Frankfurt am Main,
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BVI's response to the Commission's Public consultation on long-term and sustainable investment

1. Rationale for ESG inclusion into investment decisions

1. a. Do ESG factors play 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?

BVI represents the interests of the German investment fund and asset management industry. Its 95 members manage assets of some EUR 2.6 trillion in UCITS, AIFs and assets outside investment funds. As such, BVI is committed to promoting a level playing field for all investors. BVI members manage, directly or indirectly, the assets of 50 million private clients in over 21 million households.

ESG factors play an increasingly important role for institutional investors and hence for asset managers who act as trustees for their investors. With respect to retail investors it is difficult to convey the information how and to what extent ESG factors are taken into account. Nevertheless, many of the rationales listed in number 1.b.) are relevant for retail funds and hence have an impact on the role ESG factors play in the investment decision. The commitment might be reflected on a legal basis, e.g. in the fund rules, other fund documents or internal policies. In other cases, ESG plays a role in practice but without specific reflection in any documents but simply as a matter of e.g. proper risk management or the aim to increase performance.

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
☑ 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

There are variable rationales for asset managers and investors to take ESG factors into account in their investment decision. Some of these rationales are of a more general nature (e.g. risk management) while others depend on specific circumstances such as pressure from institutional investors / clients. Legal constraints can also be of a more general nature such as fiduciary duty or more specific such as special requirements according to national law.

Other rationales for taking ESG factors into account are the aim to increase performance, to create a long-term value or a long-term economic sustainability.

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2. Information on ESG risks and opportunities

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

There is no general answer to that question. Materiality of ESG risks (and ESG opportunities) depends on the investment strategy and the portfolio, i.e. is closely related to sector- or industry-specific risks. For instance, environmental risks are higher for investments in the manufacturing industry such as the automotive industry. Social or governmental risks such as money laundering tend to be higher in regions or countries underdeveloped regarding social and/or governance aspects. Risks relating to strategy, complexity or quality of internal controls, however, are more related to the specific set up of the company.

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?

This is an important aspect for investors and asset managers. The less information on ESG aspects is available, the more difficult it is to take these aspects into account. We do, however, perceive that data quality as well as data availability has increased significantly within the last couple of years.

Generally sources for information on ESG issues can be distinguished as follows:

- **Publications by companies**: Companies produce annual reports, covering ESG issues. In Germany, as of today, large companies[1] and groups of companies have to include non-financial performance indicators (such as information on environmental and employee matters) into their year end / group management report. Furthermore, the CSR Directive 2014/95/EU provides for some ESG information to be disclosed by public interest entities. This information will be available for the first time in reports for the financial year starting in 2017 and hence with further increase availability of ESG relevant information.

  It should also be noted that self-regulatory initiatives increase transparency. For instance, Deutsche Börse published a Best Practice Guide on sustainability reporting with recommendations on a comprehensive approach to capital market communications regarding sustainability.[2] The intention is to provide guidance in particular for smaller and medium-sized companies when providing ESG relevant information to investors.
- **Research**: Such research could include research by specialised ESG data providers, general research providers, internal research as well as tailored research. Asset managers often have their own internal research data platform and information database to search for specific information needed. The main external research providers are:
  - MSCI ESG Research
  - Sustainalytics
  - Thompson Reuters ESG Research Data
  - Morningstar
  - EIRIS Portfolio Manager
  - Oekom Research (Germany)
  - Absolute Research (Germany)
- **Other sources**: These include materials from NGOs, the media, alert services and scientific reports.

Nevertheless, the development over the next years will show whether the following obstacles to access

[1] Companies that exceed two of the following three criteria: (1) balance sheet total of 19.25 Mio. Euro after deducting any under assets shown deficit. (2) Turnover of 38.5 Mio. Euro or (3) average of 250 employees.

