UNITED NATIONS EENVIRONMENT PROGRAMME FINANCE INITIATIVE COMMENTS ON THE EUROPEAN COMMISSION'S GREEN PAPER ON THE LONG-TERM FINANCING OF THE EUROPEAN ECONOMY (JUNE 2013)

1. INTRODUCTION

We thank the European Commission for having launched this consultation and are pleased to respond to the questions it put forward in this regard, with the overall aim to support the Commission's efforts to put the EU back on the path of sustainable and inclusive growth. Caring about long-term finance is looking beyond the stabilisation phase in our financial regulatory reform.Founded in 1992 and based in Geneva, Switzerland, the United Nations Environment Programme Finance Initiative (UNEP FI) was established as a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector, to recognize the links between financial institutions and environmental, social and governance (ESG) challenges and to identify, disseminate and help implement best practices of integrating sustainability in financial institutions' operations. UNEP FI's members recognize sustainability as part of a collective responsibility, and support approaches to anticipate and prevent potential negative impacts on the environment and society.

UNEP FI's vision of a sustainable world economy that is supported by an equally sustainable financial system is reflected through its motto, 'Changing finance, financing change'. Financing sustainable development is both about promoting the integration of sustainability issues into mainstream financial systems and financial institution decision-making (changing finance) and mobilising private finance to make the economy more sustainable (financing change).

When it comes to sustainability in finance, long-term is a key factor, either in the allocation of funds, the patience of the actors, or the horizon to consider the externalities or impacts, positive or negative, of financial decisions. Long-term relates to how the financial system operates, as well as to what is financed, and how. Long-term is a challenge for governments and regulators, and for financial institutions themselves. UNEP FI acts as a stakeholder convener on the topic of sustainable finance, recognizing that the transition to a sustainable, inclusive and green economy requires the alignment of financial sector activities with the long-term needs of sustainable development. UNEP FI is increasingly facilitating dialogue between finance institutions and policy-makers across the world, to scale up the inclusion of long-term considerations in policies that are relevant for finance institutions and beneficial to society at large.

Today, UNEP FI works closely with over 200 financial institutions from the banking, insurance, and investment industries that are Signatories to the UNEP FI Statement, and a range of partner organizations in coordinating Sustainable Finance. This involves setting global standards and principles, pioneering research and tools, building capacity and engaging stakeholders to advance sustainable finance. Given the high proportion of European Union (EU) -based finance institutions in UNEP FI membership (32% in June 2013), the diversity of profiles of finance instutions that it represents, and the importance of the long-term considerations in the promotion of its mission, UNEP FI felt that it could bring a fair contribution to the consultation launched by the European Commission on the Green Paper on the long-term financing of the European economy, after consultation of UNEP FI members.

As an introduction, we would like to highlight that :

- We share the Commission's view that a revised framework is needed to allow the development of long-term finance and promote fund allocation towards certain classes of assets, both by traditional long-term investors, such as institutional investors, and mainstream finance institutions, to mobilize the necessary mass of funds needed for the transition to a sustainable economy and change the current systemic behaviour of short-term financial decision-making.

- **Having more long-term allocation of funds does not however guarantee that these funds will support sustainable projects or goals**. **We would like to invite the Commission to consider long-term and sustainability as two themes which need to be approached as interlinked**, **in order to reach quantitatively and qualitatively the targets for an inclusive and sustainable European economy**, hence establishing the connections between policies and the kinds of financings required to deliver sustainability. Our suggestion would be that the current Green Paper places more emphasis on sustainable finance issues, explaining how long-term financing integrates environmental, social and governance issues, compared to the prominence attached to capital adequacy, financial regulation, tax regimes, savings incentives, etc. All these are important aspects of the current problem of short-term financing, but they are not sufficient by themselves to deliver the needed reform. In this sense, it would be welcomed that the paper suggests mechanisms to encourage capital flows to commercial activities with an environmental and social benefit, and away from those which might increase environmental degradation.

- Eventually, long-term in finance as the opposite of short-termism traditionally applies to very long-term assets such as infrastructure, where a huge demand for investment is needed. Neverthless, all asset classes, companies, issuers and end-users would benefit from a longer-term orientation of financial market and institutions, and a framework focusing more on long-term global performance rather than on short-term results.

