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European Fund and Asset Management Association

EFAMA response to inception impact assessment – Institutional investors' and asset managers' duties regarding sustainability

EFAMA welcomes the opportunity to comment on the European Commission's Inception Impact Assessment on institutional investors' and asset managers' duties regarding sustainability.

Asset managers are considering sustainability risks within their financial decision-making

We agree with the European Commission (EC) that asset managers, as intermediaries between investors and financial markets, have a role and influence on sustainability. Asset managers embrace sustainability as an integral part of the investment process and support the development of responsible investment in all of its forms.

We also agree with the EC on the focus on institutional investors, defined as insurance companies and pension funds in the Inception Impact Assessment. To provide some context on the respective roles and purposes of institutional investors and asset managers, the former are asset owners who make strategic investment decisions with the view of meeting their long-term, medium-term and short-term liabilities (and some would explicitly have impact objectives too); whereas the latter manage the financial assets that the asset owner entrusts them to protect and enhance. Asset managers will make tactical investment decisions. Further, insurance companies and pension funds, identified as institutional investors by the EC, are only two out of a broader range of institutional asset owners (public entities, sovereign wealth funds, charities, foundations, banks, inter alia). Finally, according to McKinsey[1], asset owners manage 76% of their assets in house, while 24% is managed by third-party / external asset managers. We encourage the EC to consider these significant differences between the role, influence and purposes of institutional investors and asset owners when looking at their respective financial decision-making.

As said above, we agree that the European asset management industry has a role to play in contributing to the sustainability agenda. We see this role in 3 distinctive parts:

- First, the asset management industry provides its clients, institutional investors and other asset owners, investment solutions that respond to their investment as well as ESG / impact demands;
- Secondly, asset managers can give institutional investors the tools and advice for selecting ESG investments or mainstream investment shaped by ESG considerations;
- Thirdly, asset managers act as engaged shareholders on behalf of their clients.

[1] http://www.asset-management-summit-2015.com/pdf/2013_Asset_management_brochure_20130723.pdf

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It is fundamental to highlight that asset managers are already legally required to act in the best interests of their clients. As part of this duty, asset managers increasingly seek to integrate an assessment of material ESG factors in their investment process and decisions and to monitor and mitigate their risk, where these factors are deemed to have a material impact on performance.

It is widely acknowledged that the application of ESG strategies in the investment process is an important risk management tool which seeks to better appreciate investment performance over the long-term. Asset managers' business models revolve around protecting and enhancing their clients' assets in the long-term. To this end, asset managers often seek to integrate ESG factors into their investment process – where such integration is relevant and material – to fulfil the long-term obligations to their clients. ESG factors can serve as a key parameter for evaluating the likely long-term performance of companies and projects in which asset managers plan to invest in on behalf of their clients. Thus their consideration is an important element of how asset managers ensure they act in the best interest of their clients and protect their clients' investments over the long-term.

Furthermore, it is important to note that asset managers' business models dictate that investments are made in capital markets and projects based on their clients' (both individuals and institutional asset owners) investment guidelines, their investment profile and their best long-term interest. This requires that asset managers consider ESG factors within the parameters set out by the asset owners. This may include the material risks posed by ESG factors.

It is misleading to lead with the assertion that "asset managers do not necessarily consider sustainability risks within their financial decision-making". Whilst integration of ESG factors is not applied uniformly across the industry, evidence would suggest that integration of these factors has increased in the market over recent years. As an illustration of this, a survey[2] by CFA shows that nearly three-quarters of investment professionals worldwide (73%) take ESG factors into consideration in the investment process, with the highest concentration of CFA Institute members, who responded to the survey, considering ESG issues being in the Europe, Middle East, and Africa (EMEA) region (85%), followed closely by respondents in the Asia-Pacific (APAC) region (81%).

Asset managers are engaging with companies on ESG concerns

Asset managers also exercise stewardship and engage with companies on their ESG performance through direct contact with management or board members. This will include engagement on not just the company's governance, but also on their management of social and environmental risks, such as climate change, and will help identify and reduce ESG risks to ensure companies remain a sustainable long-term investment proposition. In doing so asset managers seek to best protect the interests of their clients today and in the future.

