



Resource Efficiency and Fiduciary Duties of Investors

Final Report

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DG Environment



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European Commission, DG Environment

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Abstract

The objective of this report is to provide clarification and policy advice on the integration of environmental and resource efficiency issues into the fiduciary duties of institutional investors (e.g. pension funds, insurance companies, asset managers, etc.) in the European Union.

While the term fiduciary duty might not exist in all Member States, similar concepts regarding duty of loyalty and prudence exist in EU and national legislation. It is clear that the integration of environmental factors in the investment policies and decision-making process of institutional investors is compatible with the existing legal framework related to fiduciary duties in all jurisdictions across the EU – as long as it is relevant to financial returns and the management of risk. This is also evident in practice: most of the leading institutional investors in the EU have sustainable and responsible investment policies that take into consideration social and environmental issues.

This study does not see a need for legal changes in relation to fiduciary duty, but instead take action to engage, enable and encourage the entire investment community in the practical aspects of taking environmental and resource efficiency issues into consideration in their investment decision process.

Résumé

L'objectif de ce rapport est d'apporter un éclairage et des recommandations sur l'intégration des enjeux environnementaux et d'efficacité des ressources dans la responsabilité fiduciaire des investisseurs institutionnels (fonds de pension, compagnies d'assurance, gestionnaires d'actifs, etc.) de l'Union Européenne (UE).

Alors que le terme de responsabilité fiduciaire n'existe pas dans tous les Pays Membres, des concepts similaires sur le devoir de vigilance ou la loyauté des pratiques sont déjà présents dans l'UE et dans les législations nationales. L'intégration des facteurs environnementaux dans les politiques d'investissement et dans les processus de décision des investisseurs institutionnels est clairement compatible avec le cadre légal de la responsabilité fiduciaire dans toutes les juridictions européennes – tant que cela ne porte pas préjudice aux bénéfices financiers et à la bonne gestion des risques. Cela se manifeste clairement dans la pratique : la plupart des grands investisseurs institutionnels de l'UE ont déjà des politiques d'investissements responsables qui intègrent des problématiques sociales et environnementales.

Cette étude ne considère pas nécessaire une évolution de la réglementation au regard de la responsabilité fiduciaire. Elle propose plutôt d'éveiller l'intérêt, de donner les moyens et d'encourager l'ensemble de la communauté des investisseurs à prendre concrètement en compte les enjeux environnementaux et d'efficacité des ressources dans leurs processus de décision d'investissement.

Executive Summary

Institutional investors such as public and private pensions, insurance companies, sovereign wealth funds, mutual funds, banks and asset managers have a key role to play when it comes to financing the transition towards a resource-efficient, low-carbon economy to achieve sustainable growth. Institutional investors act on behalf of individual investors and beneficiaries (e.g. people that are eligible to receive a pension or benefit from a life insurance policy) by investing money to secure (future) benefits in terms of financial returns. There are legal principles that exist to protect beneficiaries from abuse by the institutional investors that have been delegated to make investment decisions on their behalf (Johnson, 2014). These legal principles are referred to as *fiduciary duties*. The most important fiduciary duties are the:

- **Duty of loyalty:** Fiduciaries should act in good faith in the interests of their beneficiaries and impartially balance the conflicting interests of different beneficiaries. They should avoid conflicts of interest and should not act for the benefit of themselves or a third party.
- **Duty to act prudently:** Fiduciaries should act with due care, skill and diligence; avoiding speculative and unduly risky investments; and, invest in a suitably diverse portfolio of investments.

The concept of fiduciary duty may also include other supporting duties such as acting in good faith (e.g. being honest); avoiding conflicts of interest; disclosing all material information fully and completely (e.g. being transparent and accountable); ensuring an informed judgement before acting; controlling investment costs; and, complying with applicable laws (Rostad, 2013). An institutional investor, or so-called fiduciary, that does not follow the above principles of conduct may be held responsible and can be required to restore any economic losses that might be a result of the breach of their fiduciary duties.

When considering the legal aspects of fiduciary duty, it is important to distinguish the decision-making process and the resulting decision (i.e. outcome of the decision-making process). The law is concerned with the decision-making process as an investment decision can only be judged with hindsight (UNEP FI, 2005). The legal framework also acknowledges that portfolios of investments are selected on their overall risk-reward characteristics rather than on the basis of the risks and returns of individual investments. When making investment decisions, asset managers must take into consideration not just the expected return on investment, but also the associated risks, liquidity, capital value and the time horizon of the investment – many of these factors are subject to strict financial regulation.

