jurisdictions around the world to integrate ESG considerations in the practices of economic and financial actors, including issuers and investees companies, and institutional investors.

Moreover, we note that the GEMC mandate is "to help emerging markets regulators better understand the issues and challenges that affect the development of sustainable finance in capital markets" rather than to issue recommendations on developing frameworks for ESG investing.

Our response to the consultation is structured around some introductory comments on the report's approach to the issue, and some specific comments related to the following draft recommendations on which we felt we could more meaningfully comment from an asset management perspective:

- recommendation 1 on integration by issuers and regulated entities of ESG-specific issues in their overall risk appetite and governance;
- recommendation 2 on ESG-specific disclosures and reporting;
- recommendation 3 on data quality;
- recommendation 4 on the definition of sustainable instruments;
- recommendation 5 on eligible projects and activities;
- recommendation 9 on external reviews;
- recommendation 10 on integration of ESG-specific issues into the investment analysis, strategies and overall governance of institutional investors; and
- recommendation 11 on building capacity and expertise for ESG issuers.

General introductory comments

The AMG and its members broadly welcome the general nature, balanced approach, and particular focus on issuers and investee companies of the IOSCO GEMC's initiative.

The Consultation report notes that "recent discussions with market participants emphasized that investors want issuers to clearly demonstrate how they integrate long-term sustainable thinking into their investment decisions."[4]

We would support improved disclosure and transparency from issuers and regulated entities, as this is key for investors' decisions. Investors should be given relevant disclosures to inform their decisions aligned with the asset managers' duty to look after their investors' long-term financial interests. In general, we believe that the regulators' key task should be to enhance transparency to ensure that informed investment decisions can be taken.

[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf
[4] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD621.pdf

As regards definitions, we note that the wording of the recommendations should facilitate their workability in practice.

Moreover, in our view, generally the term "sustainable investment" implies an explicit objective of delivering a positive ESG performance. For example, the European Commission interprets sustainable finance as including "a strong green finance component that aims to support economic growth while reducing pressures on the environment; addressing green-house gas emissions and tackling pollution; and minimizing waste and improving efficiency in the use of natural resources."[5] We take the view that such an approach may ultimately limit investment options, by excluding certain sectors or activities.

In contrast, the term "ESG integration" provides more flexibility, implying that the focus is on the process rather than the end product with an explicit objective. An integrated ESG investment strategy does not restrict the investment universe according to ESG criteria.

Last but not least, representing global asset managers active cross-border and with a global investment footprint and client base, we believe that some international consistency and a degree of alignment of sustainable finance disclosure initiatives around the world with existing voluntary frameworks would be beneficial. To this end, we encourage IOSCO to promote and facilitate robust dialogue among global regulators.

<u>IOSCO RECOMMENDATIONS and associated CONSULTATION QUESTIONS</u>

Recommendation 1: **Integrating ESG-specific issues in overall risk appetite and governance.** Issuers and other regulated entities should integrate ESG-specific issues, where these are material, in the overall risk appetite and governance of these entities.

Questions relating to Recommendation 1:

1. Do you agree that it is important to include a general recommendation regarding the need for issuers and other regulated entities to integrate ESG-specific issuers in the overall risk appetite and governance?

2. Do you have specific comments on the proposed Recommendation 1?

The AMG takes the view that companies' corporate governance is key to support sustainability objectives. In turn, the integration of ESG-specific issues by issuers and regulated entities is to be welcomed, "where these are material".

We strongly support the recommendation's reference to materiality, as we believe that ESG-specific issues which are material, rather than all ESG issues indistinctly, should be integrated (and disclosed) in a sustainable finance framework. This differentiation is key to ensure an objective focus on issues relevant to decision-making and for asset managers to maintain a strong focus on investors' preferences.

Moreover, as materiality refers to the relevance of ESG factors for financial performance, we would invite IOSCO to amend recommendation 1 to include a clear reference to **financial** materiality.

[5] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

As asset managers, we take the view that it is for each company to undertake an assessment of whether, and to what extent, ESG risks may have a material impact on their business, and judge the key risks they face and allocate resources accordingly.

While we do not intend to express a preference for any existing initiative aimed at encouraging and improving voluntary ESG disclosure, and we would caution against IOSCO and its members jumping into a "favourite" framework, it is worth mentioning some of the most well known, such as for example the International Integrated Reporting Framework[6], the Sustainability Accounting Standards Board ("SASB")[7] and its work on materiality, the Global Reporting Initiative[8], and the Financial Stability Board's Task Force on Climate-related Financial Disclosures ("TCFD").

Recommendation 2: **ESG-specific disclosures and reporting**. Regulators should require disclosure with regard to material ESG-specific risks (including transition risks) and opportunities in relation to governance, strategy and risk management of an issuer or CIS. This information should be part of the overall disclosure that the issuer or CIS makes under Principle 16 or 26.

