London, 19th August 2021

CDP Response to IOSCO consultation on Sustainability-related Disclosures for Asset Managers, Greenwashing and other Investor Protection concerns

Introduction

Dear Ms Tircoci-Craciun,

CDP welcomes the opportunity presented by this consultation, and we commend IOSCO’s effort in ensuring that sustainable practices are fully integrated in Asset Management, and the financial sector at large. Our overall impression is that the proposed recommendations represent a bold step in this direction and will be instrumental in the tackling greenwashing in the asset management industry.

We are pleased to offer the feedback below from our perspective as a global non-profit that runs the world’s environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with over 590+ investors with US$110 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Over 10,000 organisations around the world disclosed data through CDP in 2020, including more than 9,600 companies worth over 50% of global market capitalisation, and over 940 cities, states and regions, representing a combined population of over 2.6 billion.

Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero-carbon, sustainable and resilient economy. data powers the global ESG ecosystem and is incorporated into platforms like Bloomberg, MSCI, DJSI, and Euronext, among others. CDP is also a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative.

CDP’s work with financial regulators spans across a range of jurisdictions, including Brazil’s CVM and Central Bank, the US SEC, UK FCA and Bank of England, the Bank Negara Malaysia and the Hong Kong Stock Exchange.

Based on our experience working with financial institutions and regulators worldwide, I would draw your attention to the following key messages from our comments expressed in the CDP’s response to questions for consultation, in the appendix to this letter. Specifically, we would
suggest IOSCO to amend the proposed recommendations to reflect the following three key suggestions:

- **Recommend requiring disclosure of impacts of asset managers portfolios, in addition to sustainability-related risks and opportunities, and integrating these impacts, risks and opportunities into their decision-making process.**
  Greenwashing can only be eliminated if all the relevant actors (from regulators to asset owners, down to retail investors) have access to the necessary information regarding environmental risks, opportunities and impacts of investment products. CDP research shows that 49% of financial institutions do not conduct any analysis of how their portfolio impacts the climate at all.¹ This does not only increase the risks faced by asset managers (and in turn the whole financial system), but also impair the achievement of the Net-Zero commitments currently being undertaken by several governments.

- **Mainstream incorporation and disclosure of environmental-related considerations across the whole asset management industry, without distinction between asset managers that take sustainability-related risks and opportunities into consideration in their investment process and those that do not.**
  Creating two “classes” of asset managers based on their adoption sustainability considerations would be counterproductive to the end goals of combating greenwashing and steering the whole economy on a sustainable path, in order to avoid the worst effects of climate change and environmental degradation. The recently released IPCC special report further strengthens the message that the transition to a Net-Zero economy cannot be delayed any further.

- **Further strengthen the messaging around the importance of capacity building for asset managers.**
  CDP has a wealth of experience in providing its data and expertise to regulators and financial institutions worldwide. We would respectfully invite IOSCO to consider CDP as a knowledge and training partner to support further training on environmental disclosure and integration for asset managers.

These proposals aim at ensuring effective guidance needed to tackle greenwashing and allowing decision-useful information is provided to clients and other capital market actors. Our feedback is also intended to ensure that the recommendations are consistent with the need to take meaningful steps towards building a sustainable financial system. To that end, we have indicated the frameworks, standards, and other reference points which our stakeholders have found most useful in enabling financial institutions to meet global best practices.

We have also drawn from our database of environmental data submitted to CDP by over 300 financial institutions globally. The database captures the performance of FIs across the four pillars of the TCFD. This year, 181 asset managers worldwide have responded to CDP. We would be ready to support IOSCO’s endeavours by providing this data and would also welcome further discussion on how CDP disclosure system may be useful to IOSCO in further developing this and other guidance and recommendations.

For further context and a deeper analysis of the environmental-related risks, opportunities and impacts identified by financial services companies responding to CDP, please see our report [here](https://www.cdp.net/en/research/global-reports/financial-services-disclosure-report-2020).
The Time to Green Finance. Additional recommendations for policymakers and regulators to incentivize corporate climate action are captured in the recent brief The Time for Action is Now.

Sincerely,

Pietro Bertazzi
Global Director Policy Engagements and External Affairs
CDP
APPENDIX: CDP’S RESPONSE TO QUESTIONS FOR CONSULTATION

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?

In CDP’s view, the recommendations currently under consultation represent an encouraging starting point and should be strengthened in order to ensure that regulators adopt the necessary measures to tackle greenwashing in financial markets.