Policy options

In view of the current regulatory landscape and evidence that practices are already strong or getting stronger, EFAMA does not believe a legislative crystallisation of integrating sustainability

[2] https://www.cfainstitute.org/learning/future/Documents/ESG_Survey_Report_July_2017.pdf

considerations in institutional investors and asset managers' duty is necessary. However, we would support clarification through guidelines, which would reinforce institutional investors' and asset managers' considerations of sustainability factors where relevant and material without creating further uncertainty and procedural delays that a Level 1 legislative process would entail.

We agree with the EC that it is of utmost importance to have transparency around the integration of sustainability in the investment process of asset managers and we agree that there could also be an opportunity to improve the framework, where relevant, for good quality disclosure by asset managers to their clients regarding their policy of how they integrate ESG considerations in their investment processes. This is effectively what is happening through market-lead Principles for Responsible Investment (PRI).

However, the following considerations are important:

- While policy makers can generally facilitate enhancement of ESG investments, the means of doing so should be carefully considered. ESG issues are linked to economic activities and associated innovation and behaviours, and therefore evolve over time. Their materiality depends on economic policy orientations regarding ESG impacts of activities. Any mandatory requirement in particular regarding investments will turn ESG into a compliance exercise and do away with the wide range of views and ways of working given that views on sustainability of specific investments differ significantly depending on the specific investor. Any one size fits all approach would limit the possibility to act according to specific investors' situation and would introduce aspects of a planned economy into a market economy.

- As well as being a risk management tool for asset managers, ESG dedicated investments, such as allocating to green projects, will hinge on client demand. Asset owners need to be clear in identifying their ESG wishes and strategies and setting their expectations as part of mandates or choosing ESG products. Any new policy initiative by the EC cannot change the fundamental fact that asset owners have a crucial role to play in setting their expectations as part of mandates or by choosing ESG products.

- Any policy option needs to be proportionate and calibrated to the different actors in the investment chain. Pursuing a uniform horizontal approach as implied with the statement that "the current rules are also not fully aligned across sectors" would ignore the fundamental differences and roles of institutional investors and asset managers. Again, this would run the risk of being seen as a tick box compliance exercise, rather than a deeper conversation about roles and impact.

- The concept of investor duty with regard to sustainability has evolved significantly over the past 20 years. The flexibility around it has been instrumental in allowing this duty to evolve in such a way that material sustainability factors have become increasingly important in the investment process as a risk management tool. However, codifying this duty in a rigid way risks creating a standard that is difficult to apply to the wide range of market participants, and also risks muddling the non-sustainability related considerations inherent within existing concepts of fiduciary duty (or related concepts of care, due skill, etc. in non-common law traditions).

There are some industry standards of best practice which the EC could leverage from in any future guidelines/ recommendations.

- We do not agree that policy options in relation to asset allocation is the way forward. It is crucial that the ESG market is not micro-managed and that we do not end up with an exclusion list or penalties/additional requirements for "brown" investments. The decision should remain with the asset owner and how it intends to fulfil its financial and possibly other needs. Though exclusion of certain assets has historically been the most accessible way of practicing responsible investment, it ignores the role that engagement can have in limiting ESG impacts.

- Policy options for risk management and governance arrangements would be impractical. Asset managers will have different risk management models depending on their investment strategies so a top–down framework could homogenise fund offerings for investors. By requiring disclosure, but not a standardised model, it is down to asset managers to design an approach that aligns with their investment mandate. This will lead to better integration of sustainability with investing.

- Standardised, reliable, comparable and credible information is a pre-condition for asset managers to invest responsibly and is decisive for a proper assessment of long-term risks or long-term factors. In particular, reliability and credibility of the data available is often uncertain and lacks sufficient comparability. Forward looking data and indicators are crucial for ESG-considerations and presently only available to a limited extent. For some ESG factors, common, measurable and comparable data is not yet sufficiently available.

- Finally, it is important to ensure a consistent and coordinated approach at international level to sustainable investment/integration of ESG factors through the adherence to international voluntary standards or the development of global standards by international bodies. European asset managers should not be subject to a more stringent framework which would lead to a distortion of competition with their non-EU counterparts.

With the above considerations in mind, we believe the best policy option would be focusing on how to best enhance systematic good quality disclosure by issuers, and potentially non-legislative action (such as Guidelines) clarifying that the integration of ESG considerations into investment or and/or stewardship processes can be consistent with asset managers' existing duty to their clients. As explained above, there could also be an opportunity, through guidance, to improve the framework, where relevant, for good quality disclosure by asset managers to their clients regarding their policy of how they integrate ESG considerations in their investment processes, though this is effectively what is happening through market-led standards today.

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