UKSIF
UK Sustainable Investment
and Finance Association

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Dear Commissioner Barnier,

Thank you for the opportunity to comment on the European Commission's consultation on the "Green paper on the long-term financing of the European economy".

Our response focuses on the issues raised in questions 1, 2, 4-8, 10, 11, 17, 18, 21, 23-26 and 30. Where it has been reasonable to do so, we have occasionally answered two or more questions together. The submission draws on consultation with some of our members, discussions with Eurosif – our partner at a European level – as well as our previous responses to: the Commission's consultation on *UCITS: Product Rules, Liquidity Management, Depository, Money Market Funds, Long-term Investments* in October 2012; the *Kay Review of Equity Markets and Long-Term Decision-Making* as commissioned by the UK Department of Business, Innovation and Skills in November 2011; the *Cox Review on the Impact of Short-Termism on British Business* that was commissioned by the UK Labour Party in August 2012 and the Financial Reporting Council's (FRC) consultations on the Stewardship Code in April 2010 and July 2012.

The issues of long-termism and moving to a more sustainable economic and financial footing have recently attracted comment from a wide variety of political decision-makers both in the UK and elsewhere in the wake of the financial crash. We believe there is an urgent need to restore public trust and legitimacy to financial markets as well as to reshape national markets to better provide the sustainable, long-term growth that is necessary for an economic recovery.

The UK Sustainable Investment and Finance Association (UKSIF) welcomes the European Commission's decision to "initiate a broad debate about how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment in Europe" along with their focus on long-term investment in its consultation on UCITS last year.

However, we feel that the Green Paper as it currently stands:

- Has an overly restrictive definition of 'long-term investment' and pays insufficient attention to the importance of environmental, social and governance factors in enhancing and protecting the long-term value of assets,
- Links insufficiently strongly to other key pieces of legislation that are currently in progress at the European level – doing so is vital for ensuring the stable, coherent policy framework necessary to encourage long-term investment,

- Does not yet fully highlight the importance of the role of incentivising asset owners such as mutual and pension funds to practice the good stewardship of assets,
- Could do more to recognise the progress and potential so far of voluntary and indirect codes of conduct – such as the UK's Stewardship Code – in encouraging movement towards a long-term and sustainable economy with the default policy 'solution' instead seeming to be regulation, which must be carefully designed in order to avoid market distortion.

About UKSIF

UKSIF supports the UK finance sector as a global leader in advancing sustainable development through financial services. We promote and support responsible investment and other forms of finance that advance 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.

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 250+ members and affiliates include pension funds, institutional and retail fund managers, banks, financial advisers, research providers, consultants and NGOs. For more information about UKSIF, please visit www.uksif.org.

Question 1: Do you agree with the analysis set out above regarding the supply and characteristics of long-term financing?

***And* Question 2: Do you have a view on the most appropriate definition of long-term financing?**

We were pleased to note that the European Commission's paper acknowledges the need for a shift in capital allocation towards the long-term and agree that this is necessary in order to restore trust in the financial system after the financial crash which began in 2007.

We also welcome the Commission's recognition in the *Europe 2020* growth strategy of the contribution of long-term investment to sustainable and inclusive growth including "investment in the low-carbon economy", as it is increasingly recognised that capital markets and an economic system which protect the environment are vital for the sustainable growth necessary to get Europe out of its current economic situation. For instance, the Confederation of British Industry (CBI) published a report, *The Colour of Growth*[1], in 2012 that demonstrated that in the UK alone, 'green' businesses provided a third of the UK's economic growth in 2011/2012.

However, we feel that the current definition of long-term investment as "the formation of long-lived capital, covering tangible assets (such as energy, transport and communication infrastructures…)" and that putting the "focus… on long-lived capital goods (such as economic and social infrastructure, buildings and R&D, education and innovation) is too narrow an approach.

Currently, the Commission's emphasis on e.g. long-term "asset classes" or "long-lived capital" as the primary characteristics of long-term financing fails to recognise that long-term finance and investment is a broader approach and one which emphasises attitudes, behaviours and the creation

[1] http://www.cbi.org.uk/media/1552876/energy_climatechangerpt_web.pdf

of financial markets which better serve the long-term needs of the end users of the market, including savers and companies.

