5 February 2015

President Jean-Claude Juncker, Commissioner Jonathan Hill
European Commission
Rue de la Loi/Wetstraat 200
1049 Brussels
Belgium

Dear President Juncker, Commissioner Hill,

Re: Core elements of the European "Capital Markets Union"

We write to you, as investors interested in deploying increased volumes of capital into European infrastructure and other concerned stakeholders to share some thoughts on the core elements of a successful European "Capital Markets Union". We applaud your focus on getting the EU economy growing again – and support the aim of exploring ways of diversifying financing sources for the real economy, improving access to finance for SMEs and allowing capital to flow cross-border to its most productive uses through a European "Capital Markets Union".

As investors we are aware of the opportunities that arise from the need to renew and decarbonise European infrastructure, and which will include financing the EU's "Energy Union". But we are also increasingly aware of the barriers and risks to such investment. These include unsustainable economic activity that assumes unlimited natural resources and capital markets that are systematically short term. What underscores both of these issues is a need to shift toward more long-term and sustainable investing – in the widest sense of the term.

If the Capital Markets Union (and indeed the Energy Union) is to be successful, it will need to include a focus on working to address these wider systemic challenges. It will need to ensure that as the financial stability reforms introduced in the wake of the financial crisis are reviewed and expanded, there is a focus on ensuring incentives and objectives are properly aligned to enable policy-makers to harness the power of the markets to help, not hinder, delivery of a sustainable economy. They include:

- Increased **certainty** for investors – through stable regulatory and tax requirements

but also through public-private partnerships that will be a key element of ensuring sufficient capital is available to deliver the decarbonised infrastructure Europe needs.
- Increased **diversity** in how investors can participate in markets – including facilitating the development of new financing instruments including green bonds and asset backed securities to enable recycling of construction capital.
- Greater **transparency** for investors – including increased requirements for disclosure and review of accounting principles to ensure better incentivisation of long-term stewardship of invested capital to promote stable and inclusive economic growth.

If the Capital Markets Union is to succeed it must ensure all these critical objectives are met. At its core, achieving this will require a significant change to business-as-usual policy making to catalyse a move away from short-termism to a better alignment of interests between all market participants over the long term.

Our experience suggests effective market design can make these objectives achievable but to do this some key principles should be integrated into the Capital Markets Union concept from the outset. They include:

- **Better information**: Robust and credible benchmarks of corporate performance in the area of environmental, social and corporate governance (ESG) performance that clearly target the creation of an inclusive and sustainable society in Europe[1]. There should be a requirement for results to be made available to the public and, as such, this type of approach could be an effective means of building on and implementing the aims of the Non-Financial Reporting Directive.

- **Rewards for long-term success**: One of the main barriers to sustainable long-term capital markets is an excessively short-termist view among market participants driven by tight benchmarking against market cap indices. Companies should be expected to report to the markets less frequently, but do so on a wider set of issues including governance, sustainability and culture in a way that builds on the requirements set out in the Non-Financial Reporting Directive. This is turn will enable investors take into account performance over the longer term – incorporating ESG considerations.

- **Increasing responsible ownership:** Market participants including pension funds, asset managers and investment consultants should be encouraged, through an ‘act or explain’ approach, to consider long-term sustainable development issues in their stewardship of capital. It would then become mainstream governance for such issues to be incorporated into investment decisions of as part of the broader fiduciary duty of asset owners and duty of care of asset managers and investment consultants to their clients.

[1] An example of such a framework is that proposed by the Future Fit Business Benchmark. See http://futurefitbusiness.org/

- **Promotion of alternative sources of finance:** long-term asset owners such as pension funds should be encouraged to consider long-term sustainable value creation in infrastructure investment.

These principles have been developed in detail in Aviva's publication 'Sustainable Capital Markets Union Manifesto'[2] and are also a key focus of the Tomorrow's Capital Markets project undertaken by Tomorrow's Company, of which we are participants[3].

In addition, to ensure the Capital Markets Union can effectively re-orientate capital to deliver a resilient Energy Union that is in line with the EU's 2050 decarbonisation goals, there is a need for:

- **Clarity on long-term real economy goals**: The financial crisis has shown the practical limitations of markets in effectively managing long term and systemic risk. To avoid investment in stranded and vulnerable assets it is critical that clear and stable long term signals are given to markets around long-term infrastructure goals. As such EU Governments should be required to develop national capital raising plans informing the Commission of how they intend to finance the delivery of a near-zero-carbon economy in 2050.

- **Better dialogue between the public and private sector:** A high-level EU forum should be created for the chief executives of leading financial institutions in the EU and the EU finance ministers to work together on new ways to raise and underwrite capital and the Energy Union but also wider infrastructure projects[4].

- **The Jobs, Growth and Investment Package must help not hinder progress**: The Jobs, Growth and Investment Package is an opportunity to kick-start sustainable and inclusive growth within the EU. We applaud the initiative but of the more than 2000 projects identified there is a need to prioritise those that are productive and scalable and are in line with Europe's target to achieve a near zero carbon economy in 2050.

By taking these factors into account the Capital Markets Union can work to ensure financial incentives are aligned with the wider long-term interests of savers and society. In this way a Sustainable Capital Markets Union can be developed with participants that are well informed, investment practices that are transparent and accountable, and instruments that are flexible enough to manage the uncertainties and risks implicit in delivering an inclusive European low carbon transition.

We would appreciate an opportunity to discuss these ideas further with you or your officials at the earliest convenience.

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[2] Aviva (2014) Sustainable Capital Markets Union Manifesto. http://www.aviva.com/research-and-discussion/future-of-capital/

[3] See http://tomorrowscompany.com/tomorrows-capital-markets

[4] This and the previous point are also identified as key recommendations in Aviva's Sustainable Capital Markets Union Manifesto.

Yours sincerely,

Katherine Garrett-Cox CBE, Chief Executive Officer, Alliance Trust PLC

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