Institutional investors in Europe managed assets worth more than EUR 19 trillion in 2014 (EFAMA, 2015) – this is more than the annual GDP of the EU (EUR 14 trillion in 2014). This means that institutional investors are a considerable economic force and source of finance for the economy – particularly when it comes to ensuring sustainable and responsible investments. However, institutional investors have traditionally interpreted fiduciary duties narrowly as focusing solely on maximising the financial returns often through short- and medium-term investments – without regard to environmental or social issues. Fiduciary duties could therefore be key for institutional investors to take long-term and sustainable investments decisions.

Objectives of the study

This report investigates the application of fiduciary duty in the EU and the state of play on the inclusion of environmental and resource efficiency factors into the fiduciary duties of institutional investors. The objective is to provide clarification and advice on

this topic in the European Union from a policy making perspective. This study provides a legal analysis of fiduciary duties at EU level and in seven Member States (France, Italy, Germany, the Netherlands, Denmark, Poland and Latvia). The integration of environmental and resource efficiency issues in the investment decisions of institutional investors is examined. The opportunities and feasibility of including resource efficiency and sustainability more explicitly into the fiduciary duties are then analysed. Finally the report provides a set of recommendations for policy action that would be effective and would further develop and advance the integration of environmental and resource efficiency issues in investment decisions of institutional investors in the EU. Social and governance issues are not the focus of this study, but were also considered to some extent.

Fiduciary duty in the EU: the legal framework is not a barrier for the integration of relevant ESG issues

The concept of fiduciary duty is mostly recognised in a common-law system (uncodified), which is based on custom and usage. Countries in continental Europe have civil-law systems (codified) and therefore rely on a comprehensive, codified set of laws (Stewart & Yermo, 2008). Common law jurisdictions tend to operationalize fiduciary relationships through trusts and provide greater interpretive discretion to judges, while civil law countries are likely to use a contractual arrangement with a financial institution or management company and focus more on specific regulatory guidance than principles. With the exception of the common-law jurisdictions such as the UK and Ireland (and to a certain extent Malta), the legal texts in civil-law jurisdictions in the EU Member States rarely recognise or refer explicitly to 'fiduciary duties' in the context of institutional investors. This does not mean that fiduciary duty does not exist in civil-law. The concept of fiduciary duty is present in the legislation of every EU Member State as similar specific obligations to institutional investors. These include (UNEP FI, 2005):

- a duty to act in the interests of beneficiaries and typically expressed as to (mainly) either seek profitability or achieve the highest returns. No jurisdiction prescribes a particular level of profitability or financial return. In some jurisdictions the duty is qualified, such as in Germany where non-binding guidance indicates that the profit must be 'sustainable';
- a duty to act prudently expressed in different terms, with jurisdictions using terms such as 'diligently' (Spain), 'professionally' (Italy) or 'prudently' (France) and take into account the risks and liabilities of investments and ensure adequate diversification; as well as,
- other duties in relation to liquidity and in some jurisdictions limits on the types of assets that may be selected for certain types of funds.

Whilst priority must typically be given to the highest possible financial return on investment, no legal framework has been identified in the EU or any of its Member States that limits institutional investors from taking relevant environmental, social and governance (ESG) issues into account in their investment decisions. This is also evident in practice: most of the leading institutional investors in the EU have sustainable and responsible investment policies and are signatories of the United Nations-supported Principles for Responsible Investment (PRI) Initiative, which commit them to put the responsible investment principles into practice, including incorporating ESG issues into investment analysis and decision-making processes. According to the Global Sustainable Investment Alliance (GSIA, 2015), 58.8% of total managed assets in Europe in 2014 were subject to some form of sustainable and responsible investment strategy.

It should be noted however that there are several strategies and methodologies to sustainable and responsible investment. The most common are exclusions of investments within certain companies, sectors or countries, e.g. investments in weapons and tobacco. Integration of ESG factors in financial analysis is also quite common, but this does not necessarily mean that the investments, i.e. the outcome of the decision making process, were sustainable - just that ESG issues were considered during the investment decision-making process. It is also contested if other strategies such as norm-based screening (using international norms and standards to exclude investments) and active engagement with companies on ESG issues and voting through shares, actually lead to more sustainable and responsible investments.

