CONSULTATION RESPONSE

IOSCO RECOMMENDATIONS ON SUSTAINABILITY-RELATED PRACTICES, POLICIES, PROCEDURES AND DISCLOSURE IN ASSET MANAGEMENT

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INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the IOSCO consultation report on sustainability related-practices, policies, procedures and disclosures in asset management.

ABOUT THIS CONSULTATION

IOSCO invites market participants and interested parties to submit comments on its consultation report entitled *Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management*.

The recommendations focus on asset managers and investor protection issues and aim to improve sustainability-related practices, policies, procedures and disclosures in the asset management industry. These include encouraging asset managers to take sustainability-related risks and opportunities into account in their investment decision-making and risk management processes and addressing the risk of greenwashing through improving transparency, comparability and consistency in sustainability-related disclosure.

"The report discusses the types, and provides examples, of greenwashing at asset manager and product levels, describes the different regulatory approaches currently taken by Sustainable Finance Board-level Task Force members to address sustainability-related practices by asset managers as well as disclosures at both firm and product levels, and provides an overview of the current landscape of sustainability-related financial and investor education". The report also presents challenges in these areas and sets out 5 recommendations and 15 associated questions.

For more information, contact

Margarita Pirovska

Director of Policy

margarita.pirovska@unpri.org

Alina Neculae

Senior Policy Analyst

alina.neculae@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes IOSCO's timely and important work on promoting sustainability-related disclosure rules for asset managers. This work, alongside the other workstreams on corporate disclosures and ESG rating agencies, is fundamental in building aligned and consistent regulations across jurisdictions, to support a global transition towards Paris Agreement and SDG-aligned economies and financial markets.

In particular, the PRI welcomes the following proposals:

- Setting regulatory and supervisory expectations for asset managers to incorporate sustainability-related risks and opportunities in investment practices, policies and procedures, and disclose how they do so;
- Building such disclosure requirements on existing policies and regulations to ensure such regulations are embedded in mainstream financial regulations;
- Underscoring the importance of policy implementation and enforcement on sustainability-related disclosures.

The PRI's key recommendations are:

- Clarify that the purpose of this work is to **support regulators and policymakers to align financial policy with sustainability goals, such as the Paris Agreement and the Sustainable Development Goals (SDGs)**. Sustainable finance is not optional or separate from mainstream finance. Financial policy frameworks and regulations need to effectively guide markets towards a sustainable and just transition to carbon neutral economies. Regulating how investors incorporate sustainability-related risks, opportunities and outcomes in investment practices, policies, procedures and disclosures is a means to achieve that end. This can be for example reflected in the draft report, p.1 of executive summary.
- Encourage the development of technical tools and objective standards to avoid greenwashing and verify sustainability claims. A fundamental tool to achieve this is a **taxonomy for sustainable activities**.
- Ensure **coherence** between the recommendations made in this report to those developed on corporate disclosures, at the **policy design, implementation and monitoring** levels. Corporate disclosure requirements should provide the necessary data for investor disclosure requirements.
- Consider **asset specific implementation** issues when designing investor disclosures.

DETAILED RESPONSE

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?

PRI response: PRI believes the following areas should be further developed:

1. Clarify the purpose of the IOSCO initiatives on sustainable finance

IOSCO should clarify that the purpose of its work on sustainable finance, including the present draft report, is to support regulators and policy makers to align financial policies with sustainability goals, and convey the message that sustainable finance is not optional or separate from mainstream finance.

Financial policy frameworks and regulations need to effectively guide markets towards a sustainable and just transition to carbon neutral economies. Regulating how investors incorporate sustainability-related risks, opportunities and outcomes in investment practices, policies, procedures and disclosures is a means to achieve that end. For example, this can be reflected in the draft report, p.1 of executive summary.

2. Development of technical tools and objective standards to avoid greenwashing

To avoid greenwashing and provide useful information to the market, any sustainability claim must be verified with reference to an objective benchmark or standard. A key tool to support that goal is a taxonomy of sustainable economic activities.[1] It sets a common language between investors, issuers, project promoters and policy makers, and helps to increase investments that are consistent with sustainability goals, such as creating a net-zero, resilient and sustainable economy. A sustainable taxonomy is essential to avoid greenwashing and provide technology neutral, objective, science-based criteria to define what investments are sustainable.

While the taxonomy and other performance benchmarks were mentioned in the body of the report and are conceptually covered under the "classification" requirements or guidance mentioned in the recommendations, IOSCO should clarify the need to develop such technical tools and objective standards in a separate recommendation.