While we believe that TCFD represents a strong foundation for any disclosure mechanism, there are some limitations that we would like to highlight. In particular, the TCFD’s focus on risks and opportunities does not consider an important additional element to ensure the climate transition and meeting the much-needed Net-zero targets: that of the impacts of investment decisions on people and planet. For this reason, we believe that regulatory requirements should adopt a double materiality approach, similar to the one adopted by the EU SFDR (through the concept of Principal Adverse Impacts). A ‘double materiality approach’ leads to assessing environmental issues as material if either they can influence the development, performance and position of the company materially, or if the company’s activities have a material environmental or social impact. Recent research shows that 49% of financial institutions responding to CDP’s Financial Services Questionnaire indicate they do not conduct any analysis of how their portfolio impacts.

Secondly, as both the present IOSCO paper and other research (e.g. NGFS report on Bridging the Data Gaps) point out, there is currently a focus from regulators on climate-related issues (compounded by the relatively limited scope of TCFD-aligned disclosures). CDP research also shows that issues of deforestation and water security are generally assessed by fewer financial institutions in making investment decisions (nearly 70% of asset managers consider climate issues, whereas for water and forests the percentages are just above 50% and 40%, respectively).

However, the largest asset managers are universal, meaning they have exposure to every sector of the economy. Moreover, irrespective of their size, asset managers in certain countries (e.g. South East Asia or Latin America) will inevitably be more exposed to issues such as deforestation. The consequence of this is that portfolios can be exposed to, and impact on, environmental concerns far beyond climate change. Indeed, it is not a surprise that regulators in countries more exposed to wider environmental risks (such as Singapore) have adopted a wider lens, including issues such as biodiversity loss, pollution and land use change. This approach should be adopted by all regulators, who should recognise the interconnected nature of environmental issues, and the spill over effect that the investment choices of asset managers operating in their jurisdictions may have.

There is a strong business case for why the financial sector should care about nature – globally, the total economic value of ecosystem services is estimated to be between US$125 and 140 trillion per year.4 In 2020, the total potential financial impact of water risks reported to CDP was up to US$333 billion.5 These numbers paint a compelling case for financial institutions to consider nature in financial decisions.

CDP is planning to expand its questionnaires to include a full range of environmental factors, with the goal to accelerate global environmental ambition and driving action. Protecting natural ecosystems and the benefits they provide is crucial for retaining resilience. For financial institutions, this means covering all climate and nature-related risks, opportunities and impacts driven by their lending, investments, and insurance underwriting. As a first step towards that goal, forests-related metrics were piloted with a limited number of banks in 2020, with encouraging results.6 From 2021 the Financial Services Forests questionnaire will be extended to other capital market actors, including asset managers. Similarly, CDP is now engaging with the financial sector, including asset managers, to establish which water-related metrics should be included in disclosures of financial institutions.

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

CDP welcomes the use of TCFD as a basis for identifying the key areas. Our Climate Change questionnaire is fully aligned with the TCFD recommendations and specifically covers financial services companies, including asset managers (181 asset managers responded in 2020).

However, we argue that the recommendations could add further detail on how the TCFD recommendations apply to asset managers, following the TCFD’s own sector specific guidance. In particular:

- Governance: What are the specific sustainability-related governance responsibilities of the board and senior management and what is the relation to investment decision making? How do asset managers ensure there is the correct knowledge of sustainability issues at board and senior management levels?

- Investment strategy: Including a plan to transition their investments to be aligned with sustainability goals. For asset managers, being able to transition portfolios requires cooperation with asset owner clients and may require changes to existing mandates. In addition to investment strategy, strategy should also cover how asset managers intend to increase the proportion of investments they are managing which can be transitioned within existing client mandates. Practices and procedures involving scenario analysis are also important in aligning portfolios with climate goals, as is disclosure of the same. Further, engagement strategy is important in addition to investment strategy – it is well publicised that divesting often only moves carbon-intensive assets around rather than reducing real world emissions.

- Risk management: Processes and procedures such as investment due diligence.

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5 https://www.cdp.net/en/research/global-reports/global-water-report-2020
Metrics and tools: The recent CDP Financial Services Disclosure Report 2020 found that portfolio emissions are on average 700 times higher than their direct accountable emissions. The outsized share of financed emissions in an FI's emissions profile necessarily makes Scope 3 emissions an exceedingly material metric. However, the same review found that only 25% of disclosing entities report portfolio emissions. This lack of data and transparency suggests that financial institutions have yet to give sufficient attention to their portfolio emissions, even though almost all their climate risks and impacts are driven by the activities financed.

