UKSIF
UK Sustainable Investment and Finance Association

UKSIF response to the European Commission consultation on institutional investors' and asset managers' duties regarding sustainability.

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

In our response to the HLEG on Sustainable Finance interim report, UKSIF strongly welcomed the development of a duty on investors at the European level which incorporates sustainability factors. This was based on feedback gathered via UKSIF members through a range of channels, including a member roundtable held in summer 2017. We are now calling on the European Commission to bring forward legislation which embeds this duty in law and provides absolute clarity for investors on their duties.

Thinking around the concept of "fiduciary duty" has been developing for many years in the UK, and has gained significant momentum since the 2012 Kay Review. The Law Commission has called for legislative changes twice since 2014 on the trust side of the market, and last summer also called for the UK's Financial Conduct Authority to require schemes on the contract side of the market to outline their policy on ESG investment, ethical investment and stewardship. A joint UKSIF, Client Earth, PRI, and ShareAction briefing on these changes is available at http://uksif.org/wp-content/uploads/2018/01/Law-Comm-2017-Short.pdf. In December the UK Government said it was "minded" to accept the Law Commission's recommendation for trust-based schemes and amend the Occupational Pension Scheme (Investment) Regulations 2005. The FCA will announce its position on changes to rules for contract-based schemes by the summer. Rules which require Local Government Pension Scheme (LGPS) funds to outline their policy on ESG, stewardship and consideration of non-financial factors were introduced in 2016.

There are clear differences between the markets and the legal systems of EU member states, yet the general trend in European pension provision is a move towards defined-contribution pension schemes. This means that increasingly investment risk lies with the pension scheme member, who should reasonably expect more robust investment strategies as default, and the option to invest in-line with their values. Given the depth of thinking on this concept in the UK, we think the EU should aim to broadly mirror its approach. This is outlined in detail in our answer to Question 3. The law should have three aims:

a. To remove the still widely held misconception that an investor's duty is to "maximise returns" and therefore schemes cannot consider ESG or ethical factors in investment decisions. Investors must weigh returns against risks – including long-term risks.
b. To make clear the expectation that all financially material factors should be considered by schemes, including where these arise from ESG considerations.
c. It makes clear that, under certain circumstances, non-financially material considerations – such as purely ethical concerns – may be considered. For example, this may be the case where end-beneficiaries do not wish to invest in a particular sector on moral grounds, or where a pension scheme member wishes to enrol in a fund geared towards social impact investment.

2) What are the sustainability factors that the relevant investment entities should consider?

Investors should be required to consider all financially material ESG factors. ESG factors are interlinked and we are concerned by the implication in this question that they might be viewed separately. Financial materiality is the key concern, and this will differ between sectors and over different time horizons. Bank of America outline this in research conducted in 2015/16. https://about.bankofamerica.com/en-us/what-guides-us/materiality.html#fbid=KkVAkf3sm8J

There is an ever increasing wealth of evidence with regards to the financial materiality of ESG factors:

Arabesque and Oxford University meta study, From the Stockholder to the Stakeholder https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf

MSCI, Can ESG add alpha? https://www.msci.com/www/blog-posts/can-esg-add-alpha-/0182820893

ILG, The value of responsible investment, https://www.cisl.cam.ac.uk/publications/publication-pdfs/ilg-the-value-of-responsible-investment.pdf

MSCI, Foundations of ESG Investing: How ESG affects equity valuation, risk and performance, https://www.msci.com/www/research-paper/foundations-of-esg-investing/0795306949?utm_source=esg&utm_medium=email&utm_campaign=esg_foundations_01_2018

Over the past few years the issue of climate risk in particular has received significant attention, including the following:

Bank of England research into climate risk https://www.bankofengland.co.uk/quarterly-bulletin/2017/the-banks-response-to-climate-change

The Taskforce on Climate-related Financial Disclosures https://www.fsb-tcfd.org/

The French Energy Transition Law https://www.unpri.org/download_report/14573

In the UK guidance introduced by The Pensions Regulator in summer 2016 which outlined trustees responsibilities with regards to consideration of sustainability factors was welcomed, but still it was not enough: In November the results of a survey was published which showed that 53% of pension professionals viewed climate risk as "overblown nonsense". (https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry) This is a key reason to require pension schemes to consider financially material factors in law.

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

We believe the EU investor duty law could usefully mirror the concept of "fiduciary duty" in the UK. There are two key criteria for investment entities to consider sustainability factors.

First, where they are financially material investors should be required to consider sustainability factors. This is the case for pension schemes trustees in the UK. Materiality will vary between firms, sectors and time horizons and is outlined in our answer to Question 2.

Second we think that, where ESG factors are not financially material, firms may still consider them in certain circumstances. For example, firms may consider such factors where there is demand from clients, beneficiaries or pension scheme members. Under the UK's common law, a two stage test has been established: First that trustees have reason to believe beneficiaries share the concern, and second that there is no risk of significant detriment to the fund. These tests seem proportionate and a good model. Investments which include consideration of such factors include social investment, impact investment, ethical investment and values-based investment (and this is a non-exhaustive list).

There is a strong demand for consideration of such factors amongst retail clients and pension scheme members. In the UK the number of people motivated solely by money has fallen from 45% to 39% in the past 12 months and this represents a clear opportunity for firms. UKSIF's Good Money Week polling goes into detail on how savers want their savings to be invested, including in relation to green finance, social issues, and their fund manager's approach to investment. Our report is available at http://goodmoneyweek.com/sites/default/files/download/public_polling_report_2017_gmw.pdf. We suspect there will be similar findings in other EU countries and would encourage further research on this topic.

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).

All and 5.

9) In which area should relevant investment entities consider sustainability factors within their investment decision-making?

Yes to all.

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).

All may be appropriate for individual firms. We would advocate flexibility in how firms are allowed to approach their responsibilities on ESG and RI to allow for innovation, and would be reluctant to see proscription in law. Ideally, education, training and responsibility relating to sustainability would be integrated throughout an organisation, rather than it being siloed in a particular department, committee or board member.

In the UK the Law Commission has recommended that pension schemes outline their approach to ESG, ethical investment and stewardship. For trust-based schemes these policies should be included in the Statement of Investment Principles (SIP). For contract-based schemes the provider's approach should be published by the Independent Governance Committee. Local Government Pension Scheme funds are already required to include this information in the SIP.

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

Yes.

A comply or explain approach would be a proportionate measure to be taken at EU level.

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

No.

We strongly believe that risk assessments should be conducted on the basis of materiality which will differ between firms, sectors and time horizons. EU level intervention in the form of legislative or regulatory intervention on this aspect is unnecessary and we believe would be extremely unhelpful.

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