[2] https://deutsche-boerse.com/dbg/dispatch/en/binary/gdb_content_pool/imported_files/public_files/10_downloads/33_going_being_public/10_products/Communicating_sustainibility.pdf

to qualitatively sufficient data will be removed or mitigated. In particular, the connectivity between financial and non-financial information could be improved. Furthermore, for some ESG factors, common, measurable and comparable data is not yet sufficiently available. Moreover, generally reliability and credibility of the data is often uncertain.

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

Please see answer to question 2 b. In addition, the following aspects are of practical relevance: First, abundance of data makes it complex to filter the relevant data. Secondly, in many cases less granular information in aggregated form is available; however, to satisfy detailed needs asset managers have to engage specific providers to provide tailored information.

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

As a general rule, access to specific or tailored data is more expensive than access to general data. In particular for smaller portfolios, the ratio between the assets under management and the costs to obtain tailored data might be high. It is less the decision of the asset manager than of the asset owner whether the benefits of tailored information outweigh the costs.

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

There are several factors preventing or discouraging companies from disclosing such data:
- In particular smaller and medium sized companies may not include ESG aspects in their company strategy. Although to some extent ESG factors will be part of a risk management, a top down approach is often not implemented or monitored.
- A first disclosure of ESG data takes an effort because either the company integrates this information in their common reporting which in particular requires connectivity between common financial and ESG information or they draft a separate report which also takes an effort, in particular, if it is not legally required.
- Establishment of a market standard takes some time. While companies listed on the market with a high transparency level generally already see the necessity to provide information as part of the investor communication, described barriers for smaller companies might be higher, in particular if no market standard for “peers” is established.

2. f. What is the main rationale for companies to publish such information? Please indicate all the relevant issues. (multiple choice)

☑ 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
☑ e) pressure from stakeholders
☑ f) other

Companies may see the business case for sustainability.

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

See answer to question 2 b.

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

We believe that a top-down approach is key in order to implement a consistent and reliable agenda and disclosure thereof. If the board does not define and control key topics and key performance indicators (KPIs) that reflect the company's economic, environmental, social and governance impacts, we think that the disclosed information is likely to be less consistent.

In this regard, also board members play a vital role. This is recognised by asset managers. For instance, the BVI voting guidelines for shareholder meetings of listed companies require that the supervisory board appoints a member of the management board to be responsible for ESG aspects.

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

"Green bonds" is a collective term for fixed income securities issued by multilateral organisations such as the world bank or government-owned banks but more and more also by private companies. Generally, issuers of green bonds intend to finance specific environmental and social projects. As a specific investment instrument, it can help investors achieve ESG goals.

For the investment, asset managers need to understand the features of the green bond, e.g. the intended use of proceeds, how projects are selected, how proceeds are managed and how issuers report. Though standards are evolving (e.g. Green Bond Principles, 2015 issued by the International Capital Market Association), there is, however, no common understanding what qualifies as a green bond. Standards can help achieving such common understanding.

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.

There are certainly several possibilities to assess risks in the long-term, however, lack of transparency as outlined above is a barrier. In addition, quantifying external influences on the long-term performance of companies is hard. Nevertheless, a good starting point is the Global Risk Report of the World Economic Forum and the Risk dashboards included therein. Here the observed risks are more broadly captured. These provide indication of megatrends which could be researched systematically and also be used to define the financial impact on industries and/or specific companies. We believe that good practice could include consideration of data and research to analyse and monitor these risks and define an approach how to take into account the results of such analysis and monitoring.

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 believe that there are several barriers other than those of a regulatory nature. Besides the mentioned reasons of lack of transparency and quantitative long-term data and other practical reasons which hinder proper assessment of long-term risks, these also include the lack of proof of the benefits and ability to value these risks.

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?

There are several best practices for the selection and remuneration:
- Questionnaires enquire after strategies available including integration of ESG criteria in the process, e.g. questionnaire complied by the Principles for Responsible Investment (PRI).
- ESG criteria are developed together with the client.
- Client determines ESG criteria and/or excluded investments as part of the strategy.
- For existing funds/portfolios effects of ESG investments can be simulated.

