Frankfurt am Main,
11 December 2017

BVI's view on responsible investment

Responsible and long-term considerations play an increasingly important role in investment decisions. Many investors feel a responsibility to address environmental, social and governance (ESG) issues by being more selective in their investments. The asset management industry plays a crucial role in facilitating this trend. BVI[1] therefore gladly takes the opportunity to present its views on responsible investment (RI).

Asset managers' role: Responsible investment and the duty to act in investors' best interest

RI is increasingly important for investors and hence for asset managers who act as trustees for them. There are various rationales for asset managers to consider ESG factors in their investment decisions. First, ESG risks have to be taken into account as part of a proper risk management – a fact which is nowadays universally accepted. Secondly, asset managers integrate ESG strategies in investment processes with the aim to increase performance and to create a long-term value for investors (often referred to as RI). Thirdly, institutional investors define their specific desires regarding ESG factors as part of the mandate or tailored fund (i.e. ESG funds). This can also be based on asset managers' advice on possible ESG strategies and related benefits.

Consequently, the existing rules within the regulatory framework appropriately reflect the asset managers' role as intermediaries and their strict obligation to follow the investment strategy as agreed with the investor. In this regard they also provide for sufficient flexibility to tailor the mandate or product according to investors' specific ESG needs. ESG considerations depend on a specific person's view regarding standards, ethical or social believes. For instance, investors have a very different understanding regarding sustainability of nuclear energy depending whether they focus on carbon dioxide emissions or nuclear waste. Furthermore, only in rare cases it is clear without any doubt whether investments can be considered sustainable or not. It is disputable for instance whether investments in a company, which on the one hand contributes to resource and climate protection but on the other hand allegedly violates human rights and pays excessive management salaries, are sustainable. In addition, investor or asset manager engagement in order to improve a company's ESG impact might often be more effective than a simple divestment. Since it is difficult to capture and properly weigh all benefits and disadvantages in a regulatory framework, the decision on ESG considerations should remain with the end investor. Therefore, any further specification of investors' duty in EU legislation should not jeopardise the flexibility to allow for different believes. Since it is clear that any material risk including material ESG risks have to be taken into account by both the investors as well as the asset manager, an amendment to EU legislation will not facilitate the objective to increase investors' and asset managers' contribution to a more efficient allocation of capital to sustainable and inclusive growth. Furthermore, the term fiduciary

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of nearly 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

BVI
Bundesverband Investment
und Asset Management e.V.

Contact
Phone +49 69 15 40 90 0
www.bvi.de

BVI Berlin
Unter den Linden 42
10117 Berlin

BVI Brussels
Rue du Trône 14–16
1000 Bruxelles

BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main

duty should not be used since this neither exists in EU law nor in civil law countries. Enshrining a complex common law concept in EU legislation does not seem to be the right way forward.

The existing EU regulation properly reflects assets managers' role as intermediaries. Existing risk management requirements entail taking into account ESG risks. The duty to act in investors' best interest requires the asset manager to follow investors' specific ESG demands. It is crucial that the decision on ESG considerations remains with the investor.

Standardisation will facilitate responsible investments

There are several barriers to RI integration, however, the main barrier is a lack of transparency and quantitative long-term data. Standardised, reliable 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. The less information on ESG aspects is available, the more difficult it is to take these aspects into account. In particular, reliability and credibility of the data available is often uncertain and lacks sufficient comparability. Furthermore, forward looking data and indicators are crucial for ESG-considerations and presently only available to a limited extent. Moreover, for some ESG factors, common, measurable and comparable data is not yet sufficiently available. In addition, the connectivity between financial and non-financial information could be improved.

A taxonomy for sustainable assets will not only facilitate comparability of data for asset managers but also serve as a basis for ESG reporting throughout the investment chain, i.e. for investee companies, asset managers and institutional investors. A taxonomy could facilitate consistent information on sustainability. It should, however, not be used to distinct between good and bad assets or green and brown assets, respectively, in order to provide a basis to ban or penalise certain investments. Such 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.

Furthermore, it will also allow regulators to properly assess the market of RI. While figures on responsible products are generally available, figures on RI, i.e. systematic integration of ESG criteria on an asset manager's level, are not. Moreover, figures are primarily based on market participants' surveys and different understandings of RI. Combinations of different ESG strategies and approaches make it even more difficult to properly assess the RI market. Any taxonomy, however, should be based on the work that has already been done, e.g. the Global Risk Report of the World Economic Forum and the Risk dashboards included therein as well as the Eurosif's taxonomy for the European market. Further, it should include all three criteria "environmental, social and governance" since they interact.

A taxonomy will facilitate Responsible Investments by improving comparability and reliability of data. It will further allow assessing the Responsible Investment market properly. It should not be combined with investors' duties in a way that bans specific investments (exclusion). Depending on the specific circumstances the investor and/or the asset manager is in the best situation to make the adequate investment decision also with respect to ESG considerations.

Policy options to foster responsible investment

We note that the establishment of market standards takes some time. Companies listed on the market with a high transparency level in general already see the necessity to provide information as part of the investor communication. Barriers might be higher for smaller companies; in particular if no market standard for "peers" is established.

It is important that regulators are aware of the existing developments in the market and have the means to evaluate these. ESG investments have become increasingly important without so far any significant interference from regulators. Recent regulatory initiatives such as the revised Shareholders' Rights Directive or the Directive on Institutions for Occupational Retirement Provision rightly focus on transparency. While policy makers can generally facilitate enhancement of ESG investments, the means of doing so should be selected cautiously. Any mandatory requirement in particular regarding investments will potentially alter the characteristics of asset management since views on sustainability of specific investments differ significantly depending on the specific investor. Furthermore, mandatory requirements will shift the question of ESG integration from a developing approach to a mere question of compliance which would likely have an effect of retrogression. We think governments generally could play an important part as role models regarding their own investments and encouraging standardisation. In addition, education on the importance of RI could further facilitate the development. This pertains not only to education of investors and asset managers but also of regulators and supervisors.

Regulatory initiatives with respect to standardisation can facilitate Responsible Investment. Other options should be selected cautiously. Education of regulators, supervisors, market participants and investors should form an essential part of a comprehensive political approach.