The lack of transparency around portfolio emissions has troubling implications beyond the performance of individuals financial institutions. The Network from Greening the Financial System, among others, has identified unaccounted for climate risk as a threat to the stability of the financial system as a whole and recommended that supervisors require regulated entities to identify vulnerabilities to climate related risks, which entails accounting for financed emissions. In this vein, supervisors like the United Kingdom’s Financial Conduct Authority have indicated that they intend to include measurement of portfolio emissions within their guidelines.

Other, more forward-looking metrics that can be useful to asset managers include a portfolio temperature alignment, and the proportion of investments in assets aligned with (or on a path to alignment with) sustainability goals.

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?

In CDP’s view, the risks connected to climate change and environmental degradation cannot be addressed in a silo. On the contrary, a whole-sector shift of the financial system towards sustainability is needed. For this reason, it would be counterproductive to limit these recommendations to asset managers that take sustainability-related risks and opportunities into consideration in their investment process.

Moreover, in order to limit climate change within 1.5°C and avoiding the worse effects of the environmental and climate crisis, a whole-economy shift to net zero is needed. Creating different requirements for asset managers not taking sustainability-related risks and opportunities into consideration in their investment process would risk creating emissions leakage, by limiting regulators' control over the financing of companies in high-emitting sectors. For example, recent WBA/CDP research shows evidence of a systemic lack of accountability and action by the largest 100 companies in the Oil and Gas sector, undoubtedly one of the most significant sectors for the low-carbon transition. Limiting regulation only to firms already considering sustainability-related risks and opportunities would leave those not considering these factors free to finance companies in these sectors, thus impairing the shift towards net zero.

Lastly, limiting the regulatory requirements only to asset managers already taking sustainability-related risks and opportunities into consideration in their investment process would risk inadvertently creating an escape route for those trying to escape these requirements.

With specific regard to disclosure requirements, data users may need to compare data of sustainability-related funds to the performance of traditional, non-sustainable financial products. Therefore, we believe that disclosure requirement should be extended to all financial
products, regardless of whether the asset managers openly take sustainability-related risks and opportunities into consideration in their investment process or not.

Lastly, CDP would welcome IOSCO’s recommendations to integrate a definitive point that, whilst considering the characteristics of the different local markets and regulatory frameworks, adopting environmental considerations does fall within the scope of asset managers’ fiduciary duty. Although already in 2005 the Freshfields Report stated that “integrating ESG considerations into an investment analysis [and in some cases beyond that] so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions” in many jurisdictions this issue has not yet been clearly settled. This discussion has recently been brought forward by yet another report by the same firm and extended to investing for sustainability impact. In this case, the report itself notes that the regulatory frameworks diverge between jurisdictions and calls for more support from policymakers and regulators.

Creating a clear link between the environment and asset managers’ fiduciary duties would at the same time support those that are already engaged in sustainable investment, while at the same time helping to push those that are not. It would also support regulators, who would be able to move from deciding IF environmental factors should be integrated into the investment process, to HOW these are being adopted. This would in turn help tackling greenwashing, by creating stronger incentives to properly integrate the environment in investment considerations.

This leads back to the issue of availability of data: as stated in CDP’s response to the European Commission’s Action Plan “Financing Sustainable Growth” investors with fiduciary duties that require them to ensure long-term, low-risk investment strategies do not encounter sufficient information on long-term climate-risk mitigation and adaptation strategies of the companies they invest in. Climate risks or opportunities that are unlikely to materialize over the next few years, but could be significant over longer horizons, tend to be under-priced or underappreciated by investors. This issue will be addressed further in our responses to the questions below.

**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?

In CDP’s view, on this issue regulators should follow the example set by the EU. Already now, the EU Sustainable Finance Disclosure Regulation defines two categories of sustainable investment products: those promoting environmental or social characteristics and those with environmental or social objectives, the latter being defined as ‘sustainable investments’.

Thresholds and criteria to be integrated in the different categories should take into account the characteristics of the different regions, while adopting a sufficient level of commonality to allow for cross-border investment. In this, the trend towards the creation of Sustainable Finance Taxonomies could be helpful. Sustainable Finance Taxonomies are currently on the
rise, with more than 50 being developed around the world, including a Common Grounds Taxonomy currently being developed by the International Platform on Sustainable Finance. These should form the basis of disclosure requirements for financial products.