From a legal perspective, divesting and excluding some types of investment are permitted if this does not affect the ability to achieve the highest possible returns, or there is general support from the beneficiaries. While there are no general provisions (yet) that require institutional investors to integrate ESG issues into their investment decisions (besides certain statutory provisions of public pension funds and sovereign wealth funds), policies are currently being developed to encourage institutional investors to be able to adopt sustainable investment strategies to a greater extent, e.g. through engagement and impact investing.

The integration of environmental and resource efficiency issues in the investment decisions of institutional investors is however limited

Despite most institutional investors claiming to apply sustainable and responsible investment strategies, the final impact on investment decisions is rarely disclosed and the actual investment decisions do not seem to result in wide spread long-term sustainable investments. While the legal framework in the EU is not an obstacle to integrating ESG factors into the fiduciary duties of institutional investors, it is not a requirement that specific financially relevant ESG factors should be taken into consideration when making investment decisions. There are several barriers to institutional investors integrating environmental and resource efficiency factors in their investment decisions:

- The **conservative interpretation of fiduciary duty as solely focusing on the highest financial returns through short- and medium-term investments** without taking wider social and environmental issues into consideration in investment decisions still seems to persist among certain legal advisers and investment consultants.
- **Asset managers and other intermediaries in the investment value chain do not take social and environmental issues into consideration** as these are not always specified in asset management contracts.
- **Social and environmental performance and risks are not recognised or valued by investors** due to investment beliefs and a lack of a 'business case' that link social and environmental issues with financial performance and risks. This is often because social and environmental impacts are externalities and policy risks are not assessed to be significant - for instance, when related environmental policies or their enforcement are either weak or lacking.
- **Trustees do not define the 'best interests' of beneficiaries in relation to social and environmental issues.**
- **Focus on the short and medium-term perspective** due to financial regulation having high degrees of medium-term capital and liquidity requirements, but also due to lack of long-term risk assessment models that can incorporate long-term environmental risks.

- **Complexity and quality of ESG information** which is not always material, consistent and reliable and it does not allow comparisons to be made.
- **Lack of skills and competences to integrate wider social and environmental issues into investment decisions** due to insufficient training, but also because there is a lack of tools and valuation models that are able to take into account ESG information.

Based on the analysis performed in this study, the challenge is not just about considering changes to the legal framework related to fiduciary duty, but on what actions could be taken to further develop and advance the integration of environmental and resource efficiency issues in investment decisions.

Actions to further develop and advance the integration of environmental and resource efficiency issues in investment decisions of institutional investors

While it could be considered to introduce legal requirements that require ESG issues such as resource efficiency to be integrated into the investment decisions of institutional investors as part of their fiduciary duty, this would not necessarily be very effective. A statutory provision would free trustees to exercise their professional judgement about what will serve their beneficiaries' best interests, but this alone would not necessarily lead to any change. As the obligations of fiduciary duty relate to the investment decision-making process and not the final investment decision, "to integrate ESG factors" could simply mean that ESG issues were considered during the investment decision-making process, but then found not to be relevant. As there are many different approaches to sustainable and responsible investment, and different degrees to taking ESG factors into consideration, institutional investors could claim to be following responsible investment principles in their investment strategies, but still continue to make investment decisions as before.

This study does not see a need for legal changes in relation to fiduciary duty, but sees ample scope to further develop and advance the integration of environmental and resource efficiency issues in the investment decisions of institutional investors. The priority should be to provide clear guidance that puts beyond doubt that the inclusion of ESG factors is not only permissible, but arguably also good practice. The consideration of ESG issues can be seen as being prudent both from a financial and legal perspective.

While this study is not based on a proper assessment of policy actions, it does propose recommendations that would be effective and would further develop and advance the integration of environmental and resource efficiency issues in investment decisions of institutional investors in the EU.

This study recommends that:

- **National financial authorities with support from the European Commission provide official guidance and interpretation** of fiduciary duties and the extent to which institutional investors may include ESG issues into their investment strategies and decisions. This is to provide a reference document and put beyond doubt the question of ESG issues and fiduciary duties.
- **Disclosure of sustainable and responsible investment policy is mandatory for all institutional investors** – including if they do not have such a policy in place (i.e. 'comply or explain').
- **Monitoring and verification ensures that institutional investors are indeed applying their sustainable and responsible investment policy as they claim.** Many institutional investors benefit from being perceived as

sustainable investors without doing anything. If institutional investors have a sustainable and responsible investment policy, they must also demonstrate that they have internal controls in place to ensure that the policy is adequately applied. External verification by a third party could be introduced in the case of PRI signatories or when benefiting from a recognised sustainable and responsible investment label or certificate.

