

OVERVIEW OF SOME QUESTIONS RAISED AT THE FRDO/CFDD SEMINAR OF 29/01/2019

I. **Good-quality, accessible and comparable ESG data provided by undertakings**

1. Institutional investors, asset managers and the FSMA believe that the absence of ESG information on issuers is an obstacle to sustainable investment.
At the European level, it has been observed that undertakings are still failing to make the disclosures that would make it possible to establish whether the four TCFD recommendations were being adhered to.
2. In France, the availability of data is not identified as a problem, because of article 173 of the energy transition act. However, the data obtained are not always comparable. In Germany, the data are provided on a voluntary basis , but there are efforts to ensure that they are comparable (the RNE's sustainability code).
3. These data must obviously be distinguished into those that relate to the account taken of ESG risks in an entity's activities, and those that relate to investment in ESG projects per se.
4. How can these data be obtained from undertakings?
 - Indirectly, via the incentive generated by investors who are subject to a duty to inform.
 - This cannot suffice. The incentive effect of the financial sector on undertakings is always limited.
 - A legal obligation is needed (European Parliament, 2008 UK Climate Law)
 - Non-binding directives expressing varied levels of expectation ("should disclose", "should consider disclosing", etc.) (TEG report).
5. The importance of a common language:
For the reporting system applicable to the financial sector and for the one provided for undertakings.
For the different types of financial products (including bank loans, sovereign bonds, etc.).
6. The information must relate to both ESG risks and ESG opportunities. Failing to seize an opportunity at the right time is also a risk. Both retrospective and forward-looking approaches are necessary.
7. Availability of good-quality data: a necessary but insufficient condition?
 - Article 11 disclosure regulation (EP amendment): provides for an assessment of the availability and quality of issuers' data on the capacity of financial players to integrate sustainability risks.
 - At EU level: launch of the process to evaluate the first batch of reports drawn up by entities that are within the scope of the directive on non-financial reporting.
 - Example of obligation in addition to the entity's duty of information: target setting. Traditional accounting principles may nevertheless obstruct this.

II. Do we need a “sustainability code” along the lines of the German code in Belgium?

1. Update on non-financial reporting in Belgium.
Existing legal regime: The directive 2013/34/EU on annual financial statements (the “accounting directive”) is applicable to all undertakings. This directive does not currently require disclosures on sustainability risks and performance, but the European Parliament has introduced an amendment that goes in this direction. The directive 2014/95/EU on the disclosure of non-financial information by certain large undertakings and groups (the “CSR” or “NFR” directive) only applies to large and listed enterprises.
There are also international standards (OECD, ISO 26000, etc.).
De facto: What are undertakings doing at present in Belgium? What non-financial reporting practices exist in Belgium?
2. Institutional investors and Belgian asset managers are calling for better non-financial reporting. Therefore, we must ask how this could be improved in Belgium:
3. Should this reporting be voluntary or mandatory?
4. If there is already a labelling system for financial products (e.g. the FEBELFIN label), what value is there in having a system for reporting and labelling/certification of undertakings themselves: an issue for investors, but also for the supervisory authorities ?
5. How can we obtain comparable information for investors ?
What can we expect of the new guidelines for non-financial reporting prepared by the European TEG (with KPIs aligned with the TCFD recommendations)?
Should there be a “sustainability code” along the lines of that developed by the RNE in Germany, which provides for “compliance declarations” in which undertakings disclose information on their strategies, objectives, measures, policies and risks? Performance indicators underlying the information provided ensure that these declarations are to some extent comparable.
6. Are Belgian investors calling for a certification or labelling system in addition to a simple reporting system? If so, how and by whom would this label be delivered?
7. Should non-financial information be available to the public, as under the German code? Should confidentiality and commercial secrecy be taken into account?
8. How can undertakings be encouraged to report non-financial information, even if it falls short of the ESG KPIs? The German code accepts “compliance declarations” even from those undertakings, provided that they give the reasons (“comply or explain”).
9. Too much information damages information. The German sustainability code is meant to be “user-friendly”.
10. Should we develop “integrated reporting”, and what does this concept mean?

III. Do the fiduciary obligation and due diligence include a duty to take account of ESG risks?

If not, would that be desirable?

