Sustainable finance recommendations published

On 31 January the High-Level Expert Group on Sustainable Finance (HLEG) published its final report with a wide range of recommendations for a financial system that supports sustainable investments. The European Commission is now poised to follow up with an action plan in March, which stipulates the timeline for translating the recommendations of the report into policy.

Perhaps the most eye-catching proposal for pension funds is the recommendation to develop a single set of principles of fiduciary duty, or **'investor duty'**, for asset owners and asset managers. This would then need to be translated into relevant pieces of regulation, including IORP II. This would not only include the mandatory incorporation of ESG factors as financial risks investment decision-making, but also entail the consultation of members and beneficiaries on their ESG preferences. Pension funds would be obliged to act upon these preferences and ensure they are taken on board in asset managers' mandates. The European Commission is already working on a legislative proposal that will implement these suggestions and PensionsEurope responded to the consultation on the subject that ran until mid-January.

Next, the HLEG wants to beef up **disclosure rules** for financial and non-financial entities to make sustainability risks more transparent, which an initial focus on climate risks. In the short term the focus should be on the development of voluntary initiatives under the framework of the FSB's Task Force on Climate-related Financial Disclosures, as well as a revision of the Non-Financial Reporting Directive. These initiatives could improve the quality of information available to institutional investors. By 2020 the EU should then develop its own climate-disclosure regime, although it is not entirely clear whether this would impose specific disclosure requirements on pension funds. Perhaps tellingly the report draws heavily on the experience with the French Energy Transition Law, which does require pension funds to report how their investment policies align with the national strategy of energy and ecological transition.

Then there are a number of commendable recommendations that could widen the choice of sustainable investments and create a common language for the markets through an ESG classification, thereby supporting the many pension funds that already take ESG issues on board. These include developing a **sustainability taxonomy**, developing **sustainable finance standards** (starting with EU Green Bonds), and stablish a **'Sustainable Infrastructure Europe' facility**, for technical assistance and match-making.

Finally, the report also envisages a larger role for the European Supervisory Authorities (ESAs). Perhaps worrying, it is suggested that the ESAs could supervise how regulated entities consult their beneficiaries and reflect nonfinancial preferences into investment strategies. The ESAs should also extend the horizon of risk monitoring of the financial sector, as it is currently too short to capture ESG risks. Therefore, the ESAs would need to build expertise on climate scenario analysis and other non-cyclical, non-linear risks that may get mispriced by financial markets. However, the explicit recommendation that IORP stress tests would include ESG risks from the interim report was removed.