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January 22, 2018

Directorate-General for Financial Stability,  
Financial Services, and Capital Markets Union  
European Commission  
1049 Bruxelles/Brussel  
Belgium

Re: European Commission Consultation on Institutional Investors and Asset Managers’  
Duties Regarding Sustainability

Dear Sirs and Mesdames:

ICI Global<sup>1</sup> welcomes the opportunity to respond to the European Commission’s consultation on the duties of institutional investors and asset managers regarding sustainability.<sup>2</sup> Our members—regulated funds in jurisdictions around the world, including UCITS and investment companies registered under the US Investment Company Act of 1940—invest on behalf of millions of individual investors saving for their long-term financial goals in the EU capital markets and elsewhere.

We recognize the European Union’s commitment to sustainable finance and its interest in fostering a financial system that focuses on the longer-term impact of material environmental, social, and governance (ESG) factors. We believe the best way to achieve this objective is for EU policymakers to encourage continued competition and market innovation and, thereby, allow market participants to respond to growing investor demand for product offerings and investment strategies that incorporate ESG-related factors. We are concerned, however, that the Commission is

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<sup>1</sup> [ICI Global](#) carries out the international work of the [Investment Company Institute](#), the leading association representing regulated funds globally. ICI’s membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$28.6 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> European Commission, *Consultation: Institutional investors and asset managers’ duties regarding sustainability*, available at [https://ec.europa.eu/info/sites/info/files/2017-investors-duties-sustainability-consultation-document\\_en.pdf](https://ec.europa.eu/info/sites/info/files/2017-investors-duties-sustainability-consultation-document_en.pdf) (Consultation Paper).

considering taking a regulatory approach to sustainability that would require EU asset managers to incorporate a mandated set of factors into their investment processes.<sup>3</sup>

Various EU laws governing the duty of asset managers already require asset managers to act in the best interests of their clients, which includes considering and managing all material risks.<sup>4</sup> This “best interests” framework guides asset managers’ consideration of ESG factors in their investment processes. We firmly believe a uniform, prescriptive ESG approach would conflict with asset managers’ duties. Such an approach would run contrary to asset managers’ need to assess the relevance and materiality of different ESG factors depending on the circumstances of a particular investment.

As described more fully below, prescribing a uniform ESG mandate for every asset manager would run counter to the European Union’s goals for the following reasons:

- *Compromise the ability of asset managers to act in the best interests of clients:* Requiring asset managers to consider a mandated list of factors in the investment process would hinder their ability to act in the best interests of their clients and would reduce asset managers’ “best interests” obligation to a compliance exercise.
- *Stifle financial and market innovation:* A prescriptive legislative approach to ESG investing risks codifying the standards of a fixed point in time and fixed point of view and stifling ongoing marketplace innovation.
- *Impede growth in the European market and drive investments to other markets:* A prescriptive approach may impede growth in the burgeoning EU market for sustainable finance. Requiring EU asset managers to consider all ESG factors in a homogenous manner will drive clients to seek asset managers in other markets that do not similarly constrain asset managers’ ability to provide the desired outcome for their clients.

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<sup>3</sup> The interim recommendations from the Commission-appointed High-Level Expert Group suggest that asset managers should integrate ESG information into their investment processes, but do not recognize that not all ESG information is material in all circumstances. EU High-Level Expert Group on Sustainable Finance, *Interim Report: Financing a Sustainable European Economy*, at p. 57, (July 2017), available at [https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report\\_en.pdf](https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf).

<sup>4</sup> See Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Commission Directive 2002/92/EC and Council Directive 2011/61/EU (MiFID II), at Article 24; Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the Coordination of Laws, Regulations, and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities, as amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 on the Coordination of Laws, Relating to Undertakings for Collective Investment in Transferable Securities as regards Depositary Functions, Remuneration Policies, and Sanctions (UCITS V), at Article 25; and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD), at Article 12. See also OECD (2017), *Investment governance and the integration of environmental, social and governance factors*, at App. 1, available at <http://www.oecd.org/cgfi/Investment-Governance-Integration-ESG-Factors.pdf> (OECD Report).

Instead of the prescriptive approach that the Consultation Paper contemplates, we recommend that EU policymakers consider implementing measures that facilitate an asset manager's ability to respond to market demand for ESG investing. We offer some suggestions in section IV of this letter.

**I. The Commission Should Avoid Incorporating a Prescriptive ESG Mandate into Asset Managers' Duties to Investors**

*A. Requiring Asset Managers to Consider All ESG Factors Would Compromise Their Ability to Act in the Best Interest of Clients*

We urge the Commission to avoid dictating whether and how asset managers consider ESG factors. Various EU laws governing the duty of asset managers already require asset managers to act in the best interests of their clients, which includes considering and managing all material risks.<sup>5</sup> A prescriptive and homogenous approach would fail to recognize that not all ESG factors are relevant to each client or fund, and not all ESG factors are material for each investment. This approach consequently would weaken asset managers' current duties and hinder their ability to act in the best interest of each client/fund. We note two particular concerns.