- In our view, **climate goals such as Europe 20/20/20 targets and financial regulation, in particular on long-term financing, need to be connected**. The EU has taken a leading role in facilitating the implementation of sustainable development practices, specifically in pursuing a low carbon, energy efficient long-term energy supply. Within this framework, we believe that the long-term strategic finance need should be addressed to be able to achieve the goal set by the EU 20/20/20 Strategy. The EU's climate and energy goals are estimated to require investments of around 1.5% of GDP per year. The banking sector and capital markets will be crucial to provide a large share of the needed funds. The new financial regulations currently put in place for banks and insurers might impact the supply of capital for low carbon investments, precisely when there are attempts to develop a market for low carbon infrastructures financing and bonds.

Based on the above considerations and with the aim to provide a response that reflects the issues that UNEP FI sees at the core of promoting long-term finance, UNEP FI chose to provide comments on a selected series of questions out of the thirty proposed by the European Commission.

2. THE SUPPLY OF LONG-TERM FINANCING AND CHARACTERISTICS OF LONG-TERM INVESTMENT

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

We globally agree with the analysis made. We would add to the list of providers of long-term finance public long-term investors. Some of them are members of UNEP FI as well of the Long-Term Investors Club.

2) Do you have a view on the most appropriate definition of long-term financing?

We suggest to the Commission to consider the following additional elements for defining long-term financing:

- Finance system/parties behaviour and the inclusion of sustainability in financing:

UNEP FI uses the term 'Sustainability / Sustainable Finance' when referring to the approach taken by financial institutions with regard to their business conduct. This approach reflects awareness of the extent of the financial sector influence and impacts at both social and environmental levels, taking into account governance issues, and a business strategy aligned with long-term development goals. **In our view, long-term finance can not be fully qualified as long-term if not sustainable, i.e. if it does not integrate ESG considerations**.

UNEP FI believes that **financing a sustainable development or growth is not just about mobilizing capital for socially and environmentally responsible projects, or over a long-term horizon, but that it is also about making sure that financial services and transactions are conducted in accordance with sustainable development principles**. Therefore long-term as sustainable financing means both 'changing finance', or the way finance operates, and 'financing change'. These two aspects reflect the engagement of UNEP FI members and its global objectives.

Long-term finance does not necessarily mean a buy and hold strategy, but rather assessing returns over long-term when building portfolios. It would mean a patient atttitude of the investor, the consideration of the ESG aspects in project assessment, as well as involvement as an active owner. The Organisation for Economic Co-operation and Development (OECD) definition of long-term investment as " patient, productive and engaged" captures that aspect.

- Asset and liability related:
  Having long-term assets implies having stable - if not long- liabilities, in order to be able to manage such assets without excessive liquidity risk.

- Consistency between the financing term and the financed asset life:
  Long-term finance could be defined by refering to the consistency between the investment horizon and the life of financed assets, rather than by the sole number of years of the financing. Long-term finance means both a long-term horizon and investment in long-term productive assets.

Globally, in UNEP FI's view, long-term finance and sustainable finance need to be as connected as long-term and sustainability.

3. ENHANCING THE LONG-TERM FINANCING OF THE EUROPEAN ECONOMY

3.1. The capacity of financial institutions to channel long-term finance

Commercial banks

3) *Given the evolving nature of the banking sector, going forward, what role do you see for banks in the channelling of financing to long-term investments?*

We support the fact that the paper makes a clear distinction between investments in the productive or real economy and investments between actors of the financial sector, with the former having much more positive effects for economic growth and job creation.

Banks are unlikely to make significant long-term investments, therefore we agree with the analysis that the EU should be focusing its attention on other providers of capital, or other ways to involve banks in the development of long-term financing solutions.

While we recognize that there is a trend towards less bank intermediation, the financial expertise and the risk assessment capacity of banks, as well as their local presence and relationship with clients or end-beneficiaries of finance are strong arguments in favour of **banks still being needed as**

intermediaries. Banks can play a significant role in long-term financing, if they find an attractive risk/reward ratio while taking financial decisions.