1. Fiduciary obligation

The European Commission deems that “acting in the investor’s interests” also means taking account of ESG risks.

Under existing law, those managing other people's money are not necessarily in breach of their fiduciary obligation if they do not take account of ESG risks for reasons of profitability.

This is why, on 4 January 2019, the European Commission published two delegated acts intended to incorporate sustainability in investment advice: 1. an amendment to the delegated MiFID regulation, and 2. an amendment to the delegated IDD regulation (insurance-based investment products). A number of technical obstacles mean that, even with these regulations, the fiduciary obligation is no guarantee to investors that their ESG preferences will be taken into account.

2. The responsibility of institutional investors and asset managers in terms of transition financing cannot be limited to the fiduciary obligation; this is far too restrictive.

3. Due diligence

The European Commission thinks that due diligence includes an obligation to take account of ESG risks, but that this must be formalised in delegated acts (“level 2” of the regulation: rules adopted on the basis of proposals of by European supervisory authorities and simplified procedure for faster adaptation to new circumstances).

Under existing law, the “prudent person rule” with which financial market participants and pillar II pension funds (IORP) must comply does not necessarily include an obligation to take ESG risks into account.

The same goes for insurance companies (prudent person principle, article 132 of the Solvency II directive).

IV. Taking account of ESG risks and opportunities (action type 1) vs integrating the ESG in an investment strategy (action type 2)

1. Most speakers distinguished between these two types of action. Financial players are much more likely to carry out type 1 than type 2 actions (e.g pension funds).
2. There are a number of reasons for this:
 - The perception that there is a lack of sustainable projects to finance
 - The link between type 1 actions and financial stability: these actions can be controlled by the supervisory authorities, in particular since the G20’s TCFD published its recommendations
3. This distinction can become less clear-cut if we think that the failure to grasp, in a timely fashion, the opportunities opened up by the financing of the

transition also constitutes a financial risk. Perhaps more consideration should be given to this topic, in conjunction with the mandate of the supervisory authorities?

V. The question of return

1. Pension funds need return on investment to provide their members' retirement income. The FSMA's survey of Belgian pension funds suggests that for some, return is more important than ESG factors. In that case, ESG factors will not be taken into account unless they have no negative impact on return. The FSMA also indicates that other pension funds don't take ESG factors into account at all when setting up investment criteria.
2. Under current legislation:
 - Pension funds can take account of ESG factors in their investment decisions, but they are not obliged to do so. More precisely, Article § 1b) of the directive IORP II provides that "within the prudent person rule, Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social and governance factors".
 - pension funds can always call on the prudent person rule to justify a failure to incorporate ESG factors. However this does not mean that pension funds using that argument are not interested by ESG. They may simply face challenges in taking ESG into account in their investments because the supply of ESG products is insufficient, because they do not know these products, etc.
3. The Belgian pensions sector believes that it is already proven that ESG has no negative impact on return (the sector refers to the risks of stranded assets but not to investments in sustainable projects) but that people are still unconvinced.
4. Return in the sense of a guarantee of stable revenues generated by a project must not be a primary consideration for investment in infrastructure projects, because these must benefit us all.

VI. Questions specific to the insurance sector

1. In Europe, insurance companies are the largest institutional investors. The sector therefore has genuine influence over the direction of the economy, and can make a difference to the financing of the transition.
2. One of the items in the European Commission's action plan of 8 March 2018 is "fostering sustainable corporate governance and attenuating short-termism in capital markets" (action 10).
3. The Belgian insurance sector believes that the capitalisation requirements for insurance companies are disproportionate to the risks covered ("value at risk"). They are over-valued because of artificial volatility (market consistency principle) and this feeds back into the capital requirement. The sector is not calling for a reduction in capital requirements, but for these to be adapted to the real risks. The Solvency II directive and the accounting standard IFRS 17

should be amended to align the accounting for responsibilities with the accounting for investments.

4. The rules under which directors are supposed to act in the long-term interest of the undertaking need clarification (Solvency II, article 132: the Prudent person principle).
5. It would appear that asset managers acting on behalf of insurance companies work with too-rapid portfolio turnover rates and too-short holding periods for capital securities (high frequency trading). This compromises the long-term investments required to finance the transition. Might redefining the concept of fiduciary obligation be an answer to this problem (see section III above)?