Public consultation on long-term and sustainable investment

Fields marked with * are mandatory.

Introduction

Fostering growth and investment is one of **European Commission's top priorities.**

To maintain and extend its competitiveness, Europe needs significant new long-term and sustainable investment.

These can also help achieve the EU's policy objectives linked to the transition to low carbon and climate resilient economy and promote environmentally and socially sustainable wealth creation, including respect for fundamental rights.

The Communication on Long-Term Financing of the European Economy [COM/2014/168 final] emphasized that one of the key features of long-term financing is that investors take longer-term aspects such as environmental, social, governance issues into account in their investment strategies. It further underlined the importance of ESG issues for the longer-term sustainable performance of companies and investors and announced further reflection on incentives for more sustainable investment. The Action Plan on building a Capital Markets Union [COM/2015/468 final] also reiterates the importance of ESG investments.

This consultation seeks to gather information on how **institutional investors, asset managers and other service providers in the investment chain factor in sustainability (ESG) information and performance of companies or assets into investment decisions.** The consultation will also gather information about possible obstacles to long-term, sustainable investment.

The results of this consultation will be used by the Commission to assess the state of play in this field. A feedback document outlining the overall results of the consultation will be made public.

Definitions

For the purpose of this consultation, the following definitions are used:

Sustainable or responsible investment is a comprehensive approach to investment that explicitly takes account of environmental, social and governance (ESG or sustainability) issues and the long-term health and stability of the market as a whole. The evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term. It also implies that an investor should be an *active asset owner* engaging with companies (for example through dialogue on strategy, risk, corporate governance) to improve their performance. [See Principles for responsible investment, What is responsible investment?]

Material *environmental* factors include, among others, carbon emissions, climate change risks, energy usage, raw material sourcing and supply risks, waste and water management. *Social* factors include, in particular, customer and employee relations, health and safety, human capital management, fundamental rights. *Governance* matters include, in particular, board accountability, structure and size, management ability to deliver a strategy, executive compensation schemes, bribery and corruption.

Specific Privacy Statement:

SpecificPrivacyStatement.pdf

About the respondent

* 1. Please provide your full name (authority, association, organisation, enterprise, ..., as applicable)

CFA UK

* 2. Please provide contact details (e-mail, phone number, postal address)

ymathieu@cfauk.org

* 3. Are you replying as:

- ○ a. Public authority
- ○ b. Institutional investor
- ○ c. Asset manager
- ○ d. Other service provider or advisor
- ○ e. Company
- ○ f. Association
- ○ g. Retail investor
- ○ h. Private person
- ◉ i. Other

* Please specify:

Member Society

* 4. Is your organisation registered in the EU Transparency Register? (If not, you may register here, although you do not have to be registered to reply to this consultation.)

- ◉ Yes
- ○ No

* If registered, please indicate your ID number:

817108014753-38

* 5. Please indicate your country of residence or establishment:

- ○ Austria
- ○ Belgium
- ○ Bulgaria
- ○ Croatia
- ○ Cyprus
- ○ Czech Republic
- ○ Denmark
- ○ Estonia
- ○ Finland
- ○ France
- ○ Germany
- ○ Greece
- ○ Hungary
- ○ Ireland
- ○ Italy
- ○ Latvia
- ○ Lithuania
- ○ Luxembourg
- ○ Malta
- ○ Netherlands
- ○ Poland
- ○ Portugal
- ○ Romania
- ○ Slovakia
- ○ Slovenia
- ○ Spain
- ○ Sweden
- ◉ United Kingdom
- ○ Other

* 6. Please indicate whether you consent to publication:

- ◉ Under the name indicated – I consent to the publication of all information in my contribution, and I declare that none of it is under copyright restrictions that prevent publication.
- ○ Anonymously – I consent to the publication of all information in my contribution, except my name/the name of my organisation, and I declare that none of it is under copyright restrictions that prevent publication.
- ○ No, I do not consent to the publication of my contribution. I understand that my anonymised responses may be included in published statistical data, for example, to show general trends in the response to this consultation.

Please note that before completing the survey you will have the opportunity to upload documents to further support or illustrate your views.

Questions

1. Rationale for ESG inclusion into investment decisions

1.a. Do ESG factors pay a role in the investment decisions of investors? If not, why?
If yes, please specify which considerations are reflecting in your investment policy and mandates? In what form is this commitment expressed?

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Yes. Typically these factors are considered as long-term risks and are
incorporated into investment decisions on that basis, according to the
time-horizon of particular investment mandates.
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1.b. What is the main rationale for institutional investors and asset managers to take ESG risks and opportunities into account in their investment decisions? Please indicate all the relevant issues (multiple choice)

- [x] a) risk management:
- [x] b) alignment of investment policies with the long-term interests of beneficiaries of the institutional investor,
- [x] c) pressure from clients on whose behalf the institutional investor invests funds,
- [ ] d) seeking a positive social or environmental impact of investments,
- [ ] e) ethical considerations,
- [ ] f) legal or regulatory constraints, please specify,
- [ ] g) other, please specify.

a) risk management:

- [ ] i) managing asset value risk in the short-term, including preservation of investment value, better investment performance,
- [ ] ii) managing asset value risk in the medium-to long-term, mitigation of exposure to long-term and systemic risks,
- [ ] iii) management of liability risks,

Please provide an explanation :

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We have ticked (c) but 'pressure' is the wrong word - client requests and
interests
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2. Information on ESG risks and opportunities

2.a. Which ESG risks do you perceive as material to investors?