As the Commission is willing to foster long-term and sustainable finance, the channelling role of banks should be made more selective, to contribute for instance to the goal of making the transition towards a more sustainable and energy efficient European economy. Heavy risk is currently embedded in "unburnable carbon" which constitutes oil and gas companies assets, and their reserves. We could imagine a legal framework to divert investments from short-term perspectives into long-term ones. Climate change mitigation and increasing long-term adaptation will need a political decision to make long-term investments in some industries more attractive. Low-carbon energy infrastructures, buildings retrofits or deep renovations, green cars, urban mining, reduced use of materials for unit of output all require upfront investment for a medium/ long-term benefit and are thus not attractive from a short-term perspective. It could be envisioned that banks channel financing to long-term investments where long-term investors could not go, and this is encouraged. As examples: 1) they could be incentivised to finance granular projects, within the framework of national plans such as those required under the Energy Efficiency Directive; banks would finance a large number of housing energy efficiency loans, before such loans are pooled to be turned into a marketable product corresponding to the appetite of institutional investors; or 2) for project finance, once the framework is in place to entice institutional investors to invest significantly in such assets, banks could be the lenders during the construction period until cash flows are stabilised and the loans refinanced by long-term bonds; this already exists in project finance, but what is at stake here is the issue of scale and significant and rapid mobilisation of funds, in a "post-crisis" environment, characterized by risk aversion and deleveraging of banks' balance sheets.

This should be appreciated in a differentiated way for core and periphery countries in Europe. For the latter, the heightened policy risk resulting from the sovereign pressures makes it difficult to obtain capital, even more so for new types of projects, such as low carbon ones.

National and multilateral development banks and financial incentives

4) *How could the role of national and multilateral development banks best support the financing of long-term investment? Is there scope for greater coordination 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?*

We suggest that public long-term investors with a general interest mission be added to the category of targeted actors, although their activities finance the economy more broadly than development banks. Illustrations of how they support best the financing of long-term investment are: investment in the development or structuring of sectors with low or slow financial return (environment, or climate change ones) yet economically viable, or those presenting a high risk profile (innovation); or the provision of risk enhancement mechanisms such as equity, quasi-equity, or garantees, making a project attractive enough for private investors to join. They can also support the long term development of the economy through the ability to hold their assets or even reinforce their investments during a period of crisis, in order to play a countercyclical role, thanks to their balance sheet structure with liabilities available over long-term.

Is there scope for greater coordination 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?

The role of development banks needs to be broader than the current focus, principally on project bonds for some of these banks. Development banks **can play significant risk mitigation** roles and, perhaps more importantly, foster new infrastructure investment models which will make long-term investment more attractive for institutional investors. The current typical infrastructure investment vehicle follows the model of the private equity industry, highly leveraged and with fee structures favouring the investment team rather than the capital provider and main risk taker. Development banks could play a role in assisting investors to develop an infrastructure investment model which matches their interests better, by allowing unlevered access directly to the assets.

European long-term public investors also have the skills to structure financial instruments. Their contribution to the implementation of EU policies could be optimized through a better coordination between all public actors involved in the creation of innovative financial instruments.

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

EU and national public policy measures to support long-term investment must be stable and reliable, and in particular **there should be no scope for retrospective changes. Investors require a clear and long-term signal from policy makers, otherwise long-term investment will remain too risky to be attractive.**

In addition, in order to support the development of new markets for new long-term assets, and drive financial institutions towards these assets, such as the low carbon ones, a certain risk sharing with the creation of support-dedicated programmes by the public sector could only help, for instance by taking a first-loss position in order to lead banks into new sectors. This should only apply to assets actually contributing to sustainable long-term economic value.

Different national subsidy schemes are also very likely to hinder the creation of a positive impact investment environment.

Other tools which should be considered are:

- Public Private Partnerships (PPP), to attract private funds. These partnerships are typically complex and takes time to structure, therefore a standardisation in the risks assessment and sharing between public and private partners, as well as for the valorisation and reporting methodology, would be welcome. As such instruments are currently illiquid, the creation of a secondary market could be envisioned, in order to attract investment funds. Public guarantee mechanisms to cover the financial risk of PPP could be investigated;
- Outside PPP, partial guarantees or co-investments of public funds with private banks, which would help expand the volume of long-term projects financed;
- The stimulation of new markets, e.g. energy efficiency retrofits applied to public buildings, allowing to train workforce, and consequently enable a larger scale application, with lower entry costs or "green" technical skills barriers;
- The creation of European long-term investment vehicles with a framework adapted to long-term specificities (fiscal, prudential and accounting), and favorable to it;
- The facilitation of direct foreign long-term investment; and
- The possible creation of a European savings account.

