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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:

AIMA

Contact email address:

The information you provide here is for administrative purposes only and will not be published

madenicolay@aima.org

*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:

232566516087-90

*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?

United Kingdom

* 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
- [x] 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
- [ ] Not applicable

Type of funds managed (in the case of asset managers)

- [x] UCITS
- [x] AIFs

Total assets under management in EUR (as of 30.09.2017)

Membership AUM: EUR 2tn

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

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:

Which sustainability factors asset managers should consider should depends on their clients' requirements. As regards existing fiduciary duty, we would like to highlight that by essence fiduciary duties are high level principles, and should remain so, to enable the agent to be fully aligned with its principal's objectives and interests. Substantive ESG requirements, which by their nature would necessarily reflect political choices, should not be forcefully imposed on the principal by regulation of the asset manager/agent. Asset managers often service clients from many different locations and each will be subject to its own regulatory requirements and have its own political views about which aspects of an ESG programme are most important and what the decision factors should be. If these choices are taken away from the client because the asset manager is required to manage assets subject to specific ESG requirements, many clients may choose to take their business to asset managers who will implement an ESG programme subject to the needs and desires of the client rather than subject to the strictures imposed externally.

Importance for others:

- ○ 1
- ○ 2
- ○ 3
- ○ 4
- ○ 5

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

Please explain:

Investor interest in responsible investment and consideration of environmental, social and governance (ESG) factors with respect to their investment portfolios has been increasing over recent years. However, even among interested investors, there are differences in what they individually think the appropriate ESG factors and limitations on an investment portfolio ought to be, reflecting differing values-based economic and social priorities. Investors who are interested in the application of ESG factors for their investments have two broad options when choosing a way to access the services of an asset manager to assist them in making these investments: (i) enter into a bilateral agreement for the management of a separate account or (ii) invest in a collective investment scheme managed by the asset manager.

While many different asset managers and asset management strategies have incorporated ESG factors in their investment process, it is our understanding that the most mature part of the market in this regard is made of equity and fixed income funds investing in public markets where ESG data is more readily available. As the investment strategy moves further away from the traditional long-only model, the application of ESG factors becomes more complex. For some alternative strategies, incorporating ESG factors may not be applicable to the types of investments being made. Due to these complexities, alternative strategies often pursue a thematic approach, such as renewable energy or real assets. Rather than mandating ESG factors be incorporated by asset managers, we encourage EU policymakers to consider adopting some guidance for ESG-compliant investment strategies that investors could rely on when selecting a manager. Such a voluntary approach could avoid the potential competitiveness concerns for EU managers that could arise from obligating EU managers to adopt a different standard than the ones applying to other managers in their respective jurisdictions, while permitting the EU to introduce a framework that could be emulated in other jurisdictions if it proves commercially successful.

For the reasons discussed below, we believe that the change in investment processes being sought by the Commission in this consultation would be best achieved though creating incentives for investors on the demand side of the asset management process rather than imposing requirements (especially any proscriptive requirements regarding factors which must be applied as part of an asset manager's fiduciary obligations) to asset managers on the supply side of the asset management process. When designing incentives for investors to incorporate ESG factors into their investments, policymakers should recognise it may be impracticable, or even impossible, to incorporate all ESG factors into every investment, as opposed to a framework that incentivises investors to incorporate different ESG factors into different investments over time. We believe this approach would better achieve the goal of having investors incorporate ESG into their investment decisions while efficiently allocating their capital to different companies and industries.

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	◯	◯	◯

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:

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

Many asset managers already integrate ESG factors to address their clients' requests or appetite, notably by following the guidance suggested by the United Nations Principles for Responsible Investment (UN PRI), with whom AIMA and other market participants have partnered to design a specific standard due diligence questionnaire for hedge funds taking into account ESG factors. These asset managers currently face a few hurdles and challenges which should be treated as a priority in the consideration of the promotion of the application of ESG factors:

1- A challenge some managers wanting to take up ESG factors voluntarily face is linked to fiduciary duty interpretation. We recognise that some interpretive guidance exists for managers http://www.oecd.org/cgfi/Investment-Governance-Integration-ESG-Factors.pdf) regarding whether the fiduciary duty of the asset manager would permit it to integrate ESG factors in its investment strategy without conflicting with fiduciary principles such as best profit outcome. To the extent there remains legal uncertainty in this regard, however, further clarification and guidance that asset managers may incorporate ESG factors consistent with their fiduciary duty when the agreement between the manager and its clients permits the incorporate of such factors would be welcome.

2- There is currently insufficient data available in relation to ESG factors from issuers, which is not helpful to asset managers who use such data to consider ESG risks when conducting fundamental analysis of listed corporates or related derivatives. Strong and empirical data showing the link between ESG factors consideration and long-term performance in financial terms would help in providing incentives to investors when making their asset allocations.