Asset Managers are intermediaries in the investment chain. Consequently, the decision as to how to incentivise the asset manager lies with the asset owner / institutional investor. If integration of ESG criteria is agreed, the asset manager is bound by this agreement.

Furthermore, the Revision of the Shareholders' Rights Directive 'SRD II', currently under discussion, will require certain institutional investors to disclose the long-term focus of asset managers' remuneration with the intention to incentive these institutional investors to focus their investments more long-term.

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?

Cf. answer to question 4.a. Other than their own remuneration, asset managers do not have any insight on how executive and/or board members of institutional investors are taken into account.

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.

Generally, we observe a significant development in this regard. Indications are shown by:
- increase of the assets under management by PRI signatories which stand at more than US$59 trillion, up from US$4 trillion at the PRI's launch in 2006.[3]
- All Sustainable and Responsible Investment strategies surveyed by EuroSIF in 2014[4] are continuing to grow at a faster rate than the broad European asset management market. EuroSIF analysed growth rates ranging from 22.6% (Sustainability themed) to 91% (Exclusions) for the more conventional strategies between 2011 and 2013.

While providing ESG services is to some extent a question of understanding and belief, it is also a question of business opportunity. Asset managers hence provide ESG services based on the investors' demand. Asset managers may advise and/or offer investors these services, however, the decision lies ultimately with the investor.

With respect to the question of lack of scale or skill, we believe there is no general answer to that question. Lager asset managers might more easily have the resources to allow for ESG investing, however, smaller asset managers may also specialise in this respect.

[3] http://www.unpri.org/news/pri-fact-sheet/.
[4] http://www.eurosif.org/publication/view/european-sri-study-2014/.

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.

As already indicated before (cf. Q2b.), reliable, credible and sufficient information is crucial for asset managers who are practicing ESG investing both for the investment decision as well as for the reporting to investors. Initiatives such as the United Nations Global Compact support disclosure of information. In addition, some regulatory initiatives such as the CSR-Directive require companies to disclose information which is relevant for ESG investing.

The reporting of companies has significantly increased on sustainability topics. In addition, further information is available through transparency initiatives also facilitating transparency of asset managers like UNPRI. Asset Managers have generally become more vocal on expressing their “beliefs” in relation to integration.

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.

With respect to both institutional investors and asset managers, fiduciary duty, risks and potential returns (financial and non-financial) are the principal factors influencing the Board and key executives take account of ESG factors in investment decision-making. Due to these principal factors, we believe that interests between institutional investors / asset managers and beneficial owners are generally aligned. Institutional investors as principals and asset managers define the terms of the investments, i.e. institutional investors are able to align the interests individually, hence in a very precise way.

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.

Funds are highly regulated products, if not directly as in the UCITS Directive than indirectly through the asset manager, as it is the case in the AIFMD. Both the AIFMD as well as the UCITS Directive require the asset manager to provide for detailed fund documentation to investors. Such documentation describes the fund’s investment beliefs and strategy, including whether or not it uses ESG investment beliefs and methods. While UCITS have stricter investment restrictions and limits, asset managers managing AIFs are also required to maintain a robust risk management system[5] and to inform the client regularly of both financial and non-financial key performance indicators.[6]

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

Yes, many beneficiaries are interested and interest in ESG is growing. Please refer to the answers provided by EFAMA which outlines the data showing the growing interest.

[5] see Art. 38 et seq. of the Commission delegated regulation No. 231/2013.
[6] see Art. 105 para. 3 of the Commission delegated regulation No. 231/2013.

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?

While quality of research has significantly improved over the last decade, there is still uncertainty regarding reliability and credibility of information. We believe the improvement of research quality will be decisive to facilitate market development of ESG investments.

We do not see any major barriers for good quality external investment research, it generally comes at a price though. Providers of research qualifying as investment recommendation according to the market abuse regulation or investment research according to MiFID II are subject to conflict of interest rules with a high standard. We hence believe that conflicts of interests should not be an issue.