Institutional investors

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

Currently, long-term financing does hardly come from banks. Disintermediation is progressing, but capital markets are not mature enough to take over and fulfil that role. This is why institutional investors (insurance companies, pension funds, long term public investors, etc.) are needed to provide long-term financing, and lead the creation of long-term markets, which can only develop if there is both supply and demand for long-term finance.

Institutional investors are willing to make long-term investments which more fully reflect the time horizons of their beneficiaries and match the duration of their liabilities. They will be able to do so most effectively if:

- Regulatory regimes reflect the long-term nature of their liabilities and so enable them to look through short-term volatilities in asset values;
- Asset owners are enabled and encouraged to assert their status and responsibility at the beginning of the investment chain, and ensure that their agents act more fully in their interests, delivering investment with appropriate attention to the time horizons of beneficiaries and long-term risks;
- Fiduciary duty encompasses issues which are about long-term value, and not just short-term returns and applies to all participants in the investment chain, without the possibility of exclusion through contractual means;
- New models of investment mandate[1] which press fund managers to adopt their clients' and beneficiaries' long-term perspectives and see risk and returns from their perspective, are introduced and encouraged.

The absence of a post-2020 EU low-carbon policy framework increases the uncertainties for investors at the time when they are invited to consider increasing their multi-decade investments.

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?*

We are concerned that the balance between prudential rules and encouraging long-term investment has gone too far in the direction of prudential rules. Insurance companies and pension funds are being more aggressively regulated since the crisis, with prudence being the main aim. We argue that the focus on the need for short-term liquidity is in fact more negative for financial stability because life insurers and pension funds as long-term investors could, in the absence of prudential rules pressing them into more liquid portfolios, invest counter-cyclically and be a counterbalance to short-term market volatilities. They currently do not fully play this role, as prudential rules prevent them from being able to do it, constituting a detrimental factor for long-term investment.

Re-/ Insurance companies are large investors that need to invest into stable and long-term assets. Infrastructure is one of the asset classes they use. The current version of the Solvency II Directive considers infrastructure and renewable energy investments as higher risk and requires a risk capital set aside of about 49% (equalling the asset class of private equity). In comparison, real estate investments are considered as lower risk and require only 25% of risk capital set aside. Here, **a strong initiative would be required to adjust the current outline of Solvency II so as to remove this barrier to infrastructure investments.**

Once prudential rules have been defined starting from the risks on the assets side, consideration must be also given to the liabilities side, covered by various regulations : a) for banks, with clients deposits and short-term debt as liabilities, regulation focuses on short-term liquidity risk and short-term market risks; and b) for insurance companies having mostly liabilities towards their insured clients, regulation concentrates on their short/ medium-term solvency and the proper matching of financial assets with liabilities.

It would seem highly wishable that the prudential model of financial risks acknowledges the positive role of long-term liabilities. Such liabilities cost more than short-term ones. Therefore, without taking other considerations into account, financial institutions would tend to prefer shorter debt, which leads them to take more risks. It is even clearer, when considered at a market level: if all institutions were to adopt the same short-term funding preference, this would immediately amplify the impact of a

[1] Such as the Model Mandate Initiative developed by the ICGN, International Network of Corporate Governance

confidence crisis or tensions on the market. On that basis, it would contribute to value longer-term actors if the nature and duration of liabilities were to be taken into account to assess the risks on the assets side.

9) What other options and instruments could be considered to enhance the capacity of banks and institutional investors to channel long-term finance?

The creation of specific government-backed investment banks can be an important catalyst to facilitating more long-term investment by asset owners.

Alternatively, banks could finance the construction phase of projects, with their expertise to finance the first phase before stabilised cashflows, and refinancing would be done by long-term investors. But this would be possible, given the limitation of banks to load their balance sheet, only if two major aspects are addressed:

- For the long-term refinancing to take place, investors should not be restrained by regulation to take long-term assets; and
- Typically the refinancing can only happen once the first phase has been successsful, based on conditions previously agreed. This uncertainty about the refinancing means for banks to have to book the full long-term risk, which is a hindrance to this model of banks financing the short-term phase before other actors taking over for the long-term refinancing, unless they are provided with some kind of refinancing guarantee.