- **Institutional investors are encouraged to inform and consult their beneficiaries** to ensure that their 'best interests' are understood. This includes that beneficiaries are made more aware and are encouraged to be more engaged in the investment decisions of fiduciaries, as well as trustees and administrators of funds are also made more aware of the environmental and social issues related to investments and the best interest of beneficiaries.
- **Institutional investors measure the environmental and social impacts of their investments** to track that they are actually contributing to a resource-efficient economy. This requires that tools and models have to be developed in order to value the environmental and social impacts and benefits of investments.
- **The regulatory requirements for institutional investors are balanced from a short and long-term perspective** in relation to the regular reporting on their financial performance and capital and liquidity requirements. This includes that financial regulations should be consistent with climate, environmental and resource efficiency policy, e.g. the 2°C target for climate change.
- **Stewardship codes are developed for asset managers and intermediaries** to increase transparency and clarify that fiduciary duties and the inclusion of ESG factors should be respected throughout the investment chain
- **Research is supported regarding measurement and quantification of ESG-related impacts and risks of investments**, including tools and valuation models that are able to take into account ESG information.
- **The quality of ESG data and information is improved** in order to be relevant, consistent, comparable, balanced and reliable.

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Synthèse

Les investisseurs institutionnels tels que les fonds de pension publics ou privés, les compagnies d'assurance, les fonds souverains, les fonds communs de placement, les banques et les gestionnaires d'actifs ont un rôle décisif à jouer pour financer la transition vers l'économie sobre en ressources et en carbone qui permettra une croissance durable. Les investisseurs institutionnels agissent au nom des investisseurs individuels et des bénéficiaires finaux (comme les personnes qui sont susceptibles de recevoir une pension ou les intérêts d'une assurance vie) en investissant leur argent de façon à sécuriser leurs (futurs) bénéfices en termes de retours financiers. Des principes légaux existent pour protéger les bénéficiaires des abus que les investisseurs institutionnels, à qui ils ont confié leurs décisions d'investissement, pourraient leur faire (Johnson, 2014). Ces principes légaux sont mieux connus sous le terme de responsabilité fiduciaire. Les tenants les plus importantes de la responsabilité fiduciaire sont :

- **Le devoir de loyauté** : les intermédiaires financiers agissent en toute bonne foi dans l'intérêt de leurs bénéficiaires et gèrent de façon impartiale les conflits d'intérêt qui peuvent exister entre les différents bénéficiaires. Ils doivent éviter les conflits d'intérêt et ne doivent pas agir en faveur de leurs propres intérêts ou des intérêts d'une tierce partie.
- **Le devoir de prudence** : les intermédiaires financiers doivent agir avec prudence, en ayant les compétences nécessaires et avec diligence. Ils doivent éviter les investissements spéculatifs et trop risqués et investir dans des portefeuilles diversifiés de façon appropriée.

Le concept de responsabilité fiduciaire peut également inclure d'autres responsabilités comme le fait d'agir en toute bonne foi (c'est-à-dire être honnête) ; d'éviter les conflits d'intérêt ; de diffuser toutes les informations importantes dans leur intégralité (c'est-à-dire être transparent et rendre des comptes) ; de s'assurer un jugement éclairé avant d'agir ; de contrôler les coûts des investissements ; et de respecter les lois en vigueur (Rostad, 2013). Un investisseur institutionnel qui ne suit pas les principes de conduite listés ci-dessus peut être porté responsable et peut se voir imposé de rembourser les pertes économiques qu'il aurait pu engendrer de par son manquement à sa responsabilité fiduciaire.

Quand on considère les aspects légaux de la responsabilité financière, il est important de distinguer le processus de décision de la décision qui en découle (c'est-à-dire le résultat du processus de décision). La loi traite du processus de décision alors qu'une décision d'investissement ne peut être jugée que rétrospectivement (UNEP FI, 2005). Le cadre légal reconnaît également que les portefeuilles d'investissement sont sélectionnés sur la base des profils de risque-rendement plutôt que sur la base des risques et de la rentabilité des investissements individuels. Quand les gestionnaires d'actifs prennent des décisions d'investissement, ils ne doivent pas seulement prendre en compte le retour sur investissement attendu mais aussi les risques associés, la liquidité, la valeur du capital et la durée de l'investissement – la plupart de ces facteurs sont soumis à des réglementations financières strictes.