To be noted:
Principle 16 (for issuers) requires consideration of the adequacy, accuracy and timeliness of both financial and non-financial disclosures as well as disclosure of risks that are material to investors' decisions;
Principle 26 (for collective investment schemes - CIS) requires that all matters material to the valuation of a CIS are disclosed to investors and potential investors on a timely basis.

Question relating to Recommendation 2:

3. Do you have specific comments on the proposed recommendation for ESG-specific disclosures and reporting?

IOSCO notes that despite demand from institutional investors for greater clarity and transparency, in general the quality of ESG disclosures by companies appears to be insufficient, lacks comparability among jurisdictions, and suffers from the lack of mandatory disclosure of financially material ESG factors in some jurisdictions.

The many existing corporate disclosure regimes adopt significantly different approaches to ESG-related reporting requirements. We would thus welcome a degree of standardization of disclosure/reporting by companies. IOSCO itself notes that "a lack of accepted standards in this area is one of the main impediments for developing sustainable capital markets."

It is important to note that issuers are already asked to disclose a variety of information on different aspects of their business in most jurisdictions around the world. For investors and asset managers, analysing companies' disclosures related to ESG risks and opportunities is part of the investment process, and this information is part of the broader picture of a company's investability.

The absence or inconsistency of data leads to uncertainty for investors, which can ultimately increase the cost of capital for issuers. While we would caution against IOSCO or the GEMC recommending mandatory ESG disclosure requirements, we believe that improving the availability and reliability of corporate disclosures is foundational in the efforts to boost the integration of ESG considerations in investment decision-making. In particular, IOSCO should facilitate member

[6] http://integratedreporting.org/the-iirc-2/
[7] https://www.sasb.org/
[8] https://www.globalreporting.org/Pages/default.aspx

dialogue around how regulators could encourage and improve available information on financially material ESG issues.

We would also underline that there currently is a significant divergence of approach in the way external ESG rating providers analyse ESG risks and opportunities, which sometimes leads to important differences in analysis within and across jurisdictions.

We would also propose to more clearly differentiate between disclosure requirements for issuers and for CIS, which are substantially different. The ultimate ESG risks are typically specific to the issuer and lie with the asset owners, rather than at the portfolio level. We would thus suggest not mixing issuers and CIS disclosures and reporting in recommendation 2.

More generally, we would question the appropriateness of including in this recommendation reference to a specific financial product, namely CIS.

Recommendation 3: **Data quality**. Where regulators determine that additional ESG-specific reporting is needed (in accordance with Recommendation 2), regulators should aim to ensure adequate data quality for ESG-specific reporting, including, among others, through updating listing rules, the use of external reviews and through the operation of other information service providers e.g. credit rating agencies (CRAs), benchmarks and auditors.

Question relating to Recommendation 3:

4. Do you agree that a separate recommendation on data quality is needed? Do you have specific comments on the proposed recommendation?

IOSCO notes that in addition to the quality of disclosure, ESG disclosure lacks comparability and there are significant differences between local requirements in different jurisdictions. While underlining once again that this issue is not unique to GEMC jurisdictions, we note that at the international level, there are several initiatives which cover sustainability disclosure requirements and ways to improve it. As mentioned in our introductory comments, we take the view that greater convergence through existing frameworks and standards could be helpful to prevent fragmentation of ESG data across jurisdictions and reduce research costs. To this end, we encourage IOSCO to facilitate broader discussions among IOSCO members on this issue.

Therefore, we strongly support IOSCO work that aims to ensure the streamlining of ESG data towards greater data transparency, accessibility, and comparability. It is important that regulators find ways to support, encourage, and incentivise issuers to provide meaningful data, not necessarily more data *per se*. At the same time, regulators must ensure that reporting is not unduly burdensome, and thus need to strike the right balance between quality (and granularity) and administrative burden/costs in any given jurisdiction.

From an asset management perspective, access to reliable data is one of the key challenges today, as it is often insufficient, and comes at an increasingly high cost. Data should be meaningful and useful: the focus should be on quality rather than quantity, and in particular on financially material information. Materiality and the material assessment of risks should always be central to regulators' approaches when considering ways to enhance comparability.

Recommendation 4: **Definition of sustainable instruments**. Sustainable instruments should be clearly defined and should refer to the categories of eligible projects and assets that the funds raised through their issuance can be used for.

Question relating to Recommendation 4:

6. Do you have specific comments on the proposed recommendation relating to the definition and taxonomy of sustainable instruments?