The combined effects of regulatory reform on financial institutions

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

In the context of a European transition from a bank-funded economy towards a more market-funded economy, prudential and accounting reforms have cumulative effects on the level and cyclicality of long-term finance. Each reform is motivated separately by dysfunctionings highlighted by the crisis. It is however really the combined effect of these reforms which proves to have a negative contribution versus the initial target. Therefore it seems key to consider a minimised combined impact when creating new rules.

One of the ways to minimise such impact is to care about keeping a variety of actors in the market. General frameworks created by regulators tend to be general, to cover the largest number of actors. The consequence is that by having to respect similar rules, various actors will tend to behave in a similar way, which is a factor of risk for the stability of financial systems and the economy in general. Therefore, the specificity and need for long-term investments should be appreciated and benefit from special accounting and prudential rules. This is why, given the broad and huge need for long-term investments, in a variety of activities and sectors, the current negative cumulated impact of rules on long-term investement can not be fully addressed by adjusting existing rules for some asset classes. What seems to be needed is a set of rules dedicated to enabling and favouring long-term investments, in addition to existing frameworks.

As a general remark on point 3.1, we would like to invite the Commission to consult the Institute for Sustainable Development and International Relations (IDDRI) Working Paper, N°05/13 April 2013 "EU low-carbon investment and new financial sector regulation: what impacts and what policy response?", recently released. This document presents many facts and analyses shared by UNEP FI on the topic of low carbon investments (covering the various types of financial actors), which we believe should be considered as a priority when mobilising funds for long-term.

3.2. The efficiency and effectiveness of financial markets to offer long-term financing instruments

11) How could capital market financing of long-term investment be improved in Europe?

Long-term investment markets need long-term oriented actors, able and willing to take long-term risk; this means actors whose investment strategy would allow them to assess return over the long-term, and therefore adopt a counter-cyclical investment behavior. **This implies an in-depth understanding and analysis of value-creation sources,** including the governance of companies. **We believe that stronger consideration needs to be given to sustainability issues**, whether environmental or social, to arrive at a better awareness of **long-term impacts of investments, as well as of the exposure of such investments to extreme risks, such as those which can arise from climate change**.

12) How can capital markets help fill the equity gap in Europe? What should change in the way market-based intermediation operates to ensure that the financing can better flow to long-term investments, better support the financing of long-term investment in economically-, socially- and environmentally-sustainable growth and ensuring adequate protection for investors and consumers?

UNEP FI would like to share a few elements for consideration in responding to this question:

- **It is UNEP FI's view that sustainable growth can only be funded by sustainable finance.** Therefore, **given the major importance of initial listings, attention should be paid to the role of stock exchanges and their consideration of ESG data**. UNEP FI is a co-partner and active supporter of the Sustainable Stock Exchanges Initiative[2], which addresses the role of stock exchange in stimulating listed companies behaviour to include sustainability and long-term criteria in their business making. Having sustainability part of the listing should be considered both for existing markets and for the development of listing structures for smaller companies, as one of the concerns of the Green Paper is to drive long-term finance to SMEs in a less bank-intermediated context. Stock exchanges are strategically placed to increase the appetite of companies for ESG-inclusive business models, stemming from a proper ESG risk understanding, and to help investors be more aware of these risks for a sound, full risk analysis.

- Another consideration relates to the **narrow understanding of fiduciary duty, indicating that pension fund trustees and their fund managers are not permitted to look beyond traditional and pure financial factors, to consider long-term, sustainability criteria**. We believe that this understanding does not reflect the interests of the underlying clients and beneficiaries. Clarifying fiduciary duty so as to ensure its clear application to all parties in the investment chain is a necessary step forward. We address this topic in question 23 below.

- With regard to the **development of new financing tools, it is important to make sure that they provide additional funding or do fund new long-term, sustainable projects,** and do not simply provide an alternative source of funding to projects which would have found funding anyway. We also need to place these tools in the context of a transition, i.e. providing funding where there are gaps or where new needs exist, in particular to move towards a sustainable economy, so as to direct funds towards climate change mitigation, energy efficiency- friendly projects, etc.

