BANKING AND FINANCE

Public consultation on institutional investors and asset managers' duties regarding sustainability

Fields marked with * are mandatory.

Introduction

At the end of 2015, governments from around the world chose a more sustainable path for our planet and our economy by adopting the Paris agreement on climate change and the UN 2030 Agenda for Sustainable Development.

Sustainability has since long been at the heart of the European project. The EU is committed to development that meets the needs of the present without compromising the ability of future generations to meet their own needs (Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions 'Next steps for a sustainable European future European action for sustainability' {SWD(2016) 390 final}).

The EU wants its financial system to be aligned with its sustainability objectives. The commitment to incorporating sustainability elements into EU financial services policies and cross cutting initiatives is ingrained in the Mid-Term Review of the Capital Markets Union Action Plan (Mid-Term Review of the Capital Markets Union Action Plan - COM(2017) 292 final).

To develop the overall vision of sustainable finance that this requires, the Commission decided last year to appoint a High-Level Expert Group (HLEG) on sustainable finance under the chairmanship of Christian Thimann. This group is supporting the Commission to develop an overarching and comprehensive EU strategy on sustainable finance.

On 13 July 2017, the HLEG published its interim report which provided a comprehensive vision on sustainable finance. It identified two imperatives for Europe's financial system. "The first is to strengthen financial stability and asset pricing, by improving the assessment and management of long term risks and intangible factors of value creation. The second is to improve the contribution of the financial sector to sustainable and inclusive growth by financing long-term needs and accelerating the shift to a sustainable economy".

In its interim report (EU High-Level Expert Group on Sustainable Finance, 'Financing a sustainable European economy' Interim report, July 2017), the HLEG proposed eight early recommendations for policy action on sustainable finance. The third recommendation focused on establishing a "fiduciary duty"

that encompasses sustainability. The HLEG suggested clarifying that the duties of institutional investors and asset managers explicitly integrate material environmental, social and governance (ESG) factors and long term sustainability.

Given the maturity and the interest of the HLEG recommendation, the Commission has decided to start work on an impact assessment to assess whether and how a clarification of the duties of institutional investors and asset managers in terms of sustainability could contribute to a more efficient allocation of capital, and to sustainable and inclusive growth.

The duties of care, loyalty and prudence are embedded in the EU's financial framework governing obligations that institutional investors and asset managers owe to their end-investors/scheme members. These duties are the foundation of investment process.

The implementation of these duties implies fulfillment of various obligations for asset managers and institutional investors that include, for instance, the duty to act in the best interest of beneficiaries /investors, with due care, skill and diligence in performing their activities, including the identification and management of conflict of interests. They are also required to act honestly, and ensure adequate and proportionate performance of their activities.

Although these duties are embedded in the EU financial legal framework, it appears unclear that they require institutional investors and asset managers to assess the materiality of sustainability risks (i.e risks relating to environmental, social and governance issues). Market practices indicate that institutional investors and asset managers generally understand these duties as requiring a focus on maximising short-term financial returns and disregard long-term effects on performance due to sustainability factors and risks. This can lead to misallocation of capital and might give rise to concerns about financial stability since markets can be vulnerable to abrupt corrections, such as those associated with the delayed transition to low carbon economies.

This consultation will help the Commission gather and analyse the necessary evidence to determine possible action to improve the assessment and integration of sustainability factors in the relevant investment entities' decision-making process.

Please note: In order to ensure a fair and transparent consultation process **only responses received through our online questionnaire will be taken into account** and included in the report summarising the responses. Should you have a problem completing this questionnaire or if you require particular assistance, please contact fisma-investors-duties-sustainability@ec.europa.eu.

More information:

- on this consultation
- on the protection of personal data regime for this consultation

Glossary

Relevant investment entities: entities managing assets entrusted to them

Sustainability factors: for the purpose of this consultation, sustainability factors refer to environmental, social and governance issues as defined by the United Nations Environment Programme (UNEP) (*UNEP Inquiry, Definitions and Concepts: Background Note, 2016*). The exact scope of sustainability factors to be addressed is also the object of this consultation.

Environmental issues relate to the quality and functioning of the natural environment and natural systems including biodiversity loss; greenhouse gas emissions, renewable energy, energy efficiency, natural resource depletion or pollution; waste management; ozone depletion; changes in land use; ocean acidification and changes to the nitrogen and phosphorus cycles

Social issues relate to rights, well-being and interests of people and communities including human rights, labour standards, health and safety, relations with local communities, activities in conflict zones, health and access to medicine, consumer protection; and controversial weapons.