Les investisseurs institutionnels européens gèrent plus de 19 milliards d'euros d'actifs en 2014 (EFAMA, 2015) – ce qui est supérieur au PIB annuel de l'Union Européenne (UE – 14 milliards d'euros en 2014). Cela signifie que les investisseurs institutionnels représentent une force économique et une source de financement considérables pour l'économie – particulièrement quand il s'agit d'assurer des investissements durables et responsables. Cependant, les investisseurs institutionnels ont traditionnellement

interprété leurs responsabilité fiduciaire de façon restreinte en se concentrant sur la maximisation des profits, souvent avec des horizons d'investissement de court ou moyen terme, sans tenir compte des enjeux environnementaux ou sociaux. La responsabilité fiduciaire pourrait donc être un concept clé pour que les investisseurs institutionnels prennent des décisions d'investissement sur le long terme.

Objectifs de l'étude

Ce rapport étudie l'application de la responsabilité fiduciaire dans l'UE et dresse un bilan de la façon dont les facteurs environnementaux et l'efficacité des ressources sont intégrés dans la responsabilité fiduciaire des investisseurs institutionnels. L'objectif est d'apporter un éclairage et des recommandations pratiques sur ce sujet pour l'UE. Cette étude comporte une analyse du contexte législatif de la responsabilité fiduciaire au niveau de l'UE et dans sept de ses Pays Membres (France, Italie, Allemagne, Pays-Bas, Danemark, Pologne, Lettonie). L'intégration des problématiques environnementales et de l'efficacité des ressources dans les décisions d'investissement des investisseurs institutionnels est examinée. Les opportunités et la faisabilité d'inclure des critères de durabilité et d'efficacité des ressources de façon plus explicite dans la responsabilité fiduciaire sont ensuite analysées. Enfin, le rapport fournit une série de recommandations pour la mise en place de plan d'actions efficaces qui accélèreraient l'intégration des enjeux environnementaux et d'efficacité des ressources dans les décisions d'investissement des investisseurs institutionnels européens. Les enjeux sociaux et de bonne gouvernance ne sont pas au cœur de cette étude mais ils seront en partie pris en compte.

La responsabilité fiduciaire dans l'UE : le cadre légal n'est pas un frein à l'intégration de problématiques ESG pertinentes

Le concept de responsabilité fiduciaire est principalement reconnu dans le système de droit commun (non codifié) basé sur la coutume et les usages. Les pays d'Europe continentale ont un système de droit civil (codifié) et par conséquent reposent sur un ensemble de lois codifiées (*Stewart & Yermo, 2008*). Les juridictions de droit commun tendent à rendre les relations fiduciaires opérationnelles en les basant sur la confiance et elles donnent aux juges une plus grande liberté d'interprétation, alors que les pays de droit civil utilisent des accords contractuels avec les institutions financières ou les dirigeants d'entreprises et se concentrent plus sur des points spécifiques de la réglementation que sur ses grands principes. A l'exception des juridictions de droit commun comme le Royaume-Uni ou l'Irlande (et jusqu'à un certain point Malte), les textes de loi des juridictions de droit civil parmi les Etats Membres de l'UE reconnaissent ou se réfèrent rarement explicitement à la notion de « responsabilité fiduciaire » pour les investisseurs institutionnels. Cela ne veut pas dire que la responsabilité fiduciaire n'existe pas dans le droit civil. Le concept de responsabilité fiduciaire est présent dans la législation de chacun des Pays Membres de l'UE comme une obligation commune aux investisseurs institutionnels. Cela inclus (UNEP FI, 2005):

- Le devoir d'agir dans l'intérêt des bénéficiaires et de définir (principalement) les objectifs de rentabilité ou de maximisation des retours financiers. Aucune juridiction ne définit un niveau précis de rentabilité ou de retour financiers. Dans certaines juridictions le devoir est qualifié, comme en Allemagne où un principe non-contraignant indique que le profit doit être « soutenable » ;
- Le devoir de prudence exprimé par différentes formulations, avec des juridictions qui utilisent les termes de « diligence » (Espagne) « professionnalisme » (Italie), ou « prudence » (France) et prennent en compte

les risques et engagements financiers en s'assurant d'une diversification adéquate des investissements ;

- D'autres devoirs en relation avec la liquidité et dans la limite de certaines juridictions sur les types d'actifs qui peuvent être sélectionnés pour certains fonds.