  Securitisations, covered bonds, and project bonds are tools which differ from usual general-purpose bonds, as they are associated with the refinancing of specific assets or with a specific

[2] http://www.sseinitiative.org/

future use of funds. As such, these products could appeal to some investors interested in green-themed investments, if the underlying assets are actually green.

UNEP FI considers that **what is at stake is really to mainstream sustainability into finance in order to be able to respond to the huge financial needs of the transition to a sustainable economy. Green products are as positive development, but they may not meet the demand from investors for liquid and sizable bond issues**. Therefore, in our view, it is key to first target to include sustainability in bonds, which will meet a large scale demand from investors, in order to enable large amount of funds to contribute to sustainable development goals. A difference could be though for such bonds to include a specific reporting on what is sustainable, or green, so that investors can monitor these aspects, as well as be able to report themselves to their end-beneficiaries. It would also contribute to the needed cultural change to have sustainability features covered more explicitly in corporate bonds, or in the tools discussed here.

- Last but not least, to build trust and sustainable capital markets, **transparency** on the underlying assets, and reporting including on ESG aspects, are critically needed, in particular for the products expected to contribute to the transition to a sustainable economy. To facilitate the monitoring by investors over the long-term, it would be valuable to have European databases, providing company ESG information in an homogeneous way (such databases already exist for instance for residential mortgage-backed securities - RMBS).

13) What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose this framework?

We put forward the following elements for consideration:

- Significant work has been achieved through the creation of the the European Covered Bond Council (ECBC) covered bond label.This framework provides investors with the standardisation they need to understand what those labelled covered bonds actually represent, as there are otherwise so-called covered bonds representing a variety of instruments. For the development of a market, facilitating risk analysis by investors, and building trust, it is very important that terms are standardised.

- As this market is expected to grow, although there will be limits on the encumbered assets of banks, a dedicated framework would be valuable. Lessons should be learned from the nearly close of the market when their resilience was first tested during the financial crisis of 2008/2009. The main causes highlighting where market functioning should be improved are a) the lack of transparency on the assets expected to serve as collateral to the covered bonds in banks' balance sheets; and b) the broad range of assets refinanced through one single issuance.

- Banks are regulated under national rules, and they can issue covered bonds under specific legal national frameworks. Between countries, these frameworks can be close but not similar.

- Investors would like to have a clear view, prior to the issuance, of the assets to be refinanced, as well as the assets performance (in terms of payment delays, default rate, recovery rate, etc.) over the term of the issuance.

- The development of a framework for green covered bonds, which we would like to be low-carbon, would be welcome given the favourable treatment of covered bonds under the banking regulation.

14) How could the securitisation market in the EU be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system?

Several measures could contribute to revitalise the European securitisation market, from the point of view of investors:

- Limiting the possibilities or doubts on possible conflicts of interest between rating agencies and issuers paying for the ratings;
- Retaining simple and readable structures, limiting or avoiding even the use of synthetic ones, and credit derivatives ones, as trust needs to be rebuilt;
- Aligning the interests of investors and banks, retaining a piece of the receivables or a portion of the equity/junior tranche of the issuance ;
- Standardising the rules to report and publish underlying assets pool performance ;
- Proceeding with the current initiative of labelling quality securitisations (PCS[3] label for Prime Collateralized Securities), as well as with the initiatives in favor of transparency on securitisations (European Central Bank database) ;
- Allowing the growth of the potential base of investors, by reducing the constraints imposed on investors with regard to analysis, monitoring and valorisation of the PCS-labelled securitisations ; and
- Avoiding the prudential weighting particularly penalising securitisations, by reducing the weighting gap with covered bonds.

3.3 Cross-cutting factors enabling long-term saving and financing

21) What kind of incentives could help promote better long-term shareholder engagement?

The term "engagement" should be understood here as long-term shareholder hold, as the long-term hold of shares does not mean nor necessarily imply any active ownership from shareholders. We view long-term incentives and shareholder engagement as two topics not necessarily going together. On the one hand, loyalty additional shares, warrants, increased voting rights or dividends only reward the long-term hold and/or patient capital. On the other hand, engagement has to do with a more qualitative aspect of ownership and is still the action of a few only; it can be either the one from the ultimate asset owner, or from asset managers, as a significant portion of investors' assets is actually managed externally by investment managers.