As the world faces the challenges of environmental limits and associated social change, public capital markets operating in the long-term interests of companies, savers and society as a whole have a vital role to play in driving the massive capital reallocation needed to enable economies to respond. At the Rio+20 Conference, there was recognition of the fact that – in the words of Caroline Spelman MP, the then UK Secretary of State for the Environment, Food and Rural Affairs – "we face a twin challenge: to eradicate poverty and drive up living standards while living with finite resources. In my view, this can only happen by ensuring that we promote sustainable and inclusive growth…the world's economic activity must be green, it must be sustainable, and it must enhance societal progress. The green economy cannot just be a subset of the global economy, and it must be inclusive[2]".

UKSIF therefore believes that a key characteristic of any long-term approach to investment is the integration of environmental, social and governance (ESG) factors into long-term investment practices. This approach appears to chime with the EU's own definition of growth as set out in *Europe 2020* and we feel that the Commission's Green Paper is a missed opportunity to link the long-term financing of the economy with explicit recognition of ESG factors – a method pioneered by the sustainable investment industry throughout the EU over the last thirty years.

Currently, across Europe, investment is not being efficiently directed towards those sectors which – like green infrastructure – are necessary for delivering the long-term sustainable growth in those areas which will allow Europe to continue to compete in a changing global economy. An acknowledgement by the European Commission that capital markets need to change in order to enable companies and investors to better take account of long-term ESG factors in their decision-making would be welcomed and would fit better with the Commission's own definition of "inclusive growth" than the current proposals.

There is a growing body of evidence to show that companies with a strategic emphasis on long-term ESG issues show financial outperformance; one recent piece of research on this topic is *The Impact of a Corporate Culture of Sustainability on Corporate Behaviour and Performance[3],* a working paper from academics at Harvard Business School and London Business School which concluded that companies with a strategic focus on long-term ESG issues displayed a stock market and accounting value premium after three years. They found that the premiums continue to rise in further years.

This built on earlier research supported by the UNEP Finance Initiative Asset Management Working Group[4] which concluded that ESG issues are material and affect shareholder value in both the short and long-term.

[2] https://www.gov.uk/government/speeches/caroline-spelman-speech-at-the-world-we-want-to-see-a-christian-conversation-on-rio-20

[3] http://www.hbs.edu/research/pdf/12-035.pdf

[4] Eg. Linking Environmental, Social and Governance Issues to Company Value (UNEP FI, 2006) http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf

Question 4: How could the role of national and multilateral development banks best support the financing of long-term investment? Is there scope for greater co-ordination between these banks in the pursuit of EU policy goals? How could financial instruments under the EU budget better support the financing of long-term investment in sustainable growth?

Our members tell us that a key problem in private sector financing of large, long-term projects is the construction risk; in general large asset owners are conservative and do not want to be exposed to the risk of cost over-runs in large scale building projects. This risk also delays public sector projects. The result is that there is a tendency for large projects to be funded solely by the public sector and to be built later than is ideal.

The national and multilateral development banks and financial instruments under the EU budget could seek to play a role in sharing such risks between the public, quasi-public and private sectors. They could seek to change the equation from the current "publicly funded but slow to build, to mixed funded and more rapid". This would still leave public funds at risk in projects but they are at risk in the current model. If funds were to be co-mingled, a given quantum of public funds could be applied across more projects. This may require a public subsidy to the projects and might appear to offer subsidised returns to the private sector; the question will be whether the societal gains in increased long-term investment are deemed to warrant the financial costs.

We would draw the Commission's attention to the UK's Green Investment Bank. Although not yet allowed to borrow money on the capital markets which UKSIF believes dampens its effectiveness, the Bank has already shown some success in channeling capital towards green infrastructure and energy efficiency measures. We are hopeful that examples like the Bank and Germany's KfW might be developed elsewhere in the EU with similar levels of success.

Question 5: Are there other public policy tools and frameworks that can support the financing of long-term investment?

Although UKSIF feels that regulation can only achieve so much without causing undue market distortion and needs to be accompanied by an underlying shift in culture, feedback from our members indicates that there are several areas where public policy tools and frameworks could be instrumental in facilitating the financing of long-term investment:

Stable regulatory regimes that drive long-term competitiveness

EU-level policy has most potential to influence investors and corporate boards to focus on the long-term through its regulation of externalities – such as through its policies on climate change. This has widespread investor support. For example in October 2011, 285 investors representing over 20 trillion US dollars in assets stressed the need for effective climate policy action and a recent report by UNEP FI and others underscored the importance of "investment-grade" policy[5]. The report emphasised that long-term policy stability is critical and retroactive changes can significantly damage investor confidence. Similar points have recently been made regarding the UK's energy and low-carbon sectors specifically by a variety of green business and consumer groups[6]. These arguments

[5] http://www.iigcc.org/__data/assets/pdf_file/0019/15283/2011-Global-Investor-Statement-Press-Release.pdf

[6] See, for instance, www.r-e-a.net/news/letter-to-pm-and-dpm-urging-clarity-on-renewables-growth-and-support

apply at the pan-European level as well and have clear implications for EU policies on climate change. Business has every right to expect a stable and consistent regulatory approach.

