

**MEMO# 31473**

November 12, 2018

# ESG Task Force: EU Disclosure and Benchmarks Proposals; SEC Proxy Roundtable

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November 12, 2018 TO: ICI Global Members

Global ESG Task Force SUBJECTS: Compensation/Remuneration

Compliance

Disclosure

Distribution

International/Global

Investment Advisers RE: ESG Task Force: EU Disclosure and Benchmarks Proposals; SEC Proxy Roundtable

We cover the following items in further detail below:

1. **European Parliament's ECON committee vote approving amendments to the Commission's disclosure proposal.** Notably, the variable remuneration provision was not part of the final compromise amendments (attached). The European Council is moving much more slowly than Parliament on the disclosure proposal, and we will discuss next steps in more detail on the next Task Force call.
2. **Parliament's draft report expanding the scope of the Commission's low-carbon benchmarks proposal.** We had not previously discussed the benchmarks proposal in meetings with policymakers, but we expect it to be raised in upcoming meetings given the developments with the draft report. We outline a few high-level points below. Please let us know if you have any additional thoughts. The draft report and most recent amendments are attached.
3. **SEC's [agenda](#) for 15 November proxy roundtable.** ICI's Proxy Working Group is developing comments to submit to the SEC at some point following the roundtable. If you would like to join the ICI Proxy Working Group, please let me know.

The next ESG Task Force call will be scheduled on 27 November from 11-12 p.m. EST (4-5 p.m. GMT). On the call, we will provide a briefing of various meetings that we have had with various EU regulators and Council attachés on sustainable finance.

1. **European Parliament's ECON committee vote approving amendments to the Commission's disclosure proposal.** The final compromise amendments significantly expand the Commission's original text beyond disclosure to require

integration of ESG-related financial risks, and also would require asset managers to consider non-financial sustainability impact. The attached amendments are identical to the final compromise amendments except that the variable remuneration amendment (Article 4a) was not finalized.

- **Variable remuneration not included.** This amendment would have required at least 50% of the performance measurement criteria for executive directors' bonuses to be tied to a sustainable investment target.
- **Definitions continue to have impact investing component.** Importantly, the definitions of 'sustainable investment' and 'sustainability risk' continue to have an impact investing component that would flow through the rest of the proposal. The amendments empower the Commission to adopt delegated acts to provide further specifics on these definitions.
  - In order to be labeled as a '**sustainable investment**,' a fund must have an investing strategy that supports products and services that aim to be consistent with ESG factors, and all of its portfolio investments must be in economic activities that significantly contribute to environmental or social objectives (and do not significantly harm other ESG objectives) or that promote or support good governance practices (and do not significantly harm other ESG objectives).
  - '**Sustainability risk**' is defined as financial or non-financial risks, both short and long term, linked to ESG factors. Non-financial risks consist of the short-term and/or long-term risk of negative impacts on the natural environment, on workforces and communities, or on the governance of investee entities, including but not limited to when linked to financial risk. So anywhere that references taking sustainability risk into account (e.g., in due diligence) includes this broad concept of non-financial impact.
- **Due diligence requirements still included.** The amendments empower the Commission to adopt delegated acts to provide further specifics on the definition of due diligence.
  - Article 3 requires asset managers to have in place due diligence policies for incorporating material 'or likely to be materialised' sustainability risks into the investment process, taking into account proportionality. Due diligence policies also must include sustainability performance assessment and annual regulatory reporting.
  - The final compromise amendments direct the Commission to adopt delegated acts to 'to ensure that adverse sustainability risks created by the financial market participant are integrated in investment decision-making,' and to provide guidance on proportionality.
  - These amendments also require the Commission to consider the principles of the [PRI](#) framework as well as the OECD's [2017 Guidance](#) on Responsible Business Conduct for Institutional Investors.
- **Prospectus disclosures now include sustainability risks, performance, and voting.**
  - Article 4 requires prospectus disclosures to describe:
  - **Due diligence procedures** 'for incorporating material or likely to be materialised sustainability risks in the investment decision-making process for that particular product and how they are applied;'
  - How asset managers measure '**sustainability performance**' (i.e., consistency with ESG factors) for each product;
  - Extent to which **sustainability risks** are expected to have a relevant impact on the fund and where in the portfolio these sustainability risks have been

identified;

- Voting instructions and voting rationales behind votes against management, abstentions and contentious votes for **sustainability-related voting**; and
- How an asset manager's **remuneration policies** are consistent with Directive (EU) 2017/828 (Shareholder Rights Directive II), the integration of sustainability risks, and follow its ESG internal and operational performance criteria, whilst delivering long-term viable growth objectives; and are in line, where relevant, with the sustainable investment target of the financial product or service.
- **Amendments extend scope of disclosure in Articles 5-7 to include all financial products.**
  - Where the fund references a benchmark index, Article 5 requires prospectus disclosure to include:
    - The **sustainable investment target**, information on how the designated index is aligned with that objective, and an explanation of how sustainability risk indicators are considered in the methodology of the index; and
    - Why the weighting and constituents of the designated index aligned with that target differ from a broad market index.
  - Where the fund does not reference a benchmark index, Article 5 requires prospectus disclosure to include a **description of its sustainability impact** using certain sustainability risk indicators.
  - Article 5 requires ESMA, EBA, and EIOPA to develop draft regulatory technical standards around the presentation of this information.
  - Article 6 requires various **website disclosure**.
  - Article 7 requires **audited annual report disclosures** to include sustainability-related impact and performance. ESMA, EBA, and EIOPA to develop draft regulatory technical standards.
- **Next steps.** The European Council is moving much more slowly than Parliament on the disclosure proposal, and we will be meeting with various attachés to discuss.

## 2. **Parliament's draft report expanding the scope of the Commission's low carbon benchmarks proposal.**

- **Commission's proposal.** The Commission's proposal would create two categories of benchmarks—low carbon and positive carbon impact benchmarks—to help investors compare the carbon footprint of investments.
- **Parliament's draft report.** The report from the Parliamentary rapporteur (MEP Neena Gill) would completely change the scope of the proposal, mandating that all benchmarks align with the Paris Agreement commitments by 2022. The draft report also suggests all asset managers should pursue an investment strategy fully aligned with the Paris Agreement by 2022. We understand that this approach lacks widespread political support.
- **Upcoming engagement.** Given the draft report developments, we expect the low carbon benchmarks proposal to be raised in our upcoming meetings with regulators. We plan to keep our discussion of issues with the benchmarks proposal high level as follows:
  - Investors and asset managers should be able to choose the most suitable benchmarks for their investment strategies.
  - Requiring all asset managers to pursue an investment strategy fully aligned with the Paris Agreement by 2022 would narrow the universe of companies in which funds can invest. This could artificially inflate asset values and ironically increase risk to investors.

- The draft report's approach would have implications for the global competitiveness of UCITS.
- **Next steps.** Parliament's ECON Committee is scheduled to vote on final compromise amendments on 3 December.

3. **SEC's [agenda](#) for 15 Nov proxy roundtable.** The SEC has released the agenda for its proxy roundtable on 15 November.

- The roundtable will consist of three panels on the following topics:
  - Proxy voting mechanics and technology
  - Shareholder proposals
  - Proxy advisory firms
- ICI's Proxy Working Group is developing comments to submit to the SEC at some point following the roundtable. If you would like to join the ICI Proxy Working Group, please let me know.

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[Attachment No. 1](#)

[Attachment No. 2](#)

[Attachment No. 3](#)

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