For many parties, **the main problem of long-term investment could be treated through the mandate given by the asset owner to its investment manager(s)**. UNEP FI shares the view that a special attention should be given to the terms of such mandates. Asset owners are at the beginning of the investment chain. **Unless they give clear directions through their mandates, no consideration will be given to ESG data and/or impacts in the investment process. This is key to make investment more sustainable and more supportive of a sustainable economy.** One more way to promote long-term behaviour would be to ask investors to what extent their staff incentives or variable pay system are based on long-term assessment and value, to make sure that the rewards are actually aligned with long-term objectives. This would also provide the opportunity to end-beneficiaries to know whether funds are managed with long-term considerations consistent with their interests.

The challenge, when it comes to incentives for long-term shareholders is that, due to the existence of long ownership chains, it is rare, even for the most consistently invested institution, to appear as a long-term shareholder when viewed from the company's perspective. For instance, the change of

[3] The existing market-led PCS initiative is aimed at increasing the quality , transparency and simplicity of asset-backed securities (ABS) with European common standards for a variety of asset classes, including SMEs' loans.

service providers and various intermediaries by asset owners could lead them to appear no longer as a loyal or long-term shareholder. In other words, delegating asset management could represent a certain discrimination of institutional investors, less likely to qualify as 'loyal' investors. This point should be clarified, so as not to prevent the favouring of extra shares or other beneficial mechanisms for long-term investors.

Finally, what is at stake with long-term shareholder hold is to shift the priority from stock price to the corporate and social value of companies, including how sustainable their strategy and practices are.

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

Incentives to asset managers are defined in their management mandate. It is therefore in this document that orientations towards long-term should be included by asset owners, to extend the time-horizon of the investment activites carried out by their fund managers.

The criteria on which performance and hence reward is based are still too often founded on excessively short-term measures and strictly on financial indicators, which is detrimental to a full analysis including long-term topics such as ESG data. A way to promote a long-term investment approach would be to require asset managers to report on their activities in an integrated manner, including the extent to which they have integrated ESG topics in their decision-making and operations.

Aligning the interests of parties along the investment chain is the only way to allow matching the interests of final beneficiaries. In this regard, the International Corporate Governance Network (ICGN) has developed a very interesting Model Mandate Initiative, which we encourage the Commission to look at to feed its own reflexion.

Overall, we welcome that the Green Paper seeks the alignment of incentives for long-term strategies of asset managers, investors and companies.

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

We are in favour of including the long-term, sustainability dimension in the definition of fiduciary duty. UNEP FI considers fiduciary duty as a key element in the investment chain to have sustainability properly and widely integrated in financial processes and decisions. UNEP FI has produced some reference reports on the topic, which it encourages the Comission to refer to[4].

The first question on fiduciary duty is to whom it should apply. The intermediaries in the investment chain may be more likely to act in the long-term interests of their underlying clients and beneficiaries if they feel they have a direct fiduciary duty. In order to ensure that no internediary along the investment chain is excluded from fiduciary duty application, potentially through complex contractual agreements, the ICGN Model Mandate Initiative proposes a specific clause through which fund managers can acknowledge that they owe fiduciary duties to their clients. UNEP FI recommends

[4] UNEP FI, 2009, Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment
(http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf)

UNEP FI, 2005, A legal framework for the integration of environmental, social and governance issues into institutional investment
(http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)

that no parties be excluded from the fiduciary duty application, so that the objective of long-term consideration is kept through the entire investment chain.

The second aspect would be a **reconsideration of the breadth of obligations embedded within the concept of fiduciary duty**. In particular, it might have been very narrowly understood to mean only the short-term financial interests of beneficiaries, leading some asset owners to hesitate over making investments which might be attractive and have longer-term benefits (such as investments related to climate change), but which might be less attractive than alternatives in the short run. UNEP FI recommends to the Commission to consider policies that would disallow litigation against fiduciaries where they have followed due process including ESG criteria and acted in good faith; fiduciary duty should be interpreted as not only legally permitting, but also requiring to integrate ESG issues into investment decision-making and ownership practices.

It also supports the introduction of "comply or explain" processes to pensions funds; e.g. the UK Pensions Act (1995) requires pensions funds to state whether they take social, environmental and ethical considerations into account, but not why they choose not to do so.