It is not what is material to investors - it is what is material to the individual company, which will vary by sector and the geographies of its exposure. Risk has to be viewed from a bottom-up perspective, not a top-down one.

2.b. What are the main sources of reliable and relevant information for investors on material medium- to long-term risks and opportunities, particularly on ESG issues?

The best source is always the company, though some companies need to be challenged to consider certain issues, and then to disclose them. There are external information providers, such as the Carbon Disclosure Project, but specific information presented in the most relevant way for investors will tend to come from individual companies or sector experts.

2.c. Is it difficult for investors to access such information? If so, please specify:

No. Some companies are better than others at disclosing material - and investors will typically have increased doubts about whether poor disclosing companies effectively manage their risks. But diligent and persistent investors can encourage fuller and clearer disclosures by companies, and find other sources of information, which may well be different for each of the ESG elements.

2.d. Is access to such data expensive? If so, please specify:

No. The cost of obtaining data - even from external service providers - is not a significant cost in the overall scheme of the investment process. The cost of companies producing this data is appropriately shared across all investors.

2e. What factors may prevent or discourage companies from disclosing such data?

Generally, investors are right to assume that companies that disclose poorly have something to hide, and are relatively poor in their risk management approach as compared to their peers.

2.f. What is the main rationale for companies to publish such information? Please indicate all the relevant issues. (multiple choice)

- [x] a) relevance of ESG issues to company performance
- [ ] b) attracting financing for specific projects, for example green bonds
- [ ] c) legal or regulatory constraints
- [x] d) demand from investors
- [ ] e) pressure from stakeholders
- [ ] f) other

2.g. Is there sufficient accountability for the disclosure by companies of such information?

Generally, yes. Boards do not – certainly should not – sanction public disclosures unless they have an appropriate basis for doing so.

2.h. What are the best practices as regards internal corporate governance processes to ensure proper reliability of the disclosed information?

As with all public disclosures, boards will need robust processes of initial measurement, and internal audit processes to assure their robustness, in order to be comfortable signing off on public disclosures.

2.i. What is the role of specific ESG investment instruments, like green bonds?

These remain niche products of interest to only a limited group of underlying investors. They are likely to continue to be so: the focus of policy should be on mainstream investment and mainstream investment instruments.

3. Integrating ESG information into risk assessment models of institutional investors and asset managers

3.a. What should an appropriate long-term risk assessment methodology look like? Please indicate some examples of good practice.

Different fund managers will do this in different ways, depending on their investment approach and the time-horizon of their investment mandates. Provided mandates are sufficiently long-term, integrating long-term risk assessments is a natural step. This might be done as part of either (1) a valuation process, with perhaps a cost of capital adjustment, or a discount on the assessed terminal value of the asset, or (2) a quality assessment process, under which companies with poor governance or risk management approaches would be deemed less suitable for investment.

3.b. Are there specific barriers, other than those of a regulatory nature (see question 9) for investors to integrate medium-to long-term risk indicators, including ESG matters in their risk assessment? If so, please indicate what you consider to be the main barriers.

No. Provided mandates are sufficiently long-term (and the behaviour of asset owners in relation to those mandates is also appropriately long-term), there should be no barriers to integrating long-term risk factors. Inevitably, by their nature, there are uncertainties in relation to such risks, but there are uncertainties across investment processes – investment is an art rather than a science – so the existence of uncertainties in themselves are no barrier.

4. Integration of ESG aspects in financial incentives

4.a. When selecting and remunerating asset managers, how do institutional investors take into account asset managers' integration of ESG issues into investment strategies? What are the best practices in this area?

Asset owners have a range of approaches, from taking no interest at all, to having highly specific expectations and asking highly specific questions. The asset owners furthest along the route seek to understand the nature of the investment process and so gain a full understanding of the integration of long-term risk factors into that process. Through a close understanding of the investment process it becomes apparent whether the integration is genuine or simply a process that sits alongside without any genuine integration.

4.b. Is ESG performance and active asset ownership taken into account in the remuneration of the executives and/or board members of institutional investors? What are the best practices in this area?

Rarely. Leading institutions do take these issues into account, but they are exceptions.

5. Capacity of institutional investors

5.a. Do you think that the lack of scale or the lack of skills and resources of some institutional investors may affect their ability to integrate ESG factors in investment decision-making and engage on such issues? If so, how? Please provide evidence if possible.

A lack of scale in the asset owner community can limit funds' ability to hold their fund managers to account generally, across ESG and stewardship matters as well as across performance and value for money. If there is genuine integration of long-term risk factors into the investment process, there should be no lack of resources among fund managers limiting their ability to deliver in these respects.

