CDP
DISCLOSURE INSIGHT ACTION

CDP Europe's comment on the European Commission's proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amendment to Directive (EU) 2016/2341

Background

CDP welcomes the proposal which shall ensure that financial market participants that receive a mandate from their clients or beneficiaries to take investment decisions on their behalf would integrate ESG considerations into their internal processes and inform their clients in this respect. We further support the objective that ESG is integrated as part of the duties of financial market participants into investment advisory towards investors. This shall help investors compare the carbon footprint of investments, and - more importantly - the positive or negative impact of their investment on the low-carbon transition.

Climate change poses severe risks, not only for our society and ecosystems, but for our long-term investments and retirement. **Research shows that the returns pensions and savings depend on will be lower in a world affected by climate change than in an economy which has taken action to mitigate these risks and losses.** Investors increasingly want to consider the environmental impact of their savings and understand the impact climate change will have on their long-term returns.

Further, there is a lack of knowledge and awareness of the impact of finance that needs to be addressed. Climate change and environmental issues are cross-cutting areas while awareness and knowledge still are comparatively small among both, investors and their clients. This might also be due to investment risks related to climate change often materialize over longer time horizons. The ability of financial market participants, policymakers and other stakeholders to **understand the environmental impact and climate-related risk and opportunity of all investments** and to assess how much of total investments made in the European Union are in line with the Paris Agreement and a well below 2-degree pathway, is key to shift all investments towards financing a sustainable economy.

Key observations

1. Designing minimum standards for sustainable investments is welcome, but the process should not stop there but extend to all financial market participants immediately. To create a favorable environment for sustainable investments, it could even be counter-productive and the wrong signal to the market to only require "sustainable" investors to disclosure the impact of their investments on climate change and environment. This will distort the level-playing field of financial market participants and **does not incentivize sustainable investment practice**.

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2. The reduction of carbon emissions is an international agreement and requires net-zero emissions by 2050 at the very latest. Disclosure requirements regarding the impact on climate change of sustainable financial products only, do not live up to the **urgent need to measure and manage the impact on climate change and the environment of all investments**. It therefore should be a mandatory requirement for all financial market participants to provide pre-contractual transparency on all investments – regardless whether the financial product is claimed to be sustainable or not.
3. Considering the sustainability of investments only at the level of “economic activities” will not allow to understand the risks management, business model and strategy of the company undertaking these economic activities. The current definition of **‘sustainable investment’ lacks disclosure that allows to shift business models and thus the entire companies towards sustainability and to understand and manage climate-related financial risks.**

A harmonized definition of ‘sustainable investment’

The proposal on the establishment of a framework to facilitate sustainable investment (Ref. Ares(2018)2679973 – 24/05/2018) sets out the definition of “environmentally sustainable investment” as an investment that funds one or several economic activities that qualify as environmentally sustainable, defined as economic activities that contribute substantially to one or more of the environmental objectives and does not significantly harm any of the environmental objectives:

- Climate change mitigation
- Climate change adaptation
- Sustainable use and protection of water and marine resources
- Transition to circular economy, waste prevention and recycling
- Pollution prevention and control
- Protection of healthy ecosystems

These objectives are interconnected, such e.g. forests protection, which is formally included in “protection of healthy ecosystems” but is also a direct driver of climate change mitigation. Corporates' and financial market participants' disclosure needs to allow understanding these interlinkages.

Considering the sustainability of investments only at the level of “economic activities” will not allow to understand the business model and strategy of the entire company undertaking these economic activities. While large corporates can have business divisions that qualify as environmentally sustainable, they can at the same time undertake activities harming the environmental objectives. This might lead to a situation of stagnancy where corporates

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receive investment for both sustainable and unsustainable business activities equally, while no other steering mechanism drives the management to shift towards sustainable-only activities.

A harmonized definition of 'sustainable investment' must include disclosure at both, business activity level and corporate level, notably on governance where sustainability issues have board-level oversight, the business strategy with an objective to achieve carbon-neutrality by 2050 at the latest, metrics that are science-based and comparable within the sector, and targets in line with a well-below 2-degree global warming.

Transparency of investments

The Article 6 of the proposal requests transparency of sustainable investments, through providing on the website of the financial market participant a description of the sustainable investment target and information on the methodologies used to assess, measure and monitor the impact of the investments selected for the financial product.

- The place of the disclosed information

  Referring to Article 7 for the cases where this disclosure is not yet covered by other regulation and assuming that disclosure on the website cannot ensure effective delivery of information to investors: To reach pension beneficiaries, ESG and climate information should be disclosed in the annual benefit statement or letter. For other financial products, this information should be disclosed in pre-contractual documents such as the Key Investor Information Document (KIID) and the prospectus, as well as post-contractual documents such as the product fact sheet, website.

- The understandability of the disclosed information

  Article 6.1 should state that sustainability information should be disclosed in a way that is understandable by all types of investors, including informed retail investors. Disclosure should adapt to the audience and make use of simple, concise and clear language, avoiding acronyms and jargon where possible.

- The scope of transparency

  Our concern is that the disclosure requirements only apply to those financial market participants claiming sustainable financial products and services. This adds a reporting burden on the small group of those who move towards sustainability while not setting any incentive for the big group of financial market participants who haven't yet taken any action on reducing the carbon emissions of the investments they make.

  We believe that all financial market participants should be requested to disclose in line with Article 4 on all of the investments they make into financial products.

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Recommendations

1. To make all finance sustainable, we need transparency and the necessary information to **measure and manage the impact on climate change and the environment of all investments**. Therefore, it should be a mandatory requirement for all financial market participants to provide pre-contractual transparency on all investments – regardless whether the financial product is claimed to be sustainable or not.

2. To create a **favorable environment for sustainable investments**, there should not be introduced reporting requirements only for those financial market participants who make sustainable investments, but all financial market participants should be incentivized to become fully sustainable by requesting disclosure of the impact of investments on climate and environment mandatorily and comprehensively.

3. A **harmonized definition of 'sustainable investment'** must include disclosure at both, business activity level and corporate level, notably on governance where sustainability issues have board-level oversight, the business strategy with an objective to achieve carbon-neutrality by 2050 at the latest, metrics that are science-based and comparable within the sector, and targets in line with a well-below 2-degree global warming. This can be achieved by adopting the TCFD recommendations for disclosures relating to sustainable investments and sustainability risks.

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For further information

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