The AMG believes that common definitions are welcome to create comparable disclosure.
A common language can greatly help in building a more sustainable economic and financial framework. For example, it is very difficult to rate issuers in ESG terms, particularly for "S" and "G", which appear more difficult to define and measure than "E". At the same time, common terms and their definitions should be sufficiently flexible, unprescriptive, and principles-based to adapt to a fast-changing sustainability environment, if we are to avoid the risk of stifling innovation. We believe IOSCO is well-situated to support substantive discussions among its broad membership to work toward developing common definitions.

Defining the "greenness" of assets can be relative, hence the importance for regulators to define what a green asset actually is and how it should be assessed in their respective jurisdictions. In this context, we would also caution against a single "one-size-fits-all" taxonomy based on arbitrary classifications that risks being neither sophisticated nor accurate for a particular market.

More generally, while we would welcome a higher degree of consistency across borders, we take the view that it would be a mistake for GEMC members' regulators to adopt initiatives or approaches developed in other jurisdictions where discussions around sustainable finance and ESG investing have become highly politicized, at the risk of losing the focus on their inherently technical nature.

Recommendation 5: Eligible projects and activities. Funds raised through sustainable instruments should be used for projects and activities falling under one or a combination of the broad ESG categories listed below:

- Environmental (renewable resources; combatting/mitigating climate change; pollution and waste; and other environmental opportunities);
- Social (human capital; product liability; and other social opportunities);
- Governance (corporate governance; corporate behaviour).

It will be up to each GEMC member to define the list of eligible projects and activities for their jurisdictions, taking into account that an eligible project or activity cannot, at the same time, do any significant harm to any other ESG categories.

Question relating to Recommendation 5:

7. Do you agree with how eligible projects have been framed in recommendation 5?

As indicated in our introductory comments and also in our contribution to Recommendation 4, and while we do not intend to comment on the specific definitions of eligible projects and activities, we take the view that a degree of flexibility here is key, in particular as regards the use of "funds raised through sustainable instruments".

In general, we would caution IOSCO against making overly prescriptive recommendations and note that common terms and their definitions should be sufficiently flexible, unprescriptive, and principles-based to adapt to a fast-changing sustainability environment.

While a general framework as regards projects and activities is to be welcomed at jurisdiction-specific regulatory level, it should not become a regulatory cage that only allows for the development and eligibility of projects and activities on the basis of specific sustainable instruments. It appears that the wording of recommendation 5 (and also recommendations 6-7-8-9) is more relevant for green bonds, rather than other instruments e.g. CIS or sustainable funds. In this context, we would note that if the suggested focus is on green bonds, then GEMC members should explore those issues specifically rather than making horizontal recommendations that may not be relevant or even appropriate in relation to other instruments.

For example, sustainable funds adopt a variety of strategies, and they do not necessarily target sustainable projects, activities or assets but consider how companies manage ESG issues. We believe that this not in line with the language of this recommendation which appears to ring-fence the investment for a specific project or asset.

Recommendation 6: Offering document requirements. Regulators should establish requirements for the offerings of sustainable instruments including, amongst others, the use and management of the funds raised through the issuance of such instruments, and the processes used by issuers for project evaluation and selection.

Recommendation 7: Ongoing disclosure requirements. Regulators should establish ongoing disclosure requirements regarding the use of the funds raised through the issuance of sustainable instruments including the extent of unutilized funds, if any.

Question relating to Recommendations 6 and 7:

8. Do you agree that it is useful to have separate recommendations for offering document requirements and for ongoing disclosure requirements, respectively? Do you have specific comments with regard to these recommendations?

No comment

Recommendation 8: Proper use of funds. Regulation should provide for measures to prevent, detect and sanction the misuse of the funds raised through the issuance of sustainable instruments.

Question relating to Recommendation 8:

9. Do you agree that regulators should provide for measures to prevent, detect and sanction misuse of funds raised through the issuance of sustainable instruments?

No comment

Recommendation 9: External reviews. Issuers should consider the use of external reviews to ensure consistency with the definition of the sustainable instruments as provided in Recommendation 4.

Question relating to Recommendation 9:

10. Do you agree with the recommendation relating to external reviews? Do you think that such external reviews should be mandatory or voluntary?

The AMG takes the view that the scope of this recommendation is somewhat unclear and can be subject to different interpretations. Moreover, we note again that this tool seems more appropriate for debt instruments e.g. green bonds rather than for other financial instruments.

In general, we would caution against the use of external reviews in relation to a broad range of financial instruments, including for debt instruments. As underlined in our comments under Recommendations 4 and 5, definitions for terms such as “sustainable instrument” should be sufficiently flexible, unprescriptive, and principles-based.

While agreeing with the need for regulators to establish functioning and efficient sustainable finance frameworks, we would underline that external reviews would face the same challenges today as investors do when it comes to consistency and quality of ESG data.

If the use of external reviews is deemed appropriate by IOSCO after this consultation, we would strongly recommend a voluntary approach, as investors are in a position to determine whether they want to invest only in instruments that have been externally reviewed.

