BlueBay Asset Management LLP: Response to the IOSCO Consultation on Sustainable Finance in Emerging Markets and the Role of Securities Regulators

March 2019

Introduction

BlueBay Asset Management LLP is one of Europe's largest specialist active fixed income managers, entrusted by clients with over US$60.1 billion in assets under management (as of 31st December 2018) in corporate and sovereign debt, rates and FX. Our investment philosophy and approach are focused on delivering absolute-style returns, with an emphasis on capital preservation. We have an established track record of innovation and performance, providing a broad range of relative return, total return and alternative investment portfolios in both public and private debt markets. BlueBay has invested in the emerging market asset class since 2002, offering active fund solutions across sovereign and corporate debt.

We welcome the opportunity to respond to this IOSCO public consultation.

NOTE: BlueBay considers, and uses, 'ESG' as a term that is synonymous with 'sustainable', which is used in this consultation. For us, both refer to non-financial (or extra financial) factors.

Response to the consultation

BlueBay is broadly supportive of the recommendations as set out in the consultation paper with regards the different stakeholder groups.

ISSUER FOCUSED

<u>Importance of emerging markets to global financial markets and to emerging markets themselves</u>

International investors are often an important source of funding for many emerging market issuers – be they sovereigns or corporates. To continue to attract investors into the region, issuers need to have the trust and confidence of these investors in their reporting on their investment attractiveness. This requires clear, accurate, timely, consistent and comparable transparency about those factors – financial or ESG - that reflect their current and future risks and opportunities. Armed with this, investors can make more informed investment decisions. Whilst we acknowledge disclosure by emerging market domiciled companies – on financial and ESG matters - has improved in recent years, broadly speaking, this is not wide spread or of a quality as seen in many developed markets. This gap can make it challenging for investors to invest in an informed way. But whilst there is more established regulation around financial reporting, this is not necessarily the case with regards to ESG related reporting.

<u>Investment case for incorporating ESG factors into investment activities</u>

We welcome the acknowledgement of IOSCO of the trend in sustainable, responsible or ESG investing practices. There are different drivers for incorporating such factors more formally and proactively into investment activities.

For BlueBay, doing so reflects the growing recognition that investment analysis of extra- or non-financial factors – commonly referred to as ESG (environmental, social and governance)* factors – adds value to investment decisions as it provides a more holistic and medium to long-term view about an issuer's potential financial sustainability, as well as about the market context within which it operates. We believe that ESG factors can potentially have a material impact on an issuer's long-term financial performance. Given the limited upside (and potentially significant downside) of fixed income investments, the focus of our ESG analysis is on understanding downside risks. Poorly-managed ESG risks can lead to inefficiencies, operational disruption, litigation and reputational damage, which may ultimately impact an issuer's ability to meet their financial responsibilities. Supplementing traditional financial analysis by reviewing ESG-related management practices and performance is, therefore, not only prudent but also in line with BlueBay's fiduciary duty to optimise investor returns. There is also increasing recognition that as some ESG factors can potentially represent systematic financial risks, ensuring a sustainable financial market is critical to avoid potential financial crises.

<u>Need for improved issuer ESG transparency</u>

BlueBay is supportive of initiatives which advocate the transparency principle. We welcome the recognition by IOSCO of the need for issuers to improve ESG disclosure as set out in Recommendations 1 through to 3. As already stated, clear, accurate, timely, consistent and comparable ESG information about investee companies is critical for investors to make informed investment decisions.

Whilst a voluntary approach is preferable, given the lack of availability, quality and consistency in what is being disclosed, we believe there is a valuable role securities regulators can play in promoting good/best practice on ESG disclosure. However, in doing so, we would encourage as much as possible, for IOSCO to avoid being too prescriptive in its recommendations and instead keep them high level and principles based, and to work on a 'comply and explain' basis. This will allow for the proportionality principle to be applied as in some instances, due to the size and nature of companies, it may not be appropriate or relevant for them to implement a specific recommendation. It will also allow for the existence of ESG data challenges (quite meaningful in some instances) as well as gaps in knowledge and understanding, and tools to better evaluate risk and materiality. Whilst there has been meaningful progress in these areas, there is still scope for improvement. There may also be cultural sensitivities which influence what issuers report that need to be taken into account.

<u>Focus ESG transparency based on materiality</u>

We believe the priority is for issuers to focus ESG disclosure on those which are most material to the long-term financial sustainability of their business. Instead of reinventing the wheel and developing new recommendations, we would encourage IOSCO to instead review existing standards and guidelines on ESG disclosure where there has been a lot of good work done (as had been referenced in the consultation paper: GRI, SASB, IIRC and TCFD) and promote these as potential reference sources for issuers to consider. They can then determine the extent to which these are relevant and appropriate for their business and share this with their key stakeholders.

Outside of a focus on investment material ESG factors, we also recognise it may be helpful if issuers also report on how their business activities have sustainability impacts, given the increasing trend in those investors looking to invest *for* (positive ESG) impact (such as green bonds or in line with the UN Sustainable Development Goals).

<u>Need for a standardised approach to ESG disclosure globally</u>

It is desirable that IOSCO work towards the adoption of a globally harmonised approach to ESG reporting across regions and markets and encourages others to do likewise. We recommend reviewing the work of other stakeholders and markets, such as the European Commission which has been quite active in this area. This will avoid confusion by issuers and investors and prevent the requirements being too onerous in requiring issuers to produce different reporting content for different markets, and so facilitate more effective and efficient markets. It is important also that emerging markets are proactive in contributing to global ESG reporting standards. Recommendation 11 is helpful in this instance as for regulators to effective carry out their role, there is a need to ensure appropriate knowledge and expertise.

PROVIDERS OF SUSTAINABLE/ESG PRODUCTS & INSTRUMENTS FOCUSED

BlueBay recognises investors and other key stakeholders are increasingly requiring investment managers such as BlueBay to demonstrate to what extent ESG factors are relevant to, and an important feature of, our investment process, and we are committed to being open and transparent about our position and efforts in this regard (as suggested by Recommendation 10). We believe this is critical to facilitating informed choice for investors as to how they wish to invest their assets, including directing capital towards strategies which more proactively and explicitly factor in ESG issues.

The proportionality principle afforded by the 'comply or explain' approach is appropriate here as there may be circumstances where the recommendations may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ. It may be helpful to revise the wording of Recommendation 10 to reflect this. We agree that where a provider claims to offer sustainable products, they need to be able to demonstrate competence and expertise (as set out in Recommendation 11).

The field of ESG investing (which can encompass responsible investing, and sustainability investing) is broad ranging and rapidly evolving given it is still in its infancy. An approach to regulation, which is principles-based in such a dynamic field can avoid stifling innovation or being too onerous, whilst delivering effective and efficient outcomes. As such, for recommendations related to sustainable instruments (number 4 through to 9, but especially numbers 4 and 5), these should avoid being too prescriptive about what qualifies and allow for evolution, whilst seeking to ensure a minimum standard to promote trust and confidence.