Although academic research on the fiduciary duty and the long term aspects of investing is abundant, the application of what is available and the approach of a tested methodology is a challenge.

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?

At the moment, we cannot recognise a mainstream approach.

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?

Consultants add approach to ESG issues in their due diligence and include questions regarding ESG investment-decision making in their questionnaires. Usually, however, this is only a small part of the total assessment. Nevertheless, if the asset managers scores equally in most of the other points, the ESG approach can make a difference.

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

Asset managers are required to set up their own voting policy,[7] which they use in their interaction with proxy advisors. Hence, proxy advisors generally just implement the voting policy according to the manager's (ultimately the investor's) specific guidelines and philosophies.

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?

There is growing interest in these topics by the rating agencies.

[7] See Art. 37 of the Commission delegated regulation No. 231/2013/EU and Art. 21 of the Commission delegated regulation No. 2010/43/EU.

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?

Some of the ESG issues as of today form part of the yearly report (cf. Q. 2b) and are hence audited. In addition, companies publishing a sustainability report often have these audited.

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 generally note that the interest of retail investors regarding ESG funds is not increasing with the same pace as the interest of institutional investors. In our view the main problem is how to convey the idea of ESG to a retail investor. Investors generally have a different understanding what ESG investments should entail. The broader the investor community is, the more difficult it is to provide an understanding which makes investors respond.

National labels intend to close this gap and there are several recent national initiatives such as LuxFlag, the FNG label in Germany or the government-backed label in France, however, the success of such labels can possibly only be evaluated within the next years. Further, rating initiatives such as the Morningstar Sustainability Rating for Funds can potentially help to promote responsible investing in funds for retail investors.

While the main obstacle in our view is investors' lack of understanding which may be mitigated by education, we think that research regarding retail investors' behaviour would facilitate the understanding of how retail investors would be interested in ESG understandings.

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.

The vast majority of institutional investors such as insurance companies, pension funds or banks are bound by certain liquidity and solvency rules. In this respect, generally, liquid assets are treated more favourably for calculation of the investors' eligible own funds.

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 do not believe that such barriers are of any significance anymore. Political discussions and research show that the legal framework and the common understanding allow asset managers to take ESG factors into account.[8] This goes back to research published in 2005[9] which has provided the basis for the development of such common understanding.

[8] Report on „Resource Efficiency and Fiduciary Duties of Investors" (2015), prepared by Ernst & Young for the European Commission; „Fiduciary duty in the 21first century" (2015) prepared by PRI, UNEP FI, UN Global Compact et al.
[9] A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment' by legal firm Freshfields.

While we think that the general understanding is not a problem anymore, there are further questions which are yet unanswered. These include the problem of how an asset manager should take ESG criteria into account if in this specific instance it is clear that this will harm the financial returns. In this respect it is unclear what exactly is the best interest of the investor and how the conflict is to be solved in order to live up to the fiduciary duty.

10. Others

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

We suggest referring to EFAMA's answer which outlines the main hurdles as follows:
- Overall perception of the public that ESG investing is in general detrimental to performance.
- absorption capacity due to market conditions.
- Lack of financial resourcing.

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.

In our view it is important that regulators are aware of the existing developments in the markets. ESG investments are becoming increasingly important without so far any significant interference from regulators. While we believe that policy makers can generally facilitate this development, we think that the means of doing so should be selected cautiously. In particular, any mandatory requirements will shift the question of ESG integration from a developing approach to a mere question of compliance which would have an effect of retrogression. We think governments generally could play an important role as role models regarding their own investments. In addition, we think that education on the importance of RI could further facilitate the development.

Asset managers themselves are bound to investors' whishes and demands according to their fiduciary duty. While they can advise investors on RI integration, they cannot force institutional investors to allow ESG investments when defining the terms of the investments or force retail investors to buy ESG products.