First, this approach would require asset managers to consider each ESG factor regardless of the factor's relevance to a fund's investment objective. Given its fiduciary agency business model, an asset manager must invest a fund's assets in a manner that it believes will best achieve the fund's stated investment objectives (as set forth in the fund documentation). For asset managers to meet their obligations, consideration of ESG factors must not diminish, but instead supplement, the rigor of 'traditional' investment diligence. For that reason, asset managers must ensure that ESG risk management adds value to the investment process and that the cost does not outweigh the benefit, unless a fund's investment mandate explicitly excludes certain ESG risks from its portfolio.

A fund's investment objective may not align with every ESG factor. Investors choose to invest in a specific fund with the expectation that the asset manager will allocate the fund's portfolio investments in line with the investment objective of the fund, whether capital preservation, long-term capital appreciation, or another objective. In questioning which sustainability factors asset managers should incorporate into the investment process, the Commission recognizes that not all of these factors are universally relevant to every client.<sup>6</sup>

Second, this approach would appear to require asset managers to adopt a uniform methodology for assessing each ESG factor. This structure runs counter to asset managers' duty to consider appropriately material information in making investment decisions that are in their clients' financial best interests. Asset managers analyze material risks and make investment decisions accordingly. For example, climate-related risk may be material with respect to an investment in an energy company but not a pharmaceutical company depending on the circumstances. ESG-related risks also exist on a continuum where a risk may be small enough that it is not material to a specific investment.

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<sup>5</sup> OECD Report, *supra* note 4, at App. 1.

<sup>6</sup> See generally Consultation Paper, *supra* note 2.

*B. A Prescriptive Approach to the Consideration of ESG Factors in the Investment Process  
Risks Reducing ESG Investing to a Compliance Exercise*

Prescribing a list of ESG factors that each asset manager must consider in its investment process risks reducing ESG investing to a rote, box-ticking compliance exercise. Asset managers still must consider material and relevant risks as part of their duty to act in the best interests of investors. A uniform, prescriptive approach to ESG investing therefore could divert an asset manager's attention and resources from risks that are material and relevant to the fund's investment proposition.

We believe a prescriptive approach is particularly inappropriate in several areas, including in asset managers' risk management, governance, and investment strategy and asset allocation. For example, developing uniform criteria for sustainability risk assessments would turn these assessments into a check-the-box exercise that is less meaningful than the more in-depth, tailored risk analysis that many asset managers currently are performing. Asset managers should, instead, maintain the flexibility to adapt their sustainability risk analyses according to their client's or fund's investment objectives, demands, and other factors.

Similarly, rigid requirements for governance arrangements would lead to an inappropriate "one size fits all" governance system that would ignore asset managers' differing business structures. Requiring a specific sustainability investment committee, for example, may not be appropriate for an asset manager with a decentralized approach that designates to certain investment professionals responsibility for monitoring specific ESG risks.

In addition, legislating how asset managers should incorporate ESG factors into investment strategy and asset allocation would handicap their ability to tailor the strategy and asset allocation to a fund's investment objective. Asset managers' investment strategies and approaches to asset allocation vary widely. For a fund with a negative screening approach, for example, the asset manager would allocate the fund's assets away from investments in companies based on specific ESG criteria. Others follow an ESG integration approach that includes ESG factors in analysis of a company's financials. Yet another asset manager might take an approach of engaging with corporate management on ESG-related issues. These approaches are not mutually exclusive, and an asset manager remains bound by the fund's investment objective and its duties to the fund and its investors. We believe the regulatory framework should allow asset managers to implement investment strategies in a manner that meets the needs and objectives of each fund and its investors.

## **II. A Prescriptive ESG Mandate Would Stifle Financial and Market Innovation**

We urge the Commission to let market forces continue to shape asset managers' approach to ESG investing. A prescriptive, legislative approach risks codifying the standards of a fixed point in time and fixed point of view and risks stifling ongoing marketplace innovation. Global investment in sustainable strategies continues to increase at a rapid pace,<sup>7</sup> and asset managers are competing to

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<sup>7</sup> 2016 *Global Sustainable Investment Review*, Global Sustainable Investment Alliance, at p. 7, available at [http://www.ussif.org/files/Publications/GSIA\\_Review2016.pdf](http://www.ussif.org/files/Publications/GSIA_Review2016.pdf) (GSIA Report) (showing 25% asset growth from 2014 to 2016).

meet investor demand for ESG-related investment strategies and products. This competitive landscape has spawned a range of asset management approaches to sustainable investment, such as exclusionary screening, ESG integration, engagement with investee companies, and impact investing.<sup>8</sup> Investor interest in these and other types of strategies continues to shift and change from year to year,<sup>9</sup> and asset managers are responding with innovative, differentiated product offerings (*e.g.*, ESG-related exchange-traded funds). Legislating an ESG mandate is likely to stifle continued market innovation in product offerings and investment strategies.