Même si habituellement la priorité doit rester la maximisation du retour sur investissement, aucun cadre légal dans l'UE ou dans aucun autre Pays Membres n'a été identifié comme empêchant les investisseurs institutionnels de prendre en compte des critères environnementaux, sociaux ou de gouvernance (ESG) pertinents dans leurs décisions d'investissement. Cela se manifeste clairement dans la pratique : la plupart des grands investisseurs institutionnels de l'UE ont des politiques d'investissement responsables et durables et sont signataires des Principes de l'Investissement Responsables définis par les Nations Unies, qui les amènent à prendre en compte des principes d'investissement responsable dans leurs pratiques, y compris l'intégration de problématiques ESG dans l'analyse des investissements et dans les processus de décision. D'après la *Global Sustainable Investment Alliance* (GSIA, 2015), 58,8% des actifs gérés en Europe en 2014 ont été soumis à une certaine forme de stratégie d'investissement durable et responsable.

Il faut noter cependant qu'il existe différentes formes de stratégie et méthodologies pour l'investissement durable et responsable. Les plus communes sont l'exclusion de l'univers d'investissement de certaines entreprises, secteurs ou pays, comme par exemple les armes ou le tabac. L'intégration de critères ESG dans les analyses financières est aussi assez répandue, mais cela ne garantit pas nécessairement que les investissements, c'est-à-dire les résultats des processus de décision, soient responsables – cela garantit seulement que des critères ESG ont été analysés durant le processus de décision de l'investissement. Il est aussi contesté que d'autres stratégies comme l'exclusion normative (basée sur les normes internationales et des standards pour exclure certains investissements) et les politiques d'engagement avec les entreprises sur des aspects ESG ou l'activisme actionnarial conduisent effectivement à des investissements durables et responsables.

D'un point de vue strictement légal, le fait de désinvestir et d'exclure certains types d'investissements est permis si cela n'affecte pas la capacité de l'investissement à maximiser son retour sur investissement, ou s'il y a une demande particulière venant des bénéficiaires. Bien qu'il n'y ait pas (encore) de dispositions générales qui obligent des investisseurs institutionnels à intégrer les enjeux ESG dans leurs décisions d'investissement (en dehors de certaines dispositions statutaires de fonds de pension publics et fonds souverains), des politiques sont actuellement en cours d'élaboration pour encourager les investisseurs institutionnels à pouvoir adopter des stratégies d'investissement durables à plus grande échelle, par exemple grâce à l'engagement actionnarial et *l'impact investing*.

L'intégration des critères environnementaux et de l'efficacité des ressources dans les décisions d'investissement des investisseurs institutionnels est cependant limitée

Bien que la plupart des investisseurs institutionnels réclame avoir des stratégies d'investissement durable et responsable en place, l'impact final sur les décisions d'investissement est rarement communiqué et la décision d'investissement effectivement prise ne semble pas aboutir une large diffusion d'investissements durables de long terme. Même si le cadre légal dans l'UE n'est pas un obstacle à l'intégration de critères ESG dans la responsabilité fiduciaire des investisseurs, il n'est pas nécessaire que des critères ESG financièrement pertinents soient pris en compte lors des décisions d'investissement. Il y a plusieurs obstacles qui empêchent les

investisseurs institutionnels d'intégrer les critères environnementaux et d'efficacité des ressources dans leurs décisions d'investissement :

- La **vision conservatrice de la responsabilité fiduciaire qui se limiterait à la maximisation financière du retour sur investissement à court ou moyen terme** sans considérer plus largement des enjeux sociaux et environnementaux dans les décisions d'investissement et qui semble persister chez certains consultants juridiques et certains conseillers en investissement ;
- **Les gestionnaires d'actifs et autres intermédiaires dans la chaîne de valeur de l'investissement qui ne prennent pas en compte les questions sociales et environnementales** puisque celles-ci ne sont pas toujours spécifiées dans les contrats de gestion ;
- **Les risques et la performance liés aux questions sociales et environnementales ne sont pas reconnus ou valorisés par les investisseurs** à cause de croyances et du manque d'études de cas qui illustrent le lien entre les enjeux environnementaux et sociaux, la performance financière et la réduction des risques. Cela s'explique souvent par le fait que les impacts sociaux et environnementaux sont des externalités et que les risques qui en découlent n'apparaissent pas significatifs – par exemple, lorsque les réglementations environnementales ou leur mise en vigueur sont faibles ou insuffisantes ;
- **Les intermédiaires financiers ne définissent pas les « meilleurs intérêts » des bénéficiaires au regard des questions sociales et environnementales ;**
- **L'accent est mis sur les perspectives de court et moyen terme** à cause de la réglementation financière dont les degrés d'exigences sont élevés sur le capital à moyen terme et sur la liquidité, mais aussi à cause du manque de modèle d'évaluation des risques à long terme qui pourraient notamment inclure les risques environnementaux de long terme ;
- **Le niveau de qualité et de complexité de l'information ESG** qui ne permet pas toujours d'avoir des informations matérielles, cohérentes et fiables et qui ne permet pas de réaliser des comparaisons ;
- **Le manque de compétences pour intégrer plus largement les questions sociales et environnementales aux décisions d'investissement** à cause d'un défaut de formation mais aussi par manque d'outils et de modèles de valorisation qui seraient capables de prendre en compte l'information ESG.