The importance of boosting asset owner demand for long-term investment

Based on our members' knowledge and experience, one of the most important factors in re-shaping capital markets to better support long-term investment is the level of demand by asset owners for responsible investment practices.

Policy interventions to support this at a pan-European level could include:

- Guidance for pension fund trustees and other fiduciaries on the effective implementation of their fiduciary responsibility. The recent UK Charity Commission guidance "Charities and Investment Matters: A guide for trustees (CC14)" is a good example of such practical guidance. Furthermore, one of the most positive recommendations of the UK Government's recent Kay Review was its proposal that the Law Commission should review the legal concept of 'fiduciary duty[7]' as it applies to investment, in order to better guide trustees.
- Encouraging improved mandates, e.g. the International Corporate Governance Network has developed a long-term investment mandate template.
- Improved selection and scrutiny of investment managers. Investment consultants have developed manager assessment techniques and made recommendations on ways for trustees to scrutinise performance in responsible ownership and ESG integration. Greater use of this support is now needed.

Please see our response to Questions 21 and 22 on the role that a possible pan-European Stewardship Code (designed along the lines of the Stewardship Code in the UK) could play in stimulating greater shareholder engagement which supports long-term investment in the European economy.

Question 6: To what extent and how can institutional investors play a greater role in the changing landscape of long-term financing?

One debate currently ongoing in the UK is the extent to which institutional investors are willing to replace public funds in the financing of e.g. large infrastructure projects (including green infrastructure).

Our institutional members – both asset managers and owners – tell us that there remain significant barriers to responsible investment both at the UK and European levels. Some of these we have addressed in our answer to Question 5 above.

Research conducted by our partner organisation, Eurosif, in 2012 found that some large institutional investors are placing a proportion of their assets in sustainability themed funds or infrastructure – which would best align with the narrow definition of long-term investment currently proposed by the Commission – but the amounts are relatively small in comparison to the overall size of their portfolios[8].

[7] See Chapter 9: "Fiduciary Duty", Kay Review.
[8] Eurosif European Sri Study 2012, http://www.eurosif.org/research/eurosif-sri-study/sri-study-2012

However, there remains a role for institutional investors in financing long-term investing in the broader sense proposed by UKSIF assuming some of the barriers mentioned in our response to Question 5 above are addressed.

Question 7: How can prudential objectives and the desire to support long-term financing best be balanced in the design and implementation of the respective prudential rules for insurers, reinsurers and pension funds, such as IORPs?

The need for prudential regulation for financial institutions is clear, especially given the outcome of the recent financial crash, and this must necessitate some estimate of the risks inherent in long-term projects and investments. For good reason such investments may tend to be disadvantaged against those which are shorter-term in focus.

There has been comment on the possible impact of Solvency II on the investment portfolios of insurers (and certain UK pension funds if the principles come to be extended to them). We are aware that there are concerns from some of our members that the proposed capital requirements on infrastructure investments could reduce renewable energy investment by some UK asset owners.

We would urge that thinking be "joined up" in the area between the various regulatory bodies so that a co-ordinated approach is taken. The subject may well be linked to the matter covered in Q4 in that if a Government is involved in a project on a risk-sharing basis it may be appropriate for long-term projects to receive a lower risk rating.

This is a complex and specialist area. The Commission should ensure it is properly examined as it considers its proposals. The need for rapid action on long-term investing argues against a sequential process.

Question 8: What are the barriers to creating pooled investment vehicles? Can platforms be developed at the EU level?

Investment in long-duration assets is deemed to be 'unusual' by the Financial Conduct Authority (FCA), who recently held a consultation on "*Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes".* Although we appreciate the FCA's concerns about the exposure of ordinary retail investors to unsuitable investment products, we feel that the resultant FCA response was disappointing in that it failed to recognise that some clients have investment objectives which go beyond financial aims, such as investing in accordance with their values e.g. according to social, environmental and local concerns.

Although specific platform design goes beyond UKSIF's expertise, we would recommend transparency, labeling, consumer education, trustworthy distribution channels and the removal of barriers to good quality advice as the most appropriate responses to combating barriers to suitable pooled investment products.