Governance issues relate to the management of investee entities. Issues include board structure, size, diversity, skills and independence; executive pay; shareholder rights; stakeholder interaction; disclosure of information; business ethics; bribery and corruption; internal controls and risk management; and, in general, issues dealing with the relationship between a company's management, its board, its shareholders and its other stakeholders.

1. Information about you

* Are you replying as:

- ○ a private individual
- ◉ an organisation or a company
- ○ a public authority or an international organisation

* Name of your organisation:

Actuarial Association of Europe

Contact email address:

The information you provide here is for administrative purposes only and will not be published

esko.kivisaari@finanssiala.fi

* Is your organisation included in the Transparency Register?

(If your organisation is not registered, we invite you to register here, although it is not compulsory to be registered to reply to this consultation. Why a transparency register?)

- ◉ Yes
- ○ No

* If so, please indicate your Register ID number:

550855911144-54

* Type of organisation:

- ○ Academic institution
- ○ Company, SME, micro-enterprise, sole trader
- ○ Institutional investor
- ○ Consultancy, law firm
- ○ Consumer association
- ○ Industry association
- ○ Media
- ◉ Non-governmental organisation
- ○ Think tank
- ○ Trade union
- ○ Other

* Where are you based and/or where do you carry out your activity?

Other country

* Please specify your country:

European association with members in all EU countries and some other European countries

* Field of activity or sector (*if applicable*):

at least 1 choice(s)

- [ ] Accounting
- [ ] Auditing
- [ ] Banking
- [ ] Credit rating agencies
- [ ] Insurance
- [ ] Occupational pension provision
- [ ] Personal pension provision
- [ ] Collective Investment Management
- [ ] Individual portfolio management
- [ ] Financial advice
- [ ] Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)
- [ ] Service provider (e.g. index provider, research providers)
- [ ] Other
- [x] Not applicable

Important notice on the publication of responses

* Contributions received are intended for publication on the Commission's website. Do you agree to your contribution being published?
(see specific privacy statement)

- (•) Yes, I agree to my response being published under the name I indicate (*name of your organisation /company/public authority or your name if your reply as an individual*)
- ( ) No, I do not want my response to be published

2. Your opinion

2.1 Questions addressed to all respondents:

I. General overview

1) Do you think relevant investment entities should consider sustainability factors in their investment decision-making?

- (•) Yes
- ( ) No

No opinion

Please explain the reasons:

Sustainability factors are essential to assess the reliability of cash flow of investments, as explained in the cover letter uploaded under 3. Additional Information
Investment decision-making is fundamental to the efficient use of capital in furtherance of the aims of society. A decision to allocate capital to an investment in an enterprise which is unsustainable must surely require justification at the very least (and could conceivably not be allowed at all). A corollary of this must then be that sustainability must be a consideration in that allocation process. While this is particularly evident in the case of long-term investors, we see no reason why similar logic should not be applied when the investor's time horizons are unconstrained.
Put another way, the financial system is a subset of the broader economic system, which is itself a subset of our wider societal systems, all within the encompassing system of the environment. None exist in isolation and the health or otherwise of one of these complex systems impacts all the others. Alignment of these systems and their continuing health could be said to be a definition of sustainability. If this is the case, the answer to the question asked must be "yes".

2) What are the sustainability factors that the relevant investment entities should consider? (Please make a choice and indicate the importance of the different factors (1 is not important and 5 is very important). (Please refer to the definition in the Glossary).

	Yes	No	No opinion
Climate factors (these include climate mitigation factors as well as climate resilience factors)	●	○	○
Other environmental factors	●	○	○
Social factors	●	○	○
Governance factors	●	○	○
Others	●	○	○

Please specify others:

At least Human Rights should be added. We appreciate potential difficulties with the topic on UN level, but are convinced that EUROPE can find appropriate wording based on its traditions. Other root causes of reputational risk should be considered.

Importance for climate factors:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ● 5

Importance for other environmental factors:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Importance for social factors:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Importance for governance factors:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Importance for others:

- ○ 1
- ○ 2
- ◉ 3
- ○ 4
- ○ 5

Please specify, which specific factors within the above categories you are considering, if any:

As a professional organisation, we do not directly make investment, lending or underwriting decisions. However, some of our ultimate members contribute to or are responsible for the assessment of investment risk. The degree to which factors will be considered may depend on the relative importance of those factors.

3) Based on which criteria should the relevant investment entities consider sustainability factors in their investment decision making?