3- Shareholder engagement is crucial to address material exposure to sustainability risks as engaged shareholders can contribute to shaping a corporate board's strategy to improve its sustainability performance by using available corporate governance tools, such as the right to put a resolution on an AGM agenda, the right to vote for or against a resolution, etc. Unfortunately, in some countries, the national law often protects a specific type of shareholders to the detriment of active minority shareholders. In France, for example, the Loi Florange grants a double-voting right to shareholders who have been holding registered shares for more than two years. Given the complexity of the local process to register shares, this right is effectively benefitting large French long-term shareholders to the detriment of non-French asset managers or shareholders.

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	○	○	○

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						

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

- Yes
- No
- No opinion

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?

- Yes
- No
- No opinion

Please explain:

The asset management industry operates using an agency business model, whereby a principal (the asset owner or the client in this instance) designates an agent (i.e., the asset manager) to act on its behalf. This relationship is contractually framed and the agent's primary duty is to protect and enhance the principal's assets. In certain markets, this duty is called 'fiduciary duty'. Where the principal wants investments on its behalf to be made applying specific ESG factors (whether these are set by the principal as a matter of preference or by reason of regulatory requirements applicable to the principal), those requirements can be incorporated into the contractual arrangement and, in this way, the application of the factors will automatically become part of the fiduciary duty owed by the agent. No separate statutory fiduciary duty is necessary. Where the application of ESG factors is handled this way, each principal is able to set its own ESG factors and should not be affected by the preferences and requirements of other principals/investors contracting with the same agent/asset manager.
If the ESG factors to be applied are instead driven by regulatory requirements applicable to the agent and therefore to be applied to all contractual relationships the agent enters into, those constraints may result in a misalignment of objectives between the agent and the principal who may have different ESG factors preferences than those imposed, or may even be subject to conflicting or incompatible regulatory requirements, thereby breaking the basic duty the agent owes its principal. AIMA and MFA members believe this fundamental distinction of roles in the principal-agent relationship that dominates the asset management industry needs to be at the heart of any consideration regarding the most efficient and efficacious means of integrating ESG factors into asset management / institutional investor relationships.

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:

There is currently insufficient data available in relation to ESG factors from issuers, which is not helpful to asset managers who use such data to consider ESG risks when conducting fundamental analysis of listed corporates or related derivatives. Strong and empirical data showing the link between ESG factors consideration and long-term performance in financial terms would help in providing incentives to investors when making their asset allocations.

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

- ◯ Yes
- ◯ No
- ◯ No opinion

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

- ◯ Yes
- ◯ No
- ◯ No opinion

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

Shareholder engagement is crucial to address material exposure to sustainability risks as engaged shareholders can contribute to shaping a corporate board's strategy to improve its sustainability performance by using available corporate governance tools, such as the right to put a resolution on an AGM agenda, the right to vote for or against a resolution, etc. Unfortunately, in some countries, the national law often protects a specific type of shareholders to the detriment of active minority shareholders. In France, for example, the Loi Florange grants a double-voting right to shareholders who have been holding registered shares for more than two years. Given the complexity of the local process to register shares, this right is effectively benefitting large French long-term shareholders to the detriment of non-French asset managers or shareholders.

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

- ◯ Yes
- ◯ No
- ◯ No opinion

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:

ESG factors imposed by law in the fiduciary duty of the asset manager would negatively affect the capacity of the asset manager to design a product primarily directed to serve investors' heterogenous preferences and objectives and may limit the asset manager's ability to attract investors who do not want their investments to be subject to the same ESG factor requirements to which the asset manager is subject. If a fund cannot attract enough investors, the cost on a per share basis may become so high that the fund is not economically viable and is forced to close, resulting in a lost opportunity for those investors who were initially interested in the strategy. Moreover, such regulation might also affect the asset manager's capacity to design innovative and competitive products because they might fall afoul of inflexible ESG factors or criteria which have been developed through the legislative process and can only be changed in that way.

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

2.3 Question specifically addressed to relevant investment entities

1) **As a relevant investment entity do you consider sustainability factors?**

- ○ Yes
- ○ No

2) **What would be the level of costs associated with the integration of sustainability factors in investment decision making in the different areas? Please tick the relevant box.** *(Costs as % of the AUM).*

	< 0.5% of the AUM	0.51% to 1% of the AUM	1.01% to 3% of the AUM	3.01% to 5% of the AUM	> 5% of the AUM	No opinion
Governance	○	○	○	○	○	○
Investment policy	○	○	○	○	○	○
Valuation	○	○	○	○	○	○
Risk management	○	○	○	○	○	○
Disclosure	○	○	○	○	○	○
Overall cost	○	○	○	○	○	○

3) **Please explain whether integration of sustainability factors in any of the above mentioned areas would lead to particularly significant (or potentially disproportionate) impacts in terms of costs or benefits incurred by stakeholders.**

4) **Do you engage with your clients/beneficiaries as regards their sustainability preference?**

- ○ Yes
- ○ No

5) **What could be the benefits associated with the integration of sustainability factors? Please, specify and quantify where possible and relevant.**

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:

86760ebc-2cc5-433b-8e9d-fe8264cf17ee/Sustainability_Consultation_-__22_January_2018.pdf

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