IOSCO also includes a question (question 5) which relates to all the sustainable instruments/activities recommendations (4 to 9)

5. Do you agree that this set of recommendations should be applicable to all sustainable instruments, and not only debt instruments?

See our comments to recommendation 9

Recommendation 10: Institutional investors. Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, should incorporate ESG specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest.

Questions relating to Recommendation 10:

11. Do you agree that it is important to have a specific recommendation with regard to institutional investors?

12. Do you agree that regulators should consider asking institutional investors to incorporate ESG-specific issues into their investment analysis, strategies and overall governance?

13. Do you agree that regulators should ask the institutional investors to take into account ESG disclosures of the entities in which they invest?

While we welcome the unprescriptive tone of recommendation 10, we also note that it might be unnecessary to include a recommendation related to institutional investors in this report (as we underlined that the inclusion of a reference to CIS in recommendation 2 might not be appropriate). We also question whether it is appropriately targeted toward GEMC members.

The consultation notes that most institutional investors active in emerging markets are from developed markets and there is no specific framework in emerging markets to encourage institutional investors to incorporate ESG-specific issues into their analysis and decision-making. We find the latter part of this assertion to be inaccurate given that the European Union ("EU") is currently developing its own framework for institutional investors to integrate ESG considerations into investment processes, and that it is one of the first jurisdictions to formally do so, even among the most advanced and complex markets.

As a general point, we would caution against replicating in emerging markets approaches being developed and adopted in jurisdictions around the world, such as in the EU, where there is a strong focus on utilizing regulatory requirements to reach specific sustainable investment goals.[9]

[9] https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

Moreover, as previously indicated, asset managers already seek to integrate financially material ESG factors in their investment process to best protect their clients' investments, and seek to provide adequate disclosure and reporting to their clients on how they include financially material ESG-issues in their investment analysis. This is often true not only of ESG-themed funds and investments, but also of funds without sustainability objectives and for investors without a specific ESG preference.

Asset managers use various approaches to integrate ESG considerations in their investment processes and meet the sustainability-related objectives of institutional investors and asset owners, including for example through impact investing, ESG- thematic investing, exclusion-based investing, stewardship, etc. We believe that this variety of approaches should be maintained as IOSCO members contemplate the best regulatory approach to sustainable investing in their respective jurisdictions. Importantly, at the end of the day, asset managers consider ESG factors on the basis of the investment parameters and objectives set out by and agreed with the asset owner.

More generally, we believe that a financially-material rather than value-based approach, as well as proportionality of application and interpretation, should be fundamental elements of any IOSCO recommendation related to institutional investors and asset managers as regards ESG investing.

Recommendation 11: Building capacity and expertise for ESG issues. Regulators should analyse the gaps in capacity and expertise with regard to ESG-related issues mentioned in the above recommendations and consider targeted capacity building to address these gaps. Regulators should also have appropriate monitoring mechanisms in place to encourage application of these recommendations.

Questions relating to Recommendation 11:

14. Do you agree that it is important to have a specific recommendation relating to capacity building?

15. Do you also agree that this recommendation should apply both to regulators and market participants?

We would like to stress the importance of financial education to build a solid framework for sustainable finance. We note that this theme has been extensively addressed in a recent report by the Sustainable Stock exchanges initiative (backed by the United Nations) on "how securities regulators can support the Sustainable Development Goals"[10]. The report includes various examples of capacity and expertise building, such as qualifications' frameworks, best practices, peer-to-peer learning, exchanges etc.

One of the five main action areas identified by the abovementioned report, where securities regulators can contribute to a more stable and resilient financial system that better supports the SDGs, is to "build market capacity and expertise on sustainability: facilitate the training of market participants on sustainability topics."

Importantly, trainings for emerging markets participants are organised by various bodies, such as the United National Environment Programme[11].

[10] http://www.sseinitiative.org/wp-content/uploads/2018/10/SSE-Regulator-Report-compressed.pdf
[11] https://www.unepfi.org/events/investment-events/training-integrating-environment-social-governance-perspectives-in-investment-decisions/

Overall, we take the view that a model built on a close partnership between securities regulators and market participants can be most effective. We thus welcome the recommendations' focus on both regulators and market participants in order to develop a holistic technical dialogue on these issues. We would also strongly encourage IOSCO to facilitate both regulators' discussions and industry partnerships, such as for example bringing together the banking, asset management and insurance industries.

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SIFMA AMG sincerely appreciates the opportunity to comment and your consideration of these views. We stand ready to provide any additional information or assistance that IOSCO might find useful. Please do not hesitate to contact either Timothy Cameron at 001-202-962-7447 or tcameron@sifma.org or Lindsey Keljo at 001-202-962-7312 or lkeljo@sifma.org with any questions.

Sincerely,

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