Question 10: Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investing and how significant are they? How could any impact be best addressed?

Please see our response to Questions 5, 6 and 7 above.

Question 11: How could capital market financing of long-term investing be improved in Europe?

Apart from our answers above about the stability of any over-arching policy framework and the need to reshape capital markets so that they better support long-term decision-making and investment, this covers products, which are outside our remit.

We also feel that it is important to boost market demand for long-term investment practices and we cover possible approaches to this in our response to Questions 5, 6 and 7 above.

For further detail of UKSIF's policy positions on how to develop capital market financing of long-term investing, please see www.uksif.org. For a European perspective, we would also direct you to our partner organisation Eurosif's website: www.eurosif.org.

Question 16: What type of CIT reforms could improve investment conditions by removing distortions between debt and equity?

Although specific changes to corporate income tax reforms go beyond UKSIF's remit, we would encourage further consultation and discussion on the use of tax incentives – including those surrounding corporate income tax – to encourage longer term ownership, including consideration of the current differential corporate tax treatment of equity and debt.

Question 17: What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term saving in a balanced way?

The design of specific incentives is outside UKSIF's remit, but we would draw the Commission's attention to the desire by UK citizens to save in a way which includes some 'green' or 'ethical considerations, as demonstrated by the figures below, which resulted from research conducted by YouGov as part of National Ethical Investment Week 2012[9]:

- **55%** of UK adults with investments wanted their bank or financial adviser to tell them more about 'impact investments', i.e. investments that produce both a financial and a social or environmental benefit. This figure was an **increase from 36%** in the previous year.
- **45%** of UK adults with savings or investments want at least some of those investments to take green and ethical considerations into account, with **15%** wanting all their investments to do this.
- **46%** of UK adults want to put at least some of their investments into 'impact investments' such as social enterprises, which produce both a financial and a social or environmental benefit.

We agree with our partner organisation, Eurosif, that any tax incentives to promote long-term saving by individuals should be designed to cause as little distortion to the market as possible. However, we feel that designing tax incentives – in addition to other measures which boost e.g. ESG disclosure, transparency and stewardship – which support the market for sustainable investment and finance in Europe would be beneficial for promoting the long-term financing of the European economy.

Question 18: Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?

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[9] www.neiw.org

Further to our answer to Question 17, we understand from some of our members that France has seen some success with tax incentives for responsible finance regarding sell-side research. A recent report[10] was also published jointly by the French Ministry of Economy and Finance, the Ministry of Foreign Commerce, the Ministry of Ecology, Sustainable Development and Energy, and the Ministry of Work, Employment, Professional Training and Social Dialogue which suggested tax breaks for both responsible private equity and for the life assurance funds market, if parts of their investment are made sustainably.

Question 21: what kind of incentives could help promote better long-term shareholder engagement?

UKSIF has long advocated high-quality shareholder engagement, believing that it is essential for long-term wealth creation and protection as well as to meet the broader interests of society and so protect the continuing "licence to operate" of asset owners and their agents. We believe that the most appropriate incentives could combine some kind of pan-European Stewardship Code (to be designed along the lines of the UK's Stewardship Code, as set up by the Financial Reporting Council (FRC) in 2010) with other steps to harness the power of asset owners and change investment industry culture.

Our detailed views on the UK Stewardship Code can be found on our website[11] but we feel that any pan-European equivalent would need to clearly highlight the role of environmental, social and governance (ESG) factors in good stewardship; we believe that there are additional opportunities and challenges for responsible owners resulting from climate change, resource management and social sustainability drivers which must be taken into account in any attempt to boost long-term investment.

Since the introduction of the Stewardship Code in the UK in 2010, asset owners have been slower than originally anticipated in signing up to the Code – as indeed, they have been in signing up to the UN-backed Principles of Responsible Investment (PRI)[12]; regulation can only achieve so much but any attempts to boost shareholder engagement must harness the power of asset owners and change investment industry culture i.e. it must combine regulatory power with the "remunerative" power of asset owners and the "normative" power created by market commentators and civil society.

To this end, the success of any regulation will depend on genuine demand from pension funds and other asset owners which create commercial drivers for high-quality implementation; it has been a recurring theme from our asset manager members that it is easier to justify effective implementation of the Stewardship Code if there is a commercial incentive to do so from their asset owner clients. Therefore we believe that any Code should be combined with the measures we outline in our response to Question 5 on stimulating asset owner demand as well as measures to boost transparency and disclosure, as outlined in our response to Questions 24 and 25.

