CFA Institute

Rue du Champ de Mars, 23
1050 Brussels
Belgium

+32 (0) 2207 12 10 tel
info@cfainstitute.org
www.cfainstitute.org

2016

CFA Institute response to the European Commission's Public Consultation on Long-Term and Sustainable Investment

CFA Institute submitted a response to the European Commission's Public Consultation on Long-Term and Sustainable Investment on 25 March 2016.

The response focused 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 also focused on possible obstacles to long-term, sustainable investment.

The final response was submitted via the European Commission's online questionnaire and is reproduced below.

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)

Rhodri Preece, Head - Capital Markets Policy: EMEA, CFA Institute

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

Rhodri.Preece@cfainstitute.org, +44 (0)20 7330 9522, 131 Finsbury Pavement, 7th Floor | London EC2A 1NT | United Kingdom

*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

*f. Association

- ○ Investor association
- ○ Association of beneficiaries of institutional investors
- ○ Association of asset managers
- ○ Business federation
- ○ Trade Union
- ○ NGO
- ●

Other

* Please specify:

Global Financial Professionals

* 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
- (selected) No

* 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
- (selected) United Kingdom
- Other

* 6. Please indicate whether you consent to publication:

- (selected)

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, incorporating ESG factors in the investment process allows investors to
know the whole story of companies in which they invest. Many non-financial
risks and opportunities, especially longer-term ones can be better evaluated
by better understanding the environmental, social or governance factors that
underlie those risks and opportunities.
In a recent survey of our membership (June 2015) 73% of survey respondents
said that they take ESG issues into consideration in the investment analysis
process. In some markets governance analysis is more prominent, and in others
E and S issues hold more sway. However, it is clear that ESG analysis is
becoming more mainstream, as the great majority of CFA Institute members do
not work at firms that have long considered ESG data in the investment
process.
Survey results can be found, here.
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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)

- [ ] a) risk management:
- [x] b) alignment of investment policies with the long-term interests of beneficiaries of the institutional investor,
- [ ] 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.

Please provide an explanation :

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The rationale will depend on the investment philosophy and the investment
process of the asset owners and asset managers taking ESG factors into
consideration. All of the above can be legitimate reasons to take ESG issues
into consideration. However, we would pick a reason not on the list above,
that is: to better understand all risks and opportunities before investing in
a company. The risk aspect of this reason is listed above, but "opportunities"
are not. Option b) comes closest to this reason, so we would pick it first,
but not exclusively.
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2. <u>Information on ESG risks and opportunities</u>

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

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Material ESG risks faced by investors will depend on the industry and the
company, as well as the strategy pursued by the investor. Poor corporate
governance is a risk to all companies, but each sector, industry, company has
unique E and S risks. Investors need to understand the unique risks and
opportunities that face each sector, industry, and company before undertaking
investment analysis.
Below is a non-exhaustive list of some issues that are material:
 ■ Climate change and carbon emissions ■ Air and water pollution ■
Biodiversity ■ Deforestation ■ Energy efficiency ■ Waste management ■ Water
scarcity ■ Customer satisfaction ■ Data protection and privacy ■ Gender and
diversity ■ Employee engagement ■ Community relations ■ Human rights ■ Labor
standards ■ Board composition ■ Audit committee structure ■ Bribery and
corruption ■ Executive compensation ■ Lobbying ■ Political contributions ■
Whistleblower schemes ■ dual class share structures ■ minority shareowner
rights ■ board structure
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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?

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Below are some examples of the main data sources investors use to obtain
information on ESG issues:



Data Provider                     Data Provided


Bloomberg LLP                   ESG Data
Calvert                              The Calvers Social Index
CRD Analytics                         Global Sustainability Index, Cleantech
100, Life Sciences
Domini                                 Domini 400 Social Index
ECPI                                   ECPI Indices
EIRIS                                 FTSE4Good Index Series and company
specific information
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EthiFinance	Gaïa Index
Maplecroft	Climate Innovation Indexes
MSCI	MSCI ESG Indices and Barclays MSCI (Fixed Income Indices)
Oekom	Global Challenges Index
OWW	Responsibility Malaysia SRI Index, Responsibility Singapore SRI
Sustainalytics	Jantzi Social Index, STOXX Global ESG Leaders Indices
Vigeo	ASPI Eurozone, Ethibel Sustainability Index, Euronext Vigeo
Thomson Reuters	Thomson Reuters Index

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

Whilst an individual investor may find it difficult to obtain certain ESG information, a sophisticated institutional investor can certainly find detailed data to execute a focused ESG strategy. In general, the availability of reliable and consistent ESG information is improving. ESG data providers have grown substantially in the past 5 – 10 years and more and more information is becoming available each month. For example the firms Morningstar and MSCI beginning to give ratings on the mutual fund/s based on the sustainability of those funds, because more and more of their clients are seeking this information. We anticipate that this desire for more ESG data will continue to grow at a fast rate, and plateau when investors generally have almost all the ESG data they need.

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

Not Applicable or Beyond our Expertise (NA)

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

If companies believe that the cost in both man-hours and money of collecting such data outweighs the benefit (they may perceive that not many investors want such data) they may feel discouraged from disclosing such data. A contributory factor is the wide range of information requested by different specialist data providers and managers.

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

- [ ] d) demand from investors
- [x] e) pressure from stakeholders
- [ ] f) other

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

At the present time, no. But the auditing of such information is increasing.

According to the 2015 survey of CFA Institute members, 69% said that it is important that ESG disclosures be subject to independent verification. Our members were split as to who should undertake the independent verification (between accounting firms and specialty ESG firms) as well as what the cost of such verification should be.

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

The information should be audited by an independent third party.

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

Green bonds enable capital-raising and investment for new and existing projects with environmental benefits. Specific ESG investment instruments such as green bonds can help train investors and analysts to consider ESG factors in the investment process.