As an example of how taxonomies can be linked to disclosure requirements, under the EU legislation, both products with sustainability-related objectives and those that promote sustainability-related characteristics must disclose their use of the EU Taxonomy, for the environmental portion of the product. However, the levels and types of disclosures are different for each, reflecting the different nature of the two.

CDP is working to align its questionnaires and databases to the requirements of the EU Taxonomy, thus supporting both asset managers and capital markets participants in complying with their reporting requirements, and EU regulators in verifying compliance.

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

CDP agrees with this recommendation.

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

In CDP’s view, over time labels are important to delineate between different requirements for different types of products and make verification and assurance processes clear and understandable in product marketing. This could help identify product providers, underlying/issuing companies’ and associated projects overall sustainability performance and make it easier for investors and their clients to understand exactly what the outcomes of each product are within the broader sustainability landscape.

Currently labelled products in capital markets fall into two categories:

1. Use of Proceeds instruments; defined as those aligned to the Green and Social Bond Principles or Sustainability Bond Guidelines or,

2. General Corporate Purpose instruments aligned to the Sustainability-Linked Bond Principles or the LMA’s sustainability linked loan principles.

One of the main concerns with the system at the moment is the focus on creating tools that are limited to defining ‘green’ financial products. This will only drive a small market which cannot absorb large capital shifts in the short term and will not deliver the holistic approach needed. We strongly recommend fostering a systemic approach: this means adopting a focus on tools and assessment that aim to drive change across all sectors and companies.

To broaden this to overall ESG, SRI, Transition (or similar) labels should mean that each label is linked to agreed jurisdictional principles that investors can look to in order to understand the objectives to which they are held.

For example:

An ‘SRI’ labelled product would need to have objectives that meet criteria showing both a social and financial return has been identified and is measurable in its performance.
An ‘ESG’ labelled product would need to align with jurisdictional regulations/ guidelines e.g. SFDR

A ‘Transition’ labelled product would need to show that there is alignment in underlying assets that with science based emissions reduction targets and provide an overall benchmark (absolute emissions reduction, implied temperature rise etc.) that it seeks to perform against. Care should be taken in any fund that markets transition to ‘Net Zero’ unless the ‘Net’ (i.e. emissions avoidance, abatement or capture + utilisation/ storage) can be clearly defined and linked to a respected standard.

All of these should be required to have 3rd party verification and assurance of claims/ performance. CDP believes that is not sufficient to have a label that can only indicate whether an investment fund is or is not environmentally sustainable. It is crucial to have a tool that measures to what extent a fund is well positioned toward the transition to a low carbon economy.

Climetrics is an ESG Data Initiative funded by EU that provides the world’s first and only climate rating for investment funds. It allows investors to find funds with strong climate or environmental credentials that are well-positioned in the transition to a low carbon economy. Climetrics measures the climate and environmental performance of a fund’s holdings, its asset manager’s governance of climate issues and its investment policy. Policymakers and supervisors can use the Climetrics fund rating, which provides a holistic assessment of more than 17,000 funds’ climate-related risks and opportunities and is used by institutional and retail investors, as well as individuals seeking an investment in Paris Climate Agreement aligned funds. The methodology is fully transparent.

Climetrics measures:

- **Transition** – helps investors choose funds that better support the transition to a lower carbon, climate resilient economy.
- **Materiality** – measures to what extend a fund is invested in companies with good management of material climate risks or opportunities.
- **Stewardship** – considers the level of public action taken by the asset manager to support climate disclosure and engagement in initiatives.

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

CDP agrees with the suggested areas of investment strategies disclosure. In our view, standardised disclosure against these areas is fundamental in understanding the nature of an investment product and its classification. Disclosures should make clear how a product aligns with its stated goals (Green, SRI, ESG, Transition etc.), the benchmarks it measures itself against and how it proposes to achieve them.

**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?**

CDP agrees with this recommendation as active ownership, engagement and in particular shareholder voting are a key way to achieve impact in the real economy. It is well publicised how divestment from carbon-intensive activities and assets, often ends up only moving carbon-intensive assets around rather than reducing real world emissions (see for example here). Therefore, engagement with portfolio companies to reduce their impact is key and
disclosures should address how engagement is aligned with sustainability objectives. Say on Climate is a powerful initiative that demonstrates the feedback mechanism shareholders can be to hold companies to account on their commitments, for example in the case of AENA.

Mandatory disclosure of voting records, which can be influenced by regulators and policy makers would be preferred to comply or explain stewardship codes. Even better would be a centralised register with all proxy voting records of all investment funds.