Question 22: How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

[10] http://www.economie.gouv.fr/files/rapport-brovelli-drago.pdf
[11] http://uksif.org/wp-content/uploads/2012/09/16072012-UKSIF_Stewardship_Code_Review_response_July_2012.pdf
[12] http://www.unpri.org/signatories/signatories/

Please see our responses to Questions 5 and 21 for our views on the role of asset owner demand in providing the commercial incentives for long-term investment strategies and relationships.

UKSIF members tell us that mandates and strategic use of investment management agreements can be effective tools in driving long-term approaches in the investment chain. For instance, the International Corporate Governance Network has developed a long-term investment template mandate which is widely considered to be a good example of its kind.

Please also note our response to Questions 24 and 25 in which we highlight the role of greater transparency and disclosure in incentivizing long-term investment practices by asset managers.

Question 23: Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

UKSIF feels that one of the most positive recommendations of the Kay Review in the UK was its proposal that the Law Commission should review the concept of 'fiduciary duty'[13] as it applies to investment in order to better guide pension fund trustees and other fiduciaries on the effective implementation of their fiduciary responsibility[14].

We would also draw the Commission's attention again to the usefulness of practical guidance, in addition to any legal clarification, for trustees and other fiduciaries; the recent UK Charity Commission guidance "Charities and Investment Matters: A guide for trustees (CC14)[15]" is a good example of this.

Question 24: To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?

***And* Question 25: Is there a need to develop specific long-term benchmarks?**

In our view, effective scrutiny and challenge within the investment sector and by civil society requires greater transparency in all parts of the investment chain in order to boost long-term investment. With this in mind, we welcome moves by the Commission to mandate disclosure of non-financial information by large companies.

UKSIF has long advocated[16] the need for greater corporate transparency regarding business strategies and key metrics to respond to environmental limits, social change and governance challenges. Investors require forward-looking and business-relevant strategies and metrics rather than boilerplate text and there is increasing evidence that incorporating environmental, social and governance information contributes to better investment choices and enhances long-term allocation of capital in the economy. Any such information must report environmental, social and community information in a way that identifies the material factors and key metrics needed for it to deliver value for investors.

[13] See Chapter 9: "Fiduciary Duty", Kay Review.
[14] See http://lawcommission.justice.gov.uk/areas/fiduciary_duties.htm
[15] http://www.charitycommission.gov.uk/publications/cc14.aspx
[16] For further UKSIF submissions on these topics, please see:

We would also draw the Commission's attention to the proposals and work of the Corporate Sustainability Reporting Coalition (CSRC) of which UKSIF is a member. The CSRC represents financial institutions, professional bodies, NGOs and investors with assets under management of approximately US $2 trillion and believes that "progressive companies understand that long-term value is enhanced by embedding long-term sustainability considerations into their business strategy and by fully disclosing their progress to investors"[17].

Question 26: What further steps could be envisaged, in terms of EU regulation or other reforms, to facilitate SME access to alternative sources of finance?

For a brief outline of the sustainable finance market in the UK and how it relates to alternative retail products, please see UKSIF's response to the UK Parliamentary Commission on Banking Standards' consultation on this topic, which is available on our website[18].

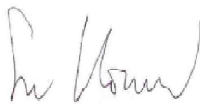
Question 30: In addition to the analysis and potential measures set out in this Green Paper, what else could contribute to the long-term financing of the European economy?

For more detail as to what has been happening in the UK markets and our views on the European-level developments relevant to sustainable investment and finance, please refer to our policy positions and our *Future of Investment* reports, all of which can be found on our website. We would particularly draw the Commission's attention to our:

- Future of Investment Report on Green Infrastructure[19]
- Response to the Commission's consultation on UCITS V[20]
- Submission to the UK Financial Services Authority (FSA)'s consultation on Unregulated Collective Investment Schemes (UCIS) [21]

We trust that our comments will prove to be self-explanatory but hope that the Commission will contact us should you require any further clarification.

Yours sincerely,



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[17] http://www.aviva.com/media/news/item/the-eu-in-2013-embedding-corporate-sustainability-reporting-15615/ Accessed 25th June 2013
[18] http://uksif.org/wp-content/uploads/2013/03/UKSIF-submission-PCBS-March-2013.pdf
[19] http://uksif.org/wp-content/uploads/2012/09/The_Future_of_Investment_-_Green_Infrastructure_June12.pdf
[20] http://uksif.org/wp-content/uploads/2012/10/Oct-Final-UKSIF-response_UCITS_181012.pdf
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