Brussels, 22 January 2018
B-15

EACB Comments on the

EC Public consultation on institutional investors and asset managers' duties regarding sustainability

January 2018

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

For further details, please visit www.eacb.coop

Introduction

The European Association of Co-operative Banks (EACB) is closely following the work of the High Level Expert Group on sustainable finance as this is a very important workstream for the EACB members due to the fact that co-operative banks, being local and regional banks, play a key role in sustainable financing. This is via sustainable investments or savings products, energy transition project financing, green financing to SMEs and energy efficiency financing of private and public buildings or via their social mission: reinvesting significant portions of available profits back into the community. Some co-operative banks are leaders in green bonds.

In this context we have taken note of the EC Public consultation on institutional investors and asset managers' duties regarding sustainability. At this juncture, the EACB has not provided individual responses to the questions as we believe that other industry associations and market participants are better placed to address the detailed questions raised in the EC Consultation. However, we would like to share with you some overrarching observations of the EACB members on this issue.

Key messages

- **Duties of care, loyalty and prudence alerady embedded in the EU's financial framework and sustainability factors are increasingly being integrated in investment processes**

As the EC aknowledges the duties of care, loyalty and prudence are embedded in the EU's financial framework governing obligations that bank, investment firms, institutional investors and asset managers owe to their clients, end-investors or scheme members. Indeed, relevant provisions are already included in wide variety of legislative pieces such as MiFID (II), UCITS, AIFMD, Solvency II and IORP II and investment entities are already legally required to act in the best interests of their clients.

As part of this duty, financial institutions and investment entities increasingly seek to integrate sustainability factors -where such integration is relevant and material- in their investment process and decisions and to monitor and mitigate their risk where necessary. Sustainability factors can serve as an important parameter for evaluating the long-term performance of companies and projects and their consideration -where appropriate- ensures acting in the best interest of clients and protect clients' investments over the long-term.

In particular, co-operative banks are based on lasting relationship to private customers and enterprises that is naturally long-term orientated. Their success depends strongly on the economic, ecological and social wellbeing of their operating area. This naturally leads intermediation by cooperative banks to more likely meet economic and social sustainability requirements.

This is why from a co-operative, retail and locally focused institutions' point of view, we think that it is important to highlight the fact that "sustainable" finance is already being carried out in Europe through banks' balance sheets, mostly putting deposits at work for the benefit of the real economy.

- **The impact of integration of sustainability factors on the financial return cannot be overlooked. Financial institutions cannot act in isolation, rather the whole economy needs to be directed towards sustainable finance.**

This said, fiduciaries in general may (seek to) integrate sustainability factors in their investment process and decisions, but this is always subject to 2 additional conditions namely (1) this is intended and supported by their clients (2) the impact on the financial return – in particular when it results in significant financial detriment.

In this context, it is also important to consider the differences between the role, influence and purposes of the different actors in financial markets – in particlar between asset owner/clients and the intermediaries i.e. those managing the assets entrusted to them with a view to protect and enhance them - when looking at their respective financial decision-making. Clients and asset owners are the ones to ultimately set their sustainability objectives and wishes. The whole economic system and all participants across the markets need to be directed towards the sustainable finance.

- **No reason to further legally prescribe in a rigid manner the incorporation of sustainability factors in institutional investors and asset managers' fiduciary duty.**

Given the current environment, the EACB does not necessarily see the reason to further legally prescribe in a rigid manner the incorporation of sustainability factors in institutional investors and asset managers' fiduciary duty. We fear that a mandatory legal requirement could prove counterproductive, as there is a danger of over-simplification of a very complex issue with different dimensions and with sustainability considerations evolving overtime. This should not become a tickbox excercice but allow felxibility and proportionality. Any one-size fits all approach would limit the possibility to act according to specific investors' situation and would introduce aspects of a planned economy into a market economy. This is all the more so considering that there is no common taxonomy for sustainable assets established yet.

- **Not in favour of policy options regarding risk management and governance arrangements**

Asset managers have different investment strategies and risk management models so a top–down framework could homogenise fund offerings for investors and limit competition. Requiring disclosure, but not a standardised model, will allow asset managers to design an approach that fits their investment mandate and strategy, leading to better integration of sustainability in their offering. Therefore, policy options regarding risk management and governance arrangements are not to be preferred.

You will find below our proposals:

- **Adequate level of Transparency**

What would be desirable is to have appropriate level of transparency around the integration of sustainability in the investment process of asset managers. The market-lead Principles for Responsible Investment (PRI) are relevant in that regard.

- **Capital Requirements reduction are relevant to the extend that the are linked to the credit risk perspective**

Capital requirement reductions are also relevant incentives to longer-term sustainable financing: in particular, we support green adjustments correlated to lower risk such as the EeMAP initiative that relates to green mortgages. We encourage the HLEG and the European Commission to advance in such direction. In general, we invite the EU to assess the risk, based on market practice data, to ensure the alignment of capital allocation with the credit risk perspective. Any "green" or "brown" adjustment of capital requirements that would distort capital allocation without taking into account a risk perspective, should be avoided.

Moreover, the porposed capital treatment of specialised lending and long-term financing is not conducive for a growth of investment in this area. One of the key factors that may impact the flow of funds towards project finance/structured finance deals and long term lending is the direction of the credit risk reforms currently being finalised at Basel. The Basel proposal to replace internal models for specialised lending with the risk weights of the USA (which depending on the final package would also floor the IRB banks) or the slotting approach is too restrictive and would not be risk sensitive enough for this bespoke type of financing. In that context the calibration was overly punitive compared to the low loss rates observed.

- **Flexibility and proportionality necessary in promoting sustainable finance**

All sustainability factors could be relevant for investment entities, but their relevance and intensity might vary across sectors and activity and evolve over time. There is significant work when it comes to environmental issues. For example the green bond market has developed dynamically in recent years, also supported by green bond principles introduced and updated by ICMA. In general, EU standards could accelerate such development as long as there are not too strict guidelines/frameworks and that will focus on minimum reporting obligations. Keeping the flexibility and proportionality principles in mind, is an important point.

- **Social aims are also key for sustainable finance**

In particular, we believe that employment, social inclusion and affordable housing should be priorities. As it is the case with environmental issues, an accurate but simple (and with some degree of flexibility) taxonomy has to be developed.

- **List of priotities**

In our view, the EC should focus on the following priorities:

- Developing a common taxonomy for sustainable assets with minimum standards
- The creation of market opportunities (private capital in public projects)
- Awareness raising and creation of an (investors) culture towards sustainable finance

- **Geater emphasis shall be put on the retail side of sustainable financing**

Having said that, the European Commission and the international initiatives are often too focused on the capital and asset management side. We believe that a greater emphasis should be put on the value that local and regionally oriented banks such as cooperative banks can bring to sustainable financing by providing a series of tools and policies that are conducive the continued existence of such banks that can finance green growth in the regions via SMEs, households and local actors. This should be a priority in the further steps of the European Institutions in which cooperative banks would like to be closely involved.

Contact:

The EACB trusts that its comments will be taken into account.

For further information or questions on this paper, please contact:

- Ms Marieke van Berkel, Head of Retail Department (marieke.vanberkel@eacb.coop)
- Ms E. Bevilacqua, Head of Communication (e.bevilacqua@eacb.coop)
- Ms Ilektra Zarzoura, Senior Adviser, Financial markets (ilektra.zarzoura@eacb.coop)