



Institute
and Faculty
of Actuaries

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

IFoA response to European Commission

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About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



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

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 fulfilment 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. Your opinion

1.1 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:

Investment decision-making is fundamental to the efficient use of capital in furtherance of the aims of society. Sustainability factors are relevant in all investment decisions and in order to properly fulfil fiduciary responsibilities to clients/customers, investment entities should give appropriate consideration of these factors, given their potential impact on financial returns.

Consideration of these factors can also have secondary benefits for clients/customers through supporting a more sustainable world, enhancing long term returns and reducing risks. To achieve these benefits, the regulatory system may need to encourage investors to take account of sustainability factors to the extent that it is in their collective, not just their individual, interests to do so.

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).

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

Please specify others: n/a

- 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 body, we do not directly make investment, lending or underwriting decisions. However, we believe that analysis of disclosed risk information relating to climate change, as well as consideration of the direct and indirect impacts of wider environmental and social factors are critical to good investment decision-making. This is also true of the governance structure, both of the investing entity and the entity to which capital is being allocated. In particular, it is vital for sustainability that businesses have in place appropriate incentive structures that reward long-term rather than short-term outcomes.

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

We have not proposed specific criteria for considering sustainability factors, as investment managers and asset owners are best placed to do this.

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).

Occupational pension providers Yes ~~/No~~ ~~/No opinion~~

Personal pension providers Yes ~~/No~~ ~~/No opinion~~

Life insurance providers Yes ~~/No~~ ~~/No opinion~~

Non-life insurance providers Yes ~~/No~~ ~~/No opinion~~

Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF) Yes ~~/No~~ ~~/No opinion~~

Individual portfolio managers Yes ~~/No~~ ~~/No opinion~~

Please explain:

All of the above organisations above should consider sustainability factors in their investment decision-making because all have a stewardship duty to consider their investors' long term interests.

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
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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:

Lack of expertise and experience (first line of table above) - we believe there is a widespread lack of awareness (within the investment community and indeed within society at large) of the importance of sustainability and what it really means. Incentives within an organisation are also important - for example the 2012 Kay Review of Equity Markets in the UK found strong evidence of a short-term investment culture.

Lack of data and research – data may be a bigger issue for investment managers than for asset owners. Although the availability of data on sustainability factors is growing, the quality of the data that is available may not be sufficiently robust.

Lack of impact on asset performance – the constraint is not so much that long-term asset performance will be harmed (although there is a widespread perception that this is the case). The constraint is more that the impact is hard to measure. It may only emerge over longer periods (and may therefore not be seen as a concern for investors with shorter investment timeframes) and may be difficult to isolate from other factors.

Methodologies for the calculation of sustainability risks – evidence that these are inadequate in respect of climate change was a large part of the rationale for the TCFD work.

Excessive cost – while integrating sustainability factors will have associated costs, we do not see these as a major constraint.

No interest from intermediaries / beneficiaries – this includes a lack of awareness of the importance of sustainability, but it can also be difficult to identify what asset owners' goals are. There is also a mental separation between financial and other considerations when making investment decisions, with such decisions seemingly divorced from their real world consequences. The impact of clients' age can be observed in the level of interest in sustainability, with more interest typically from younger clients. This suggests this barrier may reduce over time.

European and national regulatory barriers - there may be some friction around, or barriers caused by, liquidity and capital requirements, which may impede sustainability investment, for example in infrastructure; this needs further analysis and a holistic approach (the HLEG interim report refers to this).

Lack of fiscal incentive – some fiscal incentives are mis-aligned, e.g. fossil fuel subsidies. More fiscal incentives could encourage sustainable investment, particularly if they help to address a mismatch

between shorter-term risks and longer-term returns. It is possible that there is a lack of eligible entities, thinking again here about suitable infrastructure programmes, for example.

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						

Please specify others:

Please explain:

Regarding the first line, “climate factors”, we are aware that levels of integration vary considerably between different investment entities. However, we are also aware that new practices are starting to emerge and innovation is occurring, such as low carbon tilted tracking solutions, which may be a convenient and low cost proxy. This is supported by changes within the investment management industry which has also begun to move beyond the consideration of backward looking, data-dependent climate risk measures such as carbon intensity to more forward looking metrics that consider the alignment with a 2 degree pathway.

The second line, “other environmental factors”, covers an enormous range of considerations from sustainable fishing to the nitrogen and phosphorous cycles. While in theory it would be possible to incorporate such considerations, information availability and quality is a huge challenge, particularly as many environmental factors cannot adequately be summarised in quantitative form and such factors are not equally relevant to each underlying entity in which an investment may be made. There are similar challenges, we believe, for the third line, social factors.

However, the availability and quality of governance information is greater, and the importance of strong governance is more widely accepted, so developing procedures and incorporating them within the investment process is likely to be simpler.