Please explain:

This is an extremely broad question. However, at a high level, our view is that this question of setting criteria flows directly from the investment objectives of the asset owner. Insurance and pensions undertakings have a firm obligation to invest in a reliable way to ensure that their liabilities can be met with a high probability. The criteria should be set in line with these objectives.

4) Which of the following entities should consider sustainability factors in their investment decision-making? (Possibility to select several answers). If so, please indicate the level of impact that this would have (1 is the smallest impact and 5 is the highest impact).

	Yes	No	No opinion
Occupational pension providers	◉	○	○
Personal pension providers	◉	○	○
Life insurance providers	◉	○	○
Non-life insurance providers	◉	○	○
Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF)	◉	○	○
Individual portfolio managers	◉	○	○

Please explain:

For insurance and pension providers, the need to consider and the ranking is a consequence of the answers giver to Question 1-3 and the reason explained in the cover letter uploaded under 3. Additional information. To the extent that Collective Investment Funds and Portfolio Managers want to offer investment solution to insurers and pensions providers they need to follow the same logic.
It is impossible for an organisation of professionals to answer the following questions under II. Problem, since it will depend on the concrete undertaking, its location, main currency etc.

Level of impact for occupational pension providers:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Level of impact for personal pension providers:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Level of impact for life insurance providers:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Level of impact non-life insurance providers:

- ○ 1
- ○ 2
- ○ 3
- ◉ 4
- ○ 5

Level of impact for collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF):

- ○ 1
- ○ 2
- ○ 3
- ◉ 4
- ○ 5

Level of impact for individual portfolio managers:

- ○ 1
- ○ 2
- ◉ 3
- ○ 4
- ○ 5

II. Problem

5) To your knowledge, what share of investment entities active in the EEA (European Economic Area) currently consider sustainability factors in their investment decisions?

	All or almost all	More than two thirds	More than half	More than a third	None or almost none	No opinion
Occupational pension providers	○	○	○	○	○	◉
Personal pension providers	○	○	○	○	○	◉
Life insurance providers	○	○	○	○	○	◉
Non-life insurance providers	○	○	○	○	○	◉
Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF)	○	○	○	○	○	◉
Individual portfolio managers	○	○	○	○	○	◉

6) To your knowledge, which is the level of integration of sustainability factors by the different investment entities (active in the EEA)?

	High integration	Medium integration	Low integration	No integration	No opinion

Occupational pension providers	○	○	○	○	◉
Personal pension providers	○	○	○	○	◉
Life insurance providers	○	○	○	○	◉
Non-life insurance providers	○	○	○	○	◉
Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF)	○	○	○	○	◉
Individual portfolio managers	○	○	○	○	◉

7) Which constraints prevent relevant investment entities from integrating sustainability factors or facilitate their disregard. Please provide the importance of the different constraints that you consider relevant (1 is not important and 5 is very important).

	1	2	3	4	5	No opinion
Lack of expertise and experience	○	○	○	○	○	◉
Lack of data/research	○	○	○	○	○	◉
Lack of impact on asset performance	○	○	○	○	○	◉
Inadequate methodologies for the calculation of sustainability risks	○	○	○	○	○	◉
Inadequate sustainable impact metrics	○	○	○	○	○	◉
Excessive costs for the scale of your company	○	○	○	○	○	◉
No interest from financial intermediaries	○	○	○	○	○	◉
No interest from beneficiaries/clients	○	○	○	○	○	◉
European regulatory barriers	○	○	○	○	○	◉
National regulatory barriers	○	○	○	○	○	◉
Lack of fiscal incentives	○	○	○	○	○	◉
Lack of eligible entities	○	○	○	○	○	◉
Others	◉	○	○	○	○	○

Please specify others:

Others added only to express the following:

It seems that it is challenging for the investment community and indeed within society at large to understand sustainability and its true meaning for mankind. There is a lack of data and of research, both on sustainability and indeed its impacts on performance of undertakings. That the current methodologies for the calculation of sustainability risks are inadequate was the in large part the rationale for the TCFD work.

For insurers and pension providers there are regulatory constrains to investments. Some of them are well founded and reasonable to protect policyholders and beneficiaries. Sustainable investments should comply with those prudential requirements to be eligible (the HLEG interim report refers). We cannot see that there is a lack of fiscal incentive for investing sustainably, although it is possible that there is a lack of eligible entities, thinking here about for example suitable infrastructure programmes.
Contradictory signals by Governments or state agencies facilitate disregard. Inertia is further entrenched by failure to interpret fiduciary duty in the light of the clear financial warnings issued by the TCFD and the FSB about the need for an "orderly" transition. As a counter-balance, it may therefore be useful to consider ESG issues (which is a very wide collection of risks) through the lens that is provided by the SDGs. We would urge the EU or HLEG to explore this further, and would be happy to engage if helpful.