D'après l'analyse effectuée dans cette étude, le défi n'est pas seulement d'envisager des changements au niveau du cadre légal de la responsabilité fiduciaire mais de savoir quelles actions pourraient être menées pour développer davantage et faire progresser l'intégration des questions environnementales et d'efficacité des ressources dans les décisions d'investissement.

Plan d'actions pour faire progresser l'intégration des enjeux d'efficacité environnementale et des ressources dans les décisions d'investissement des investisseurs institutionnels

Alors qu'il pourrait être envisagé d'introduire des exigences réglementaires imposant l'intégration des enjeux ESG tels que l'efficacité des ressources dans la décision d'investissement des investisseurs institutionnels dans le cadre de leur responsabilité fiduciaire, cette possibilité ne serait pas nécessairement très efficace. Une telle disposition législative libérerait les intermédiaires financiers de leur jugement professionnel sur ce qui pourrait servir les meilleurs intérêts du bénéficiaire, et cela n'aboutirait pas forcément à un quelconque changement. Puisque les devoirs de la responsabilité fiduciaire sont liés au processus de décision de l'investissement et non

à la décision finale d'investissement, « intégrer des critères ESG » pourrait simplement signifier que les critères d'ESG doivent être pris en compte pendant le processus de décision d'investissement mais ils pourraient se révéler par la suite non pertinents. Comme il existe de nombreuses approches de l'investissement durable et responsable, et différents degrés de prise en compte des facteurs ESG, les investisseurs institutionnels peuvent prétendre suivre des principes d'investissement responsable dans leurs stratégies d'investissement mais continuer de prendre les mêmes décisions d'investissement qu'avant.

Cette étude n'identifie pas un besoin de changement juridique à propos de la responsabilité fiduciaire mais envisage de larges opportunités pour développer et faire progresser l'intégration de problématiques environnementales et d'efficacité des ressources dans les décisions d'investissement des investisseurs institutionnels. La priorité devrait être de fournir des orientations claires qui permettent de souligner que l'inclusion de critères ESG est non seulement permise mais surtout une bonne pratique. La prise en compte des problématiques ESG peut être vue comme une marque de prudence aussi bien du point de vue financier que du point de vue juridique.

Bien que cette étude ne repose pas sur une évaluation concrète des actions politiques, elle propose des recommandations qui permettraient de développer et de faire progresser l'intégration des problématiques environnementales et d'efficacité des ressources dans les décisions d'investissement des investisseurs institutionnels de l'UE.

Cette étude recommande :

- **Que les autorités financières nationales, avec le soutien de la Commission Européenne, établissent des orientations et une interprétation officielles** de la responsabilité fiduciaire et précisent jusqu'à quel point les investisseurs institutionnels devraient inclure les problématiques ESG dans leurs stratégies et leurs décisions d'investissement. Il s'agit de fournir un document de référence et d'écarter les derniers doutes sur les liens entre responsabilité fiduciaire et enjeux ESG ;
- **Que les investisseurs institutionnels doivent exposer leur politique en matière d'investissement durable et responsable** – y compris s'ils n'ont pas de telle politique en place (principe « *comply or explain* ») ;
- **Que les investisseurs institutionnels fassent l'objet d'un suivi et d'une vérification quant à l'application effective de la politique dont ils se réclament.** De nombreux investisseurs sont perçus comme des investisseurs responsables sans réaliser de véritables efforts. Si les investisseurs institutionnels ont une politique d'investissement durable et responsable, ils doivent aussi pouvoir démontrer qu'ils ont mis en place un contrôle interne permettant d'assurer que la politique est correctement appliquée. Une vérification par une tierce partie pourrait être mise en place pour les signataires des PRI ou dans le cadre d'une certification ou d'un label d'investissement responsable reconnu ;
- **Que les investisseurs institutionnels soient encouragés à informer et consulter leurs bénéficiaires** pour s'assurer que leurs « meilleurs intérêts » soient bien compris. Cela implique que les bénéficiaires soient davantage sensibilisés et soient encouragés à s'engager dans les décisions d'investissement de leur intermédiaire financier, tout comme cela implique que les mandataires et les administrateurs de fonds soit aussi davantage conscients des enjeux sociaux et environnementaux liées aux investissements et des intérêts des bénéficiaires ;

- **Que les impacts sociaux et environnementaux des investissements soient mesurés par les investisseurs institutionnels** afin de déterminer leur contribution à une économie plus sobre en ressources. Cela suppose que des outils et des modèles soient développés afin de pouvoir évaluer les impacts et les bénéfices environnementaux et sociaux des investissements ;
- **Que les exigences réglementaires pour les investisseurs institutionnels soient équilibrées entre le court et le long terme** quant à la fréquence de leur reporting sur la performance financière et sur les exigences en matière de capital et de liquidité. Cela comprend que les réglementations financières soient cohérente avec les politiques climatiques, environnementales et d'efficacité des ressources, comme par exemple l'objectif de limiter le réchauffement climatique à 2°C ;
- **Que des codes de conduite soient développés à destination des gestionnaires d'actifs et des intermédiaires** afin d'améliorer la transparence et de clarifier le fait que la responsabilité fiduciaire et l'inclusion de critères d'ESG doivent être respectées tout au long de la chaîne d'investissement ;
- **Que la recherche soit soutenue dans le domaine de la mesure et de la quantification des impacts et des risques d'investissement liés aux enjeux ESG**, ce qui inclut des outils et des modèles de valorisation capables de prendre en compte l'information ESG ;
- **Que la qualité des données et des informations ESG soient améliorée** pour qu'elles soient pertinentes, cohérentes, comparables, équitables et fiables.

1. Introduction

1.1. Context

The economy and our well-being depend on natural resources and the environment. Yet, the current use of resources and associated environmental impacts are unsustainable (UNEP, 2011a). If we continue to exhaust our natural resources and degrade the environment, we risk endangering economic development and our own well-being (OECD, 2012). While it is possible to manage resources more sustainably and use them more efficiently to improve productivity, competitiveness, growth and job creation (UNEP, 2014), this requires a long-term view and significant initial investments (UNEP, 2011b).

The European Commission's flagship initiative for a resource-efficient Europe¹ under the Europe 2020 Strategy² aims to support the shift towards a resource-efficient, low-carbon economy to achieve sustainable growth. Finance and securing investments in resource efficiency is a fundamental component to make this transition happen.

Since the launch of the flagship initiative, the Commission has engaged in various stakeholder discussions including on the role of the finance sector in relation to resource efficiency such as the European Resource Efficiency Platform and the Resource Efficiency Finance Roundtable. One potential measure that has been identified to steer capital towards resource efficiency is the integration of environmental and natural resource issues in the responsibility of institutional investors through fiduciary duty.

Box 1: UNEP FI and fiduciary duties



For the past ten years, the United Nations Environment Programme Finance Initiative (UNEP FI) has investigated the legal aspects of integrating environmental, social and governance (ESG) issues into fiduciary responsibility. This year UNEP FI together with PRI, UN Global Compact and UN Inquiry published a joint report entitled "Fiduciary Duty in the 21st Century" as a follow-up to the 2005 Freshfields' report (UNEP FI, 2005). This last report explored whether fiduciary duty is a legitimate obstacle to investors taking account of ESG issues in their investment processes. The question of whether investors' fiduciary duties require them to consider the impacts of their investment activities on wider society and on the environment was also investigated. The report examined eight jurisdictions

worldwide: Australia, Brazil, Canada, the European Union, Germany, United Kingdom, Japan, South Africa and the United States of America.

As the work behind the UNEP FI report and this study ran in parallel and shared many similarities, the project team in this study worked together with UNEP FI and developed consistent conclusions. One of the key results which is unanimously shared is that integrating ESG factors into the investment decisions of institutional investors as part of their fiduciary duties is "*clearly permissible and is arguably required*".

The UNEP FI Report is available at: www.unepfi.org/publications/investment

¹ http://ec.europa.eu/resource-efficient-europe/index_en.htm

² http://ec.europa.eu/europe2020/index_en.htm

1.2. Objectives

The overall aim of this study is to provide clarification and advice on the integration of environmental and resource efficiency issues into fiduciary duties in the European Union, from a policy making perspective. More concretely, the objectives of this study are:

- To review the state of fiduciary duties at EU level and in seven Member States