CDP is going to introduce a question into its reporting framework for financial institutions in 2022 on proxy voting policies and how they align in 2022.

**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?

CDP agrees with this recommendation, as it supports comparability and consistency in environmental data.

**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?

CDP would suggest that securities regulators and policymakers encourage the use of specific metrics and key performance indicators. A standardized approach would aid comparability between asset managers for asset owner clients.

There needs to be rigour in the indicators selected and the methods for calculating those indicators, and the choice of indicators should be agreed, for example during a consultation period with asset managers and clients of asset managers.

CDP would point out that some of this work is already ongoing in various fora including most relevantly the TCFD’s consultation on metrics and targets and IFRS work to develop international sustainability standards. CDP is deeply engaged in both those pieces of work.

We would suggest the following specific metrics are useful for asset managers:

- Assets under management invested in carbon-related assets (amount/proportion) (by asset class)
- Assets under management invested in assets aligned to the goals of the Paris Agreement (amount/proportion) (by asset class)
- Financed emissions (calculated using PCAF standard)
- Weighted average carbon intensity of portfolio
- Temperature alignment of portfolio

**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?
CDP suggests that periodic reporting should include both quantitative and qualitative sustainability-related information. With regards to the specific information disclosed, in addition to that already mentioned in the paper, we refer to the answer to Question 10 above.

**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?**

CDP agrees with the view expressed in this recommendation. We believe that a standardised terminology would increase certainty and reduce confusion among capital markets actors and retail investors.

Standardisation is part of CDP’s DNA. Indeed, CDP offers a disclosure mechanism which is informed by existing internationally accepted frameworks, recommendations and standards. CDP’s disclosure platform enables structured disclosures which leads to an instantly standardized data set that is being used by capital markets participants at unprecedented scale, as well as by regulators, governments, NGOs, and many other stakeholders.

CDP, despite not being a formal standard-setting organization (i.e. it does not have the same governance or due process as a standard-setter), plays a critical role both in informing sustainability disclosure standards, including the accompanying terminology, and in contributing to the evolution of standards and terminology over time. Through its questionnaires, CDP captures the fast evolution of sustainability topics and reflects evolving market needs, and therefore is a catalyst for innovation as well as standardized disclosures.

As a best practice, CDP and the initiatives that it sponsors, is part of, or works in close proximity with (such as SBTi and PCAF), use same terminology. For example, the three initiatives use a definition of Scope 1, 2 and 3 emissions developed by the GHG Protocol Corporate Standard.

For a further analysis of this terminology, as employed by CDP, we would point IOSCO towards our Climate Change questionnaire guidance and the accompanying Technical Note on Portfolio Impact Metrics for Financial Services Sector Companies.

PCAF also published a Strategic Framework for Paris Alignment with the aim to “provide clarity to financial institutions seeking alignment with the Paris Agreement”.

A specific point raised by the discussion paper (Chapter 5, section C) focused on the concept of “temperature alignment”. Regarding this particular term, CDP would point towards the Partnership for Carbon Accounting Financials (PCAF) Global GHG Accounting and Reporting Standard for the Financial Industry.

With regards to the IFRS work to establish a Sustainability Standards Board, cited in Chapter 5, section A of the document, CDP welcomes the work of the Foundation and is currently involved in the development. IOSCO can find our response to the December 2020 consultation at this link. In June 2021, CDP also provided comments to the public consultation on governance and suggested changes in the consultation for the creation of a separate board in charge of the sustainability-related financial standards.

Lastly, CDP welcomes the reference made by IOSCO to the work of the Alliance of Sustainability Reporting Organisations and its work on progressing towards comprehensive corporate reporting. CDP supports the notion of dynamic materiality expressed in the paper.
(Chapter 5, section E), and for this reason advocates for the disclosure of factors that go beyond what is directly financially material for enterprise value creation.

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?

Please refer to the response to question 12 above.

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?

CDP agrees with this recommendation.

In Latin America, CDP has developed a training programme called CDP Educacion. This programme was designed to satisfy the needs of the actors with which CDP works: investors, governments, firms and academic institutions. It provides firms (including financial firms) with courses on environmental issues and prepares them to disclosure on their environmental impacts through the CDP platform.

In addition, CDP operates within the framework of programmes such as UK PACT in several jurisdictions and regions, including Latin America (Brazil and Colombia), China, and South-East Asia (Indonesia and Thailand). All these programmes include a focus on capacity building for Financial Institutions on environmental disclosure, including TCFD.

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?

For further information, please see the response to question 14 above.