5.b. Please indicate measures/practices that have contributed to enhance institutional investors' capacity and ability to integrate ESG factors in investment decision-making and engage on such issues.

Fund managers that are humble about their approach and are always willing to learn more, and discover new sources of insight, have led the way in these areas. There is scope for all to continue to improve and enhance their approaches, those firms that recognise this are most likely to do so.

6. Internal governance and accountability of the institutional investor

6.a. To what extent can good internal governance of institutional investors, such as mechanisms aiming to align interests between beneficiaries, board and key executives, influence their ability and willingness to integrate ESG factors in investment decision-making and engage on these issues? Please provide evidence or good practices if possible.

Given that stewardship and long-term risk management arise from a recognition that fund managers operate as fiduciaries in the interests of their ultimate beneficiaries, governance structures which operate to bring this accountability and fiduciary duty to life are helpful.

6.b. Do beneficiaries of pension funds and other institutional investors with long-term liabilities obtain sufficient and clear information about how the fund or investor is managing ESG risks? Can they give their opinion/be consulted on these aspects? Please provide examples of good practice.

See response to 6c.

6.c. Are beneficiaries interested in matters referred to above? Please provide evidence if possible.

Our experience is that this interest is intensely felt where it exists but extremely unusual among the bulk of beneficiaries.

7. The role of other service providers

7.a. Is there sufficient long-term oriented, reliable and relevant external investment research? Are there barriers to good quality external investment research on ESG risks and opportunities? If so, please explain. What role, if any, do financial incentives or conflicts of interests of some service providers play?

There is limited sell-side research in this area, and the definition of research that can be paid for through commission under Mifid II will essentially mean that all such research will need to be paid for separately and independently - whether from traditional sell-side firms or other providers. Fund managers will thus need to actively justify the expenses that they incur. This may have an impact on what is funded and so what is available.

At the moment, we are aware of a few independent research houses that specialise in ESG investment which can be used as a third party input by investors. However, it is worth pointing out that it is as important to fully understand the methodologies employed by these specialists as it is to understand the measurement methods used by the companies themselves, in order that they fit with the investors' own opinions of ESG factors.

7.b. To what extent do investment banks, investments analysts and brokers provide information on medium-to long-term company performance, including corporate governance and corporate sustainability factors, when they make buy, sell and hold recommendations to investors?

This is entirely variable. Some individuals at some sell-side providers do integrate these issues, others do so not at all. Generally, ESG issues are not a significant factor in sell-side sell/buy recommendations.

7.c. To what extent do investment consultants consider the asset managers' approach to ESG issues and active asset ownership when advising institutional investors about the selection of asset managers?

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This is increasing, but from a (very) low level.
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7.d. To what extent do proxy advisors consider medium-to long term performance of companies, including ESG performance, in their voting recommendations?

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This is done variably, but generally there is some consideration to such
matters in voting recommendations.
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7.e. To what extent do credit rating agencies take medium-to long term performance of companies, including ESG performance, into account in their ratings?

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This is increasing, but from a (very) low level.
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7.f. What are the best practices as regards independent external assurance (for example auditor review) for the disclosure by companies of material medium- to long-term risks and opportunities, particularly ESG issues?

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Some matters can be subject to independent external review and assurance, but
many of these issues will more appropriately be assured through internal audit
processes, and the independent audit limited to identification of any
disclosures that are inconsistent with what the external auditor has become
aware of through the audit process.
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8. <u>The role of non-professional investors</u>

8.a. Do you know of initiatives that led to more sustainable and responsible investment from non-professional investors? Please provide details about them.

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We are not aware of any.
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9. <u>Legal or regulatory constraints</u>

9.a. Are there legal or regulatory constraints likely to significantly and unduly prevent or discourage investors from taking a long-term view in their investment strategies and decisions and from investing in a sustainable way? If so, please provide details.

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Fiduciary duties are understood differently in different markets; it would be
useful to provide clarity for all investors that they are not obliged to
consider only narrow financial matters but that they can also consider
material ESG factors as relevant. We also note that a number of European
initiatives - such as Solvency II and some versions of the draft IORP
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Directive seem to discourage long-term investment and a long-term investment mindset.

9.b. Do you believe that there are any barriers to the understanding by institutional investors and asset managers of their fiduciary duties that would not enable them to appropriately take ESG factors into account in their investment decisions? Please explain.

As discussed above, fiduciary duty is understood differently in different markets (in some it is not understood at all); greater consistency might be helpful.

10. Others

10.a. Are you aware of any other incentives or obstacle(s) with a significant impact? If so, which ones?

None

10.b. Would you consider further increase in sustainable investments if market or regulatory conditions for sustainable investment would be more favourable? If so, please provide estimations, if possible.

N/a

You can upload additional documents here:

3320428d-69bf-4458-aa90-e061b3deb857/issues_esg_investing.pdf

Disclaimer:

This document is a working document of the Commission services for consultation and does not in any manner prejudge the final form of any future decision to be taken by the Commission.

Contact

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