### **III. A Prescriptive ESG Mandate Would Impede Growth in the European Market and Risk Driving Investors to Other Markets**

A regulatory framework that stifles innovation and produces a more uniform approach to ESG investing would impede growth in the EU market and risk driving clients and investors to non-EU markets for two reasons. First, clients with less interest in ESG investing may leave for non-EU asset managers and markets that do not mandate that all investing must incorporate regulator-approved ESG factors. Second, this type of system could drive clients with a strong interest in ESG investing to migrate to markets that permit wider ranges of product offerings and a less homogenous approach to ESG investing.

Asset managers currently compete to cater to investors' preferences for sustainable investing—preferences that are diverse and differentiated. Investors do not universally agree on what constitutes ESG investing or how asset managers should consider certain ESG factors in the investing process. Standards have developed gradually, taking into account these differing views, with corporate disclosure as an important first step. The market has adapted to this environment by offering investors choices in sustainable investment products and strategies, and this landscape continues to grow and shift. For example, although negative or exclusionary screening approaches have been popular historically, other sustainable investing strategies are garnering increasing interest from investors. Only a small portion of assets are invested in impact investing strategies, but this type of investing is growing rapidly, with 146% growth from 2014 to 2016.<sup>10</sup>

The Commission should allow EU asset managers to continue competing in the global marketplace in response to diverse investor demand rather than a uniform regulatory mandate. Otherwise, investors in search of greater choice (both for ESG and non-ESG investing) may be forced to turn to jurisdictions that foster innovation and allow asset managers to provide investors with their desired outcomes. We believe this result would be in contravention of the Commission's goals.

Finally, we offer caution in how a prescriptive ESG mandate may affect EU financial products. UCITS, for instance, have become the investment vehicle of choice around the world. Applying prescriptive and inappropriate regulations to how EU asset managers must manage UCITS could risk significantly damaging the attractiveness of the UCITS brand internationally.

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<sup>8</sup> *Id.* (defining impact investing as targeted investments, typically made in private markets, aimed at solving social or environmental problems).

<sup>9</sup> *Id.*, at App. 3 (showing varying levels of growth in assets across several types of sustainable investing strategies).

<sup>10</sup> *Id.*

#### **IV. The Commission Should Adopt Policies that Foster Competition and Allow Asset Managers to Better Serve Their Clients**

Instead of a prescriptive approach to promoting sustainable investing, we recommend that the Commission consider adopting policies that would facilitate an asset manager's ability to respond to market demand for ESG investing. This approach may involve removing barriers to ESG investing, while allowing asset managers and investors to continue driving product offerings and market developments. For example, regulators in a number of jurisdictions have removed barriers to ESG integration through clarification that regulatory frameworks do not prohibit ESG integration, as long as it does not negatively impact portfolio performance.<sup>11</sup>

Improving the availability, reliability, and consistency of corporate disclosure also would facilitate asset managers' efforts to analyze and act on material ESG-related information. We raised this issue in our comments on the recommendations from the Task Force on Climate-related Financial Disclosures.<sup>12</sup> The Task Force recommended that asset managers disclose normalized greenhouse gas (GHG) emissions associated with a fund's portfolio companies. Our response noted that any data aggregation would be incomplete at best, and potentially even misleading, given the lack of GHG data availability and consistency. More broadly, corporate disclosure regimes have significantly different approaches to ESG-related reporting requirements.<sup>13</sup> We therefore would welcome an increased focus on corporate disclosure that would improve asset managers' access to information about material ESG factors.

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<sup>11</sup> OECD Report, *supra* note 4, at p. 12.

<sup>12</sup> Letter from David Blass, General Counsel, Investment Company Institute, to Task Force on Climate-related Financial Disclosures, dated February 10, 2017, *available at* <https://www.ici.org/pdf/30581a.pdf>.

<sup>13</sup> OECD Report, *supra* note 4, at p. 17.

We recognize the substantial efforts that the Commission is undertaking to achieve a sustainable financial system and welcome the opportunity to share our views on asset managers' duties regarding sustainability. We believe that the best way to achieve the Commission's objective is to encourage continued competition and market innovation, allowing market participants to respond to growing investor demand for product offerings and investment strategies that incorporate ESG factors. Instead of a prescriptive approach to promoting sustainable investing, we recommend that the Commission consider adopting policies that would facilitate an asset manager's ability to respond to market demand for ESG investing. We therefore would welcome an increased focus on corporate disclosure that would improve asset managers' access to information about material ESG factors.

We look forward to working with the Commission as it further develops initiatives for a sustainable financial system. If you have any questions about our comments or would like additional information, please contact the undersigned at [dan.waters@iciglobal.org](mailto:dan.waters@iciglobal.org), Jennifer Choi, Chief Counsel, at [jennifer.choi@iciglobal.org](mailto:jennifer.choi@iciglobal.org), or Linda French, Assistant General Counsel, at [linda.french@ici.org](mailto:linda.french@ici.org).

Sincerely,

Dan Waters

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Managing Director  
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