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.

NA

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.

We find that the main barriers are cultural and educational. Many practitioners have never formally factored ESG data into the investment process. It usually takes some educational efforts - on the merits of ESG integration - to change such a culture.
With regard to data considerations, quantitative approaches to managing money are likely to take a different approach to more qualitative ones as quantitative models usually try to isolate ESG factors that they believe are

material and quantifiable to insert into the investment process. As more information becomes systematically available for more and more companies, it will become more practical for quantitative investment managers to use some kind of scoring system of ESG factors. On the other hand, this puts the onus on the quality of the specialist data sources.

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 need to work with asset managers to ensure that those managers understand how and why the asset owners want ESG factors incorporated in the investment process. However, this is enormously variable and likely to remain so. In any case, the implication that institutional investors ought to take ESG factors into account in remunerating managers is highly contentious. Many asset owners are putting language about ESG integration in their requests for proposal when they are seeking asset managers. The asset manager will then need to explain to the asset owner how they incorporate ESG factors into the investment process.

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?

NA

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.

Yes. ESG analysts and ESG teams at such investors are relatively small. As both investors and issuers understand the importance of ESG integration in the investment process, we expect ESG professionals at both investors and issuers to grow.
Many “institutional investors” (e.g. asset owners) employ no investment staff at all, but they are able to access the resources and skills of asset managers in this respect. Of course, some asset managers are small too, and struggle to commit significant resources to these areas, thought they can “buy-in” expertise from third party service providers.

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.

The greater availability of ESG data is the most important factor. As noted in our response to question 2b, there are now several data vendors supplying ESG information to institutional investors. Also, in the past 5 -10 years, more and more individuals have been trained in incorporating ESG data in the investment process. We expect this growth to continue. Consistency of data is important. It is difficult to “integrate” anything where the inputs are not uniformly reported.

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.

Aligning the interests of beneficiaries, boards and key executives is clearly desirable. Over the long-term, such alignment allows institutional investors to better incorporate ESG issues in the investment process and evaluate their impact. However, good governance requires alignment of interests between these parties, not just for E and S issues, but all issues.

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.

It is now common practice, albeit not universally, for asset managers to include ESG reporting routinely in the regular reports they provide to investors. In many ways, the more ESG factors are taken into account routinely by managers, the more it is difficult to disentangle assessment and management of these risks from the investment process as a whole.
It is incumbent upon asset owners to identify the issues the feel are important and want tracked by asset managers. It is also important for investors to engage with issuers on these issues so that both parties can work together to provide the information that investors find beneficial and not waste time collecting and measuring data investors do not find important.

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

Yes, as the incorporation of ESG issues into the investment process becomes more mainstream, more investors will become interested in ESG issues. This is evident from the proliferation of ESG data in recent years. This data is being gathered because asset owners are asking for it.

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?

Investment research that takes into consideration ESG issues is growing. Nearly all large investment banks now dedicate resources to understanding ESG issues and incorporating ESG analysis into their investment processes. Data providers now also give investors a lot of ESG information and specialty ESG data providers have emerged. These service providers are crucial to the ability of the industry as a whole to incorporate ESG factors routinely into investment management processes. Even for very large managers and investors, it is rarely practical to reinvent the wheel on basic data selection. Of course, there will always be space and sometimes a need for additional research and different approaches; but these are likely to be in addition to, not instead of, the data and research supplied by external service providers. We are not aware of any significant barriers to the provision of good quality external research on ESG issues.

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?

NA

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?

NA

7.d. To what extent do proxy advisors consider medium-to long term performance of companies, including ESG performance, in their voting recommendations?

NA

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?

NA

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?

NA

8. The role of non-professional investors

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

We are not award of any such initiatives.

9. Legal or regulatory constraints

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.

Legal and regulatory constraints vary and depend on the market, but generally we perceive a shift towards removing such constraints to long-term or sustainable investing. Until recently in the United States for example, legal constraints may have been an issue. For the most part, US pension fund fiduciaries can consider ESG factors in their investment decisions without worrying about repercussions from the Department of Labor, under new guidance announced in October by Labor Secretary Thomas Perez.
A 2008 interpretative bulletin from the Labor Department “unduly discouraged plan fiduciaries” from considering environmental, social and governance factors under appropriate circumstances, Mr. Perez said in a recent statement. “Changes in the financial markets since that time, particularly improved metrics and tools allowing for better analyses of investments, make this the right time to clarify our position.”
Under the new guidance, Interpretive Bulletin 2015-01, fiduciaries cannot accept lower expected returns or greater risks, but may take ESG benefits into account as “tiebreakers” when investments are otherwise equal. When ESG factors have a direct relationship to the economic and financial value of an investment, “these factors are more than just tiebreakers,” a DOL statement said.

In Europe, we are not aware of any specific legal constraints that may discourage investors from investing in a sustainable way. A number of steps already have been initiated by policymakers to facilitate long-term investing. For example, the 2014 communication by the Commission on long-term financing of the European economy includes various measures aimed at banks, insurers, and pension funds. Among these measures, the Solvency II directive for insurance companies has been amended to allow insurers to be free to invest in any type of asset in which they can “properly identify, measure, monitor, manage, control, and report” the risks associated with such assets.

Further steps under the Capital Markets Union initiative (such as proposals to recalibrate risk-capital weights for “infrastructure” investments under Solvency II) continue in the direction of reducing constraints and making long-term and sustainable investment more attractive.

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.

We are not aware of specific conflicts between fiduciary duties or equivalent local laws and the abilities of investment managers to incorporate ESG factors into investment decisions.

10. Others

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

NA

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.

NA

You can upload additional documents here:

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

✉ just-a3@ec.europa.eu