

12 February 2010

The logo for UKSIF (UK Sustainable Investment and Finance Association) is displayed in a grey rectangular box. The letters 'UKSIF' are in a bold, white, sans-serif font.

Comments on “Discussion paper on non-bank lending” from UKSIF – the sustainable investment and finance association

UKSIF, the sustainable investment and finance association, promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. We aim to support the UK finance sector to be the world leader in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 200+ members and affiliates include pension funds, institutional and retail fund managers, investment banks, financial advisers, research providers, consultants, trade unions, banks, building societies and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

We welcome the opportunity to comment on this discussion paper. Our interest stems from the increasing investor appetite we now see for sustainable and responsible investment in fixed income. We would be delighted to discuss this response further with you.

Responses to Discussion Paper Questions for Investors

Question 12: As described below, we see an increased appetite for fixed income investments selected using environmental, social and governance criteria in addition to more traditional financial analysis. This demand comes from both institutional and retail investors and is driven in part by demographic change and in response to the recent financial crisis.

Question 20: We urge HM Treasury to promote the development of an effective bond market that enables investor assessment of securities using environmental, social and governance criteria alongside more traditional financial analysis. Taking a far-sighted approach, this bond market should not be restricted to the needs of companies limited by shares but should also support mutual, social enterprise and government (particularly municipal) bonds.

For example, UKSIF has supported the launch of the Climate Bonds Initiative, an international network that promotes the development and use of “Climate Bonds”. The Climate Bonds Initiative has identified a range of opportunities for climate bonds, together with suggestions on the role of government and others to enable an effective market. More details are available at <http://climatebonds.net/>, with a summary description at http://climatebonds.net/wp-content/uploads/2009/12/climate_bonds_4pager_14Dec09.pdf. Suggestions on the role of government are at <http://climatebonds.net/proposals/governmen/>.

Question 21: We believe that the development of a UK bond market that enables the effective integration of environmental, social and governance issues into fixed income investment can play an important role in developing and supporting the UK's leadership as a world centre for sustainable and responsible investment. We would particularly highlight (a) need for transparency on environmental, social and governance issues and (b) affordable rating, listing and other transaction costs so that bond finance is an attractive and viable option for medium sized innovative companies and social enterprises addressing key societal and environmental needs.

Annex A: Investor Appetite for Sustainable and Responsible Fixed Income Investments

Examples of this increased appetite for sustainable and responsible fixed income investments include:

Environment Agency Pension Fund “Green” Bond Mandate, December 2009

In December 2009, the Environment Agency Pension Fund sought tenders for a global bond mandate that included an environmental dimension. The announcement¹ stated (emphasis added):

*In addition to mainstream bond managers with a strong and credible process **we are also looking for bond managers who incorporate and integrate financially material environmental, social and governance (ESG) criteria** in line with best practice sustainable environmentally responsible investment. While integration of ESG issues are important to us we are also keen to hear from all global bond fund managers able to offer excellent returns.*

*In terms of integrating ESG factors, we are open to a broad range of product types and or combinations of bond products including green or sustainable bond products. Although in no way limited to, these could include traditional bond mandate with an ESG overview, allocations to green bonds, climate change bonds, supranational and agency bonds, weather catastrophe bonds, and other environmental or sustainability bond products. Our preference is for **positive bond selection using financial and sustainable criteria** rather than negative screening.*

We are open to the use of either in-house or external company research and/or partnering with third parties on the integration of ESG issues into the managers investment strategy. Other innovative approaches may also be considered.

Principles for Responsible Investment

Support for the UN-backed Principles for Responsible Investment (PRI) by institutional investors internationally (including but not restricted to those in the UK) has grown dramatically since their 2006 launch. Signatories commit to incorporate environmental, social and governance issues into their investment decision-making. The PRI Report on Progress for 2009 is available at www.unpri.org.

Recent Institutional Investor Debate on Green Bonds

UKSIF partnered with the World Bank in September 2009 to organise a seminar for UKSIF investment institution members and guests on the World Bank’s issuances of green bonds. Hosted by SEB in the City, the seminar attracted over 60 participants.

The London Accord Autumn Conference “Climate Change – New Financial Products & Indices”, co-hosted by UKSIF in October 2009, also included a panel discussion on green bonds.

UKSIF and selected members have met with the European Investment Bank to discuss its climate bonds.

Progress towards Sustainable Stock Exchanges

With support from the UN-backed Principles for Responsible Investment Initiative (PRI), UN Global Compact and the United Nations Conference on Trade and Development (UNCTAD), stock exchanges are working together with investors, regulators, and companies to enhance corporate transparency, and ultimately performance, on ESG (environmental, social and corporate governance) issues and encourage responsible long-term approaches to investment. A major meeting took place at the United Nations in New York in November 2009 to advance this agenda. Details at <http://www.unpri.org/sustainablestockexchanges09/index.php>.

Responses to Personal Accounts Delivery Authority (PADA) investment consultation

In ‘Building personal accounts: designing an investment approach: Key findings of the public consultation’ (published November 2009), PADA reported strong support for both responsible ownership across all personal accounts investments and member choice of religious and ethical options. Details at: www.padeliveryauthority.org.uk.

¹See <http://www.publictenders.net/tenders/archive/101947>

Increased Fixed Income Appetite from UK Retail Green and Ethical Investors

In Summer 2009, the Ethical Investment Association (UKSIF's membership chapter for independent financial advisers) undertook a telephone survey² of a sample of 34 financial advisers in its membership.

Nearly five in every six advisers (82%) said that their clients' commitment to green and ethical investment had not waned as a result of the financial crisis. However, over five in six advisers (85%) reported that it had affected the types of investments sought. In particular, they identified an increased emphasis on fixed income products. In addition, over five in every six advisers (85%) thought that transparency was more important now than it was prior to the financial crisis. The remaining one in six advisers (15%) thought that it remained as important as previously.

Annex B: Future Demand from Issuers of "Responsible and Sustainable Bonds"

Looking forward, we expect strong demand from issuers for efficient bond markets that recognise and reward superior environmental, social and/or governance (ESG) characteristics. Sources of demand include:

Integration of ESG Issues into Corporate Bond Rating and Assessment

- A range of UKSIF members already integrate ESG considerations into their fixed income investment selection and/or provide fixed income products specifically for ESG investors. The growing investor interest described in Annex A introduces opportunities for issuers with superior ESG performance.

Climate Change Mitigation and Adaption

Fixed income opportunities associated with climate change mitigation and adaption include municipal, social enterprise and corporate bonds to address capital needs for:

- Housing retrofit
- New energy infrastructure, including renewable energy and smart metering
- Transport infrastructure (high speed rail, electric car charging points)

Mutual and Social Enterprise Solutions to Societal Needs

Bonds for:

- Mutual and Social Enterprise competitors to listed companies. Well established examples include John Lewis Partnership, Bupa and mutual building societies.
- Affordable housing, eg. bonds issued by The Housing Finance Corporation.
- Provision of services such as health services using social enterprise models, including use of Social Impact Bonds³

²Details at http://www.ethicalinvestment.org.uk/cmsfiles/176956/EIA_TG_Report.pdf

³www.socialfinance.org.uk/downloads/press_releases/Press%20Release%20SIB%20Dec%2009%20FINAL.pdf