Please provide more details on what the constraints/reasons are and how they limit the integration of sustainability factors:

8) How challenging is it for relevant investment entities to integrate the different sustainability factors? (1 is not challenging and 5 is very challenging) - Please refer to the definition in the Glossary).

	1	2	3	4	5	No opinion
Climate factors (*these include climate mitigation factors as well as climate resilience factors*)	○	○	○	○	○	◉
Other Environment factors	○	○	○	○	○	◉
Social factors	○	○	○	○	○	◉
Governance factors	○	○	○	○	○	◉
Others	○	○	○	○	○	◉

III. Policy options

9) In which area should relevant investment entities consider sustainability factors within their investment decision-making? Please make a choice and indicate the relevance of the different areas (1 is minor relevance and 5 is very high relevance).

	Yes	No	No opinion
Governance	◉	○	○
Investment strategy	◉	○	○

Asset allocation	◉	○	○
Risk management	◉	○	○
Others	◉	○	○

Please specify others:

Manager selection

Relevance for governance:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for investment strategy:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for asset allocation:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for risk management:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for others:

- ○ 1
- ○ 2
- ○ 3
- ○ 4

- [x] 5

10) Within the area of governance, which arrangements would be most appropriate to enable the integration of sustainability factors? (1 is the not appropriate and 5 is the very appropriate).

	1	2	3	4	5	No opinion
Specific sustainability investment Committee	○	○	○	○	○	●
Specific sustainability member of the Board	●	○	○	○	○	○
Sustainability performance as part of remuneration criteria	○	○	○	○	●	○
Integration of sustainability factors in the investment decision process	○	○	○	○	●	○
Integration of sustainability checks in the control process	○	○	○	○	●	○
Periodic reporting to senior management/board	○	○	○	○	●	○
Others	●	○	○	○	○	○

Please specify others:

see Comment uploaded under III Additional Information.

11) Should insurance and pension providers consult their beneficiaries on an annual/periodic basis on their preference as regards sustainability factors?

- [ ] Yes
- [x] No
- [ ] No opinion

Please explain:

We believe that insurance and pension providers should think and act sustainably. Where the investment risk and return is attributed to the insurer or pension provider, the undertaking should inform their Stakeholders including their beneficiaries as part of their annual report. Where the investment risk and return is attributed to the beneficiary, the beneficiary should be consulted appropriately. That this is relevant and important is most easily seen in the case of the intersection of climate risk and pension products. Here people in their 20s will be investing and decumulating over a timescale in which the effects attributable to warming and related climate factors will come to pass.

12) Within the portfolio's asset allocation, should relevant investment entities consider sustainability factors even if the consideration of these factors would lead to lower returns to beneficiaries/clients in the medium/short term?

- [x] Yes

- ○ No
- ○ No opinion

Please explain:

They should be considered as a fundamental part of the investment process. It may be that the asset owner who ultimately should determine the strategy may, having considered all the relevant factors, choose to deviate from a "pure" sustainability agenda in certain aspects, whether tactically or strategically, over different timeframes. However, the consideration of all the pertinent facts is axiomatic, regardless of the ultimate specific decision.
This said, we believe this is a misleading question, which goes to the heart of a widespread and mistaken belief that sustainability costs money in terms of foregoing maximum returns. This is not necessarily the case. Actually, often, the reverse is true. Proper consideration of all factors, including sustainability ones, means the investor can eliminate unremunerated risks, such as being overweight in carbon-emitting assets, with the end result of improving long-term risk return outcomes.

13) Within the area of risk management, does the current set of corporate disclosures provide the relevant investment entities with adequate information to perform sustainability risk assessments in respect of investee companies?

- ○ Yes
- ◉ No
- ○ No opinion

Please explain where the possible gaps are, if any:

These gaps were explored in, for example, the work done by the Task Force on Climate-related Financial Disclosures – the "Bloomberg recommendations". We endorsed those recommendations, which would, if implemented at scale, significantly improve risk disclosures and understanding. In time, once "Bloomberg" has been adopted either voluntarily or through compulsion, we believe it will be appropriate to commission a similar piece of work, extending the remit from "climate-related" to sustainability in a wider context.

14) Do the overall information or risk metrics available enable the relevant investment entities to adequately perform sustainability risk assessments?