3. Coherence with corporate disclosure regulations

Investors rely on consistent, reliable, and comparable disclosures by corporates to assess, manage and disclose sustainability risks and opportunities. Corporate disclosure requirements should provide the necessary data for investors to fulfil their disclosure requirements. In this light, IOSCO should ensure coherence between the recommendations made in this report and those developed on corporate disclosures, at the policy design, implementation and monitoring level.

4. Asset class specific issues

Regulators should consider asset specific implementation issues when designing investor disclosure frameworks. These frameworks and related taxonomies should reflect the diversity of asset classes by recognising the range of issuer types and instruments, as well as the significant data and methodological issues that exist.

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[1] See PRI's and the World Bank's policy toolkit: [How policy makers can implement reforms for a sustainable financial system]

"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?

PRI response: We agree with using the key pillars of the TCFD Framework as a foundation for asset manager climate-related disclosure requirements. This will ensure consistency between corporate and investor disclosure. Moreover, we would welcome that IOSCO incentivises the development of mandatory climate-related disclosures built on the TCFD framework in all jurisdictions. To further ensure that climate-related disclosure standards are meaningful and comprehensive, we recommend considering the forthcoming TCFD updated guidance on cross industry metrics, transition plans, monitoring and the disclosure of financed emissions and Paris alignment.

While the PRI strongly supports the recommendations of the TCFD, the pillars and content elements are designed to reflect the specific risk and opportunities posed by climate change and may not automatically be an appropriate framework for disclosure on other issues (e.g. human rights). When building from the TCFD framework, policymakers and securities regulators should ensure that the overarching structure and design of disclosure frameworks are sufficiently flexible to accommodate additional sustainability issues.

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?

PRI response: The scope of the recommendation should cover all asset managers as ESG factors may be material for any investment and should be integrated in decision-making regardless of whether the investment strategy has an ESG focus or not. The PRI's work on Fiduciary Duty in the 21 Century demonstrated that it is investors' duty to systematically and explicitly incorporate financially material ESG factors in investment decision-making, and disclose how they do so.[2]

[2] Fiduciary Duty - Fiduciary Duty in the 21st Century (fiduciaryduty21.org)

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?

PRI response: We do not see added value in setting out different disclosure requirements for these types of products. To help substantiate the sustainability claim and mitigate the risk of greenwashing, the focus should be on developing clear, consistent disclosure requirements for all products with sustainability-related objectives and characteristics. This will allow end investors to make a judgement based on clear performance indicators rather than distinctions created by different disclosure requirements.

The urgency of climate change and the need to implement the SDGs lead to a growing interest by investors in what are the real-world outcomes of their investment decisions. All investments have outcomes, which can be positive or negative, intentional or unintentional. The PRI, together with the UN Environment Programme Finance Initiative and the Generation Foundation, have commissioned a legal analysis to determine the extent to which current law enables investors to incorporate sustainability impact in their investment decision-making. This project provides options for policy change to better address sustainability impact as a core part of investment. The Legal Framework for Impact report was released on 21 July 2021[3] and will be followed by a three-year work programme of investor and policymaker outreach. The PRI encourages IOSCO to draw on the project's analysis when assessing policy reform areas to consider sustainability impacts as part of the legal and regulatory framework for institutional investors.[4]

Key sustainability objectives include the Paris Agreement goals and the SDGs. The urgency and scale of climate related risks require the alignment of all investment activity with net zero carbon emissions goals. However, the pursuit of one sustainability goal should not be done at the expense of others. The principle of do no significant harm, as set out in the EU taxonomy[5], could be considered when developing criteria for sustainability-related investment objectives.

For asset manager's financial products, the EU Taxonomy offers a common ESG baseline against which funds can measure and assess the environmental performance of one financial product with another[6].

[3] A legal framework for impact | PRI Web Page | PRI (unpri.org)
[4] Concepts from the report could be useful in developing the thinking around different types of sustainable products i.e. the differentiation between Instrumental and Ultimate Ends Investment for Sustainability Impact (IFSI) can be used as a conceptual framework. Instrumental IFSI is where achieving the relevant sustainability impact goal is 'instrumental' in realising the investor's financial return goals whereas Ultimate Ends IFSI is where achieving the relevant sustainability impact goal, and the associated overarching sustainability outcome, is a distinct goal, pursued alongside the investor's financial return goals, but not wholly as a means to achieving them.
[5] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en
[6] Activities which cause significant harm to climate change mitigation or adaptation under the EU Taxonomy framework may be understood as broad proxies for transition and physical risk. Similarly, activities which make a substantial contribution to climate change mitigation and adaptation can indicate climate-related opportunities.