> *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?*

UNEP FI would like to bring to the attention of the Commission that **what is too often considered as 'non-financial' information, is information with strong potential to become financially material in terms of ESG-related reputational and financial risks, both at the company and investors level. Non-financial information is often overlooked by many investors while it actually reflects** the financial fragility of a business that is not resilient to environmental or social factors (climate change, water scarcity, etc.)

The context of the financial crisis since 2008 has provided the financial community with multiple examples of environmental, social and business governance failures that have led to a very sudden drop of several companies' equity share prices. While such risks are too often neglected, UNEP FI strongly believes that more integration of non-financial information in the investment decision-making process will help provide investors with a clearer overview of a company's' long-term performance.

Back in 2006, UNEP FI had worked already on strenghening the business case for ESG materiality in the financial performance of a company. It published a report[5] that showed that: a) ESG issues are material; there is robust evidence that ESG issues affect shareholder value in both the short and long term; b) the impact of ESG issues on share price can be valued and quantified; and c) key material ESG issues are becoming apparent, and their importance can vary between sectors. For investors to be able to include ESG issues in their analyses, companies need to engage in a proper ESG reporting. An important part of the global push towards sustainability practices involves a need to account for, and report on sustainability.

The corporate sector has already developed experience and capacity to disclose practices on sustainability issues, and, supported by UNEP[6], mandatory sustainability reporting has already been

[5] These findings are based on research by established financial analysts and backed by the views of an independent investment consultant. We call on investors, asset managers and financial service providers to act on the links between ESG issues and company profitability. "Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value", UNEP FI, 2006

[6] Early June 2013, the United Nations High-level Panel on the Post-2015 Development Agenda has released its report on the recommended goals to replace the Millennium Development Goals (MDGs). This also includes a wider sustainability reporting for both business and governments, and better information for governments and people. It

implemented successfully in several countries, including South Africa, Brazil or France. Several Global Stock Exchanges are now requiring disclosure of ESG-related information from companies whose shares they list. The Carbon Disclosure Projecti[7], the Global Reporting Initiative[8] and the International Integrated Reporting Council (IIRC)[9] are all excellent initiatives testifying of this increasing need, as is the legislation currently under consideration by the EU.

UNEP FI is also supporting the promotion of Paragraph 47 of 'The Future We Want', Rio+20 outcome document. The paragraph acknowledges the importance of corporate sustainability reporting and recognizes the role of governments in supporting and encouraging it in both developed and developing countries. Four governments - Brazil, Denmark, France and South Africa- recently joined by Norway, launched the initiative 'The Group of Friends of paragraph 47' [10] to encourage companies to integrate sustainability information into their reporting cycle. UNEP FI encourages countries join in the call for a reporting standard that is globally harmonized and usable; to be able to reward sustainability practices by the corporate sector, investors must be able to measure company performance on a comparable basis.

We also want to highlight the need to learn from the short-term pressure created by quarterly financial results releases. The integration of ESG data into standard financial data reporting should probably not happen more frequently than once a year, in order not to push inadvertently market participants towards more short-termism, or a short-term read of the long-term indicators that ESG data represent.

Investors should report on how they integrate ESG and to what extent they are long-term oriented, as well as, where applicable and possible, on the environmental (e.g. financed GHG emissions11), and social impacts of their activities. Impact measures should be used to complement and support the understanding of investments. This could partially make up for the fact that current accounting rules do not include contingent liabilities of future environmental costs for instance, implicitly working with the assumption that these costs will be socialized. Environmental and social impacts are currently priced out of models, and their internalization into the economics of long-term financing, starting with their inclusion in the risk analysis process, would be part of the solution for sustainable long-term financing.

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UNEP FI thanks the European Commission for the opportunity to comment on the Green paper on long-term financing of the European economy and is available to pursue dialogue on this topic.

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contains a call to large corporations as well as governments, to report on their social and environmental impacts, in addition to releasing financial accounts.

7 https://www.cdproject.net
8 https://www.globalreporting.org
9 http://www.theiirc.org/
10http://www.unep.org/resourceefficiency/Business/SustainableandResponsibleBusiness/Reporting/FriendsofParagraph47/tabid/105011/Default.aspx
11 See UNEP FI's new « Investors Briefing » on the topic, forthcoming release, July 2013.