July 17th, 2017

Statement by Share Action, Friends of the Earth Europe and Global Witness on the interim recommendations of the High-Level Expert Group on Sustainable Finance (HLEG)

The High-Level Expert Group on Sustainable Finance (HLEG) established in late 2016 by the European Commission presents its interim recommendations to make finance sustainable in a public hearing on July 18th. We urge the European Commission (EC) to build upon those recommendations, but also call upon the Expert Group to be bolder and more courageous in the final recommendations to be issued at the end of this year.

The signatories to this statement share strong concerns that the finance industry in the European Union (EU) is not sufficiently regulated. As such, it is free to contribute to real environmental harm and human rights abuses in investment projects within and outside the EU. The regulatory framework to date leaves the finance industry with ample leeway to define its own risk, and is characterized by self-regulation and voluntary action on Environmental, Social and Governance (ESG) related issues. Global Witness and Friends of the Earth Europe issued a briefing underlining concern that a voluntary approach to financial regulation is inadequate. Today's finance industry is not geared towards contributing to sustainable development and it repeatedly fails to contribute fully to the real economy. We have previously called on the European Union to adopt and implement binding regulation to address these concerns. These recommendations are laid out in a briefing issued together with other members of the Regulate Finance Coalition of NGOs in June 2017.

The creation of the HLEG is a welcome step by the EC. We also welcome the commitment made by the EC, announced in its mid-term review of the Capital Markets Union (CMU), to take concrete action to follow up on the recommendations issued by the HLEG in early 2018.[1]

The HLEG interim report contains many positive points including:

- A recognition that a sustainable development model requires ensuring "environmental, social and governance factors are at the heart of financial decision-making".
- Language effectively calling for greater disclosure by firms and financial institutions which would help "managers, investors and other stakeholders to analyse ESG risks and opportunities".

[1] "**Priority action 6** The Commission will decide by Q1 2018 at the latest on the concrete follow up that it will give to the recommendations of the High Level Expert Group on Sustainable Finance. In particular, it shall already set in motion work to prepare measures to improve disclosure and better integrate sustainability/ESG in rating methodologies and supervisory processes, as well as in the investment mandates of institutional investors and asset managers. It will also develop an approach for taking sustainability considerations into account in upcoming legislative reviews of financial legislation."

- A call for action by regulatory authorities to "make clear to all involved in the investment and lending chain that managing ESG risks is integral to fulfilling fiduciary duty" and building on EU legal texts so that financial actors are clear that fiduciary duty includes action to integrate ESG considerations in their decision-making processes.

The report does discuss the need to define sustainability. However, whilst the report appears to hint at the lack of definition of the ESG acronym[2] it does not lay out sufficient steps to come to such a definition. The report should also go further and ask for binding regulation to ensure that financial actors are obliged to recognize ESG harm as risks; to take decisive action to avoid ESG harm and to hold unscrupulous financial actors that fail to exercise due diligence to avoid ESG risks and/or seek to benefit from such harm to account, including in legal proceedings.

We are concerned that the EC has repeatedly stated that climate change issues are the priority thereby possibly relegating social and governance and human rights issues to a secondary position. Whilst decisive action by the EU on climate change is welcome, we firmly believe that action on other environmental, social and governance issues, such as human rights and deforestation, should not be side-lined. We fear that this position could herald a reluctance by the EC to fully endorse interim report recommendations related to the full integration of binding ESG regulations in a sustainable finance strategy.

If the HLEG is to develop an understanding of sustainable finance it must be given the space to develop a strong, holistic definition of ESG in the following minimum terms:

- An emerging definition should recognize that environmental issues are broader than those relating to climate, including those causing environmental destruction such as deforestation. Reference should be made to international environmental treaties ratified by EU Member States.[3]

- Social matters should be understood as incorporating human rights and labour rights standards as stated in the international human rights treaties signed by EU Member States, including United Nations, regional and International Labour Organisation treaties, as well as a focus on aggressive tax planning/arrangements and strong anti-corruption measures.

- Governance matters should not be understood only as an internal issue of company management. Instead they should encompass both internal management matters together with the due diligence responsibilities of companies to avoid causing and benefiting from harm and mitigating any negative social and environmental impacts.

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[2] The report draws attention to the fact that EU regulations do not appear to explain what is meant by ESG:"**To date, regulatory standards for sustainable products remain limited to general provisions on ESG integration within EU regulations for financial products (for example, ELTIF, EuSEF, UCITS, AIMFD, MiFID II, PRIIPS, etc.).** These provisions do not specify what the integration of ESG factors means, and very different approaches are mixed under the same vocabulary (SRI, ESG, sustainable, green and social). This does not enable market organisations to reject investment choices and should be clarified."

[3] These would include the international treaties included in the United Nations Portal on Multilateral Environmental Agreements (InforMEA): https://www.informea.org/

The Rio and Stockholm Conferences[4] made clear that sustainable development is dependent on three central interlinked components: environment, development and human rights. The 2030 Agenda also imposes upon the EU a duty to pay equal attention to the social, environmental, economic and governance dimensions of sustainable development. As such, the recommendations from the HLEG should ensure that investors avoid *all* significant ESG related harm.

The development of a sustainable finance strategy should be based on a broad interpretation of ESG risks and impacts. ESG factors have been recognized by much of the investment world as crucial to ensuring that investments support sustainable and ethical projects. [5] Binding regulations will create a level playing field and help investors avoid the risks associated with ESG related problems.

ESG understood in this way should be incorporated in all EU financial regulation complemented by a stand-alone piece of legislation covering the whole financial sector. The development of a strong EU sustainable finance strategy could provide important guidance for the approval of such legislation. Such legislation should develop:

- Greater transparency requirements on financial industry companies to publish clear and full information on any potential ESG risks involved in any investment process and what due diligence measures have been undertaken to avoid, prevent, mitigate and account for negative ESG impacts.

- Greater accountability of the finance industry entities to individuals or groups who may be impacted by company operations in which they have invested. Finance industry companies which have failed to exercise due diligence to avoid such impacts or which have deliberately sought to benefit from them should be made accountable in criminal or civil proceedings as appropriate. Provisions should be put in place to ensure that communities outside the EU that have faced the brunt of such harm are able to bring criminal proceeding or civil lawsuits for environmental damage or human rights abuses before courts in the EU. This would be in line with the United Nations Guiding Principles on Business and Human Rights which call on states to remove barriers to effective legal remedy.

- Requirements to oblige financial industry companies to exercise due diligence to avoid ESG harm.

[4] United Nations Conference on Human Development 1972 and the UN Conference on Environment and Development 1992.
[5] The United Nations-supported Principles for Responsible Investment refer to the incorporation of ESG in investment decisions: https://www.unpri.org/about/what-is-responsible-investment and https://www.unpri.org/about/the-six-principles