- ○ Yes
- ◉ No
- ○ No opinion

Please explain where the possible gaps are, if any:

See our response to 13 above.

15) Do you think that uniform criteria to perform sustainability risk assessments should be developed at EU level?

- ○ Yes

- [x] No
- [ ] No opinion

Please explain:

Our preferred approach would be to see the development of principles based regulation on a holistically consistent footing, spanning fiduciary duties in their widest context. Having set the principles, the development of detailed criteria would then be for the entities themselves. A regulatory approach is warranted, as it is clear that a voluntary system is insufficient.

16) In case material exposure to sustainability factors is identified, what are the most appropriate actions to be performed by the relevant investment entity?

Consistent with our previous responses, the answer to this question must lie with the ultimate asset owner, and needs to be consistent with their underlying objectives. It may be that the asset owner is content to be long or short on sustainability, in the common investment jargon, within specific time-periods. This is a matter for each investor to decide. If they are not content with their position, having analysed it in the light of additional sustainability information, they will need to develop a re-risking in the context of an overall risk management plan in conjunction with their asset managers and investment consultants as applicable.
There is, however, another valid school of thought that suggests that the scale of the challenge is such that maintaining a short position, or in the language of the question, a “material exposure”, should not be permitted, as it effectively allows entities to bet against a common public good. However, the mechanism should be compatible with the economic assessment of the investment, i.e. the cost associated with the lack of sustainability affecting the public good should be internalised with the investment return of the investment.

17) Should relevant investment entities disclose how they consider sustainability factors within their investment decision-making?

- [x] Yes
- [ ] No
- [ ] No opinion

Please explain:

This process is well within the scope of good governance and regulation, and we would expect relevant regulators to expect and insist on disclosure of this type of information periodically. We would not necessarily expect detailed disclosure to be public however. The outcomes of the decision-making process should clearly be in the public realm in any event.

If yes, what areas should the disclosure cover? Please make a choice and indicate the relevance of disclosure within the different areas (1 is minor relevance and 5 is high relevance):

	Yes	No	No opinion
Governance	◉	○	○
Investment strategy	◉	○	○

Asset allocation	◉	○	○
Risk management	◉	○	○
Other	◉	○	○

Please specify others:

Manager selection

Relevance for governance:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for investment strategy:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for asset allocation:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for risk management:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ◉ 5

Relevance for other:

- ○ 1
- ○ 2
- ○ 3

- ○ 4
- ◉ 5

If yes, where?

	Yes	No	No opinion
Pre-contractual disclosure (e.g. prospectuses)	◉	○	○
Semi-annual/annual reports	○	◉	○
Periodic reports	○	○	◉
Website	○	○	◉
Newsletters	○	○	◉
Factsheets	○	○	◉
Marketing materials	○	○	◉
Others	◉	○	○

Please specify others:

Regulatory disclosures

IV. Impacts for stakeholders

18) Which stakeholder groups would incur costs and which would benefit from integrating sustainability factors within investment decision-making by relevant investment entities?

	Benefits	Costs
Occupational pension providers	☑	☐
Personal pension providers	☑	☐
Life insurance providers	☐	☐
Non-life insurance providers	☑	☐
Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF)	☑	☐
Individual portfolio managers	☑	☐
General public	☑	☐

Retail investors	☑	☐
Financial advisors	☑	☐
Service providers (index provider, research providers…)	☑	☐
Other stakeholders (please specify)	☑	☐

Please explain:

Clearly there will be costs. However, in the long run, performance must be improved in the light of better informed decision making, and besides, the ultimate cost of failing to be sustainable is existential by definition. Given that the purpose of intermediation of savings is to invest sustainably it follows doing things towards sustainability is a necessary cost of business.
The cost should be borne by the investments lacking sustainability and should affect their return.

2.2 Questions addressed to end-investors

1) Do you take into account sustainability factors when you choose your investment products or investment entity?

- ○ Yes
- ○ No

3. Additional information

Should you wish to provide additional information (e.g. a position paper, report) or raise specific points not covered by the questionnaire, you can upload your additional document(s) here:

926342d8-80e9-4981-bbad-d558566f5d66/180121_-_investors-duties-sustainability-_AAE_Coverletter_and_Comments.docx

Useful links

More on the Transparency register (http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en)

Consultation details (https://ec.europa.eu/info/consultations/finance-2017-investors-duties-sustainability_en)

Specific privacy statement (https://ec.europa.eu/info/files/specific-privacy-statement-institutional-investors-and-asset-managers-duties-regarding-sustainability_en)

Contact

fisma-investors-duties-sustainability@ec.europa.eu