II. 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).

Governance Yes ~~/No/~~ ~~No opinion~~

Investment strategy Yes ~~/No/~~ ~~No opinion~~

Asset allocation Yes ~~/No/~~ ~~No opinion~~

Risk management Yes ~~/No/~~ ~~No opinion~~

Others Yes ~~/No/~~ ~~No opinion~~

Please specify others: Manager Selection and Monitoring

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 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:

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

Please explain:

We are open to engaging separately with the HLEG on this topic. We are not opposed to such consultation in principle, which is a positive action. However, the practical implications are challenging. For example, organisations may lack the expertise to analyse the results thoroughly. The exercise could also expose differences of opinion among beneficiaries which are difficult for the organisation to translate into a clear policy. On the pensions side the nature of any consultation exercise would be very different for defined benefit and defined contribution schemes.

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:

We have answered no because we do not wish to be prescriptive as to what investment entities should consider. However, there is an increasing body of academic evidence that taking account of sustainability factors can improve risk-adjusted returns even over relatively short periods (see for example the aggregated evidence from over 2000 studies here <https://doi.org/10.1080/20430795.2015.1118917>).

Information about sustainability is less readily available and less readily quantifiable than much of the information used by investors. Market prices may not fully reflect this information and hence sustainability factors should be considered, as a fundamental part of the investment process, regardless of whether the investor has explicit sustainability objectives. It may be that the asset owner who ultimately should determine the strategy may, having considered all the relevant factors, choose to deviate from “pure” sustainability objectives 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.

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 the work done by the Task Force on Climate-related Financial Disclosures. We endorsed those recommendations, which would, if implemented at scale, significantly improve risk disclosures and understanding. Should the TCFD recommendations be widely adopted, either voluntarily or through compulsion, we believe it would be appropriate to commission a similar piece of work, extending the remit from “climate-related” to sustainability in a wider context. This would tackle the extent to which a business’s strategy was properly focused on long-term outcomes or on rewarding short term performance.

Currently, however, corporate disclosures fail to provide information on sustainability risks which is sufficiently comprehensive, accurate and consistent for investors to make adequately informed decisions.

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:

To be able to construct aggregate risk metrics (for example at a portfolio level) consistency of the underlying data is key. Not only does individual company data need to be consistent, but – for asset owners who use multiple investment managers – investment managers need to use consistent metrics when reporting risk exposures to asset owners.

Our response to 13 above is also relevant here.

15) Do you think that uniform criteria to perform sustainability risk assessments should be developed at EU level? Yes No ~~No opinion~~

Please explain:

Our preferred approach would be to see the development of principles-based regulation on a holistically consistent footing that spans fiduciary duties in their widest context. Having set the principles, the development of detailed criteria would then be for the entities themselves.

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

17) Should relevant investment entities disclose how they consider sustainability factors within their investment decision-making? Yes ~~No~~ ~~No opinion~~

Please explain:

This process is well within the ambit of good regulation, and we would expect relevant regulators to expect and insist on disclosure of this type of information. This could include disclosures on the sustainability of businesses' long-term strategy and incentive structures, as mentioned above (see Q13 and Q2). We would not necessarily expect the full disclosures to be public, and any disclosure requirements should be proportionate.

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):

Governance Yes ~~/No/~~ No opinion

Investment strategy Yes ~~/No/~~ No opinion

Asset allocation Yes ~~/No/~~ No opinion

Risk management Yes ~~/No/~~ No opinion

Other Yes ~~/No/~~ No opinion

Please specify others: Manager selection and monitoring

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?

Pre-contractual disclosure (e.g. prospectuses) Yes ~~/No/~~ No opinion

Semi-annual/annual reports Yes ~~/No/~~ No opinion

Periodic reports Yes ~~/No/~~ No opinion

Website Yes ~~/No/~~ No opinion

Newsletters Yes ~~/No/~~ No opinion

Factsheets Yes ~~/No/~~ No opinion

Marketing materials Yes ~~/No/~~ No opinion

Others Yes ~~/No/~~ No opinion

Please specify others:

III. 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?

Occupational pension providers	Benefits / Costs
Personal pension providers	Benefits / Costs
Life insurance providers	Benefits / Costs
Non-life insurance providers	Benefits / Costs
Collective investment funds (UCITS, AIF, EuVECA, EuSEF, ELTIF)	Benefits / Costs
Individual portfolio managers	Benefits / Costs
General public	Benefits / Costs
Retail investors	Benefits / Costs
Financial advisors	Benefits / Costs
Service providers (index provider, research providers...)	Benefits / Costs
Other stakeholders (please specify)	Benefits / Costs

Please explain:

Clearly there will be costs. However, our thesis is that in the long run, the benefits will outweigh the costs overall. Performance must be improved in the light of better informed decision making, while the cost of failing to be sustainable is existential by definition.

The question could perhaps be phrased in a more granular way to provide greater policy value regarding these stakeholder groups.

Useful links

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

<http://ec.europa.eu/transparencyregister/public/homePage.do?locale=en> [Consultation details \(https://ec.europa.eu/info/consultations/finance-2017-investors-duties-sustainability_en\)](https://ec.europa.eu/info/consultations/finance-2017-investors-duties-sustainability_en)

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