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

PRI response: The PRI is generally supportive of regulators' efforts to ensure that funds' names reflect their investments.

The PRI believes a fund should not be required, as a blanket matter, to include "ESG", "sustainable", or related terms in their name simply because they consider ESG factors. Asset managers should be already considering financially material sustainability (ESG) information and as a wide body of evidence shows, ESG integration is material to long-term financial performance.

In instances where asset managers intend to deliberately follow a particular sustainability goal, in parallel to financial returns, naming parameters, consistent with related disclosures at product and issuer level, and supported by evidence, can contribute to mitigating the risk of "greenwashing". IOSCO and securities regulators should establish consistent and comprehensive fund naming parameters that prevent the use of materially deceptive or misleading names in order to protect market participants.

Naming parameters are already in use in some markets such as France, where the Autorité des Marchés (AMF) imposed detailed new requirements for the use of non-financial (ESG) criteria in the marketing of funds.

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

PRI response: The substance of a sustainability claim must be verified relative to an objective standard. This could be a sustainability performance benchmark like a taxonomy or if there are specific claims made, against a specific standard, e.g. Paris aligned passive product or a specific label e.g. Paris aligned benchmarks. Therefore, while the sustainability claims should be substantiated, the use of labels should not be mandatory as there are other ways of demonstrating the sustainability aspects of the product.

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

PRI response: The PRI agrees with the specified areas of investment strategies disclosure.
On disclosure of investment objectives, we recommend using the types of objectives defined in the report "Legal Framework for Impact"[7].

On disclosure of investment strategies, we recommend adding a description of:

- the type of investment strategy used to attain the sustainable investment objective/characteristics of the financial product;
- the key elements of that strategy to select the investments to attain the objective/characteristics;
- how the strategy is implemented in the investment process on a continuous basis;
- the policy used to assess good governance practices of the investee companies.

[7] See Instrumental versus Ultimate Ends Investment for Sustainability Impact (IFSI) in the Legal Framework for Impact report available at A legal framework for impact | PRI Web Page | PRI (unpri.org)

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?

PRI response: Yes, disclosures should address how past proxy voting and shareholder engagement records align with the investment objectives or characteristics of a sustainability-related product. Disclosures should also address how investors anticipate their stewardship activities will lead to the attainment of the investment sustainability objectives/characteristics.

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?

PRI response: Securities regulators and/or policymakers should ensure the format and presentation of marketing materials and website disclosure for sustainability-related products provide accessible, consistent and comparable information to improve transparency and mitigate the risk of greenwashing.

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?

PRI response: Securities regulators and/or policymakers should mandate standardised sustainability-related disclosures for asset managers. Such disclosures should be aligned and consistent with the corporate sustainability-related disclosures, including on climate. The disclosures should allow for measuring the sustainability performance against an objective, technical sustainability benchmark like a taxonomy of sustainable economic activities. Investors should disclose a minimum set of standardised and comparable indicators to show how the financial product meets the investment objectives/characteristics it promotes.

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?

PRI response: Including both quantitative and qualitative information in period reporting will provide the information needed to substantiate the sustainability claim. While quantitative information is easier to compare, additional qualitative disclosures may be needed to substantiate certain claims (e.g. human rights oriented fund).

"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?

PRI response: Securities regulators and/or policymakers should develop common sustainable finance-related terms and definitions in collaboration with industry participants. Significant progress has already been made so any formalisation of the process should draw from existing work by industry and other bodies. We recommend a focus on developing technical benchmarks to define sustainable economic activities as a prerequisite to terminology development.

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?

PRI response: The PRI definitions from the Reporting Framework[8] are a useful source of standardised sustainability-related terms that could be considered by securities regulators and/or policymakers. Other country examples include the work of the BSI on a Sustainable Finance Standardization Programme[9] expected to feed into ISO work in the future.

[8] Reporting Framework glossary | PRI Web Page | PRI (unpri.org)
[9] Sustainable Finance Standardization Programme | BSI (bsigroup.com)

"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?

PRI response: Yes. Increasing the understanding and awareness of sustainable finance issues amongst regulators/policymakers and market participants is a key step in developing sustainable finance markets. Such education should be embedded in existing IOSCO initiatives such as the World Investor Week, and not treated separately from mainstream investor education.

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?

No response.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of IOSCO to develop sustainable investment practices, policies, procedures and disclosure in asset management.

Any question or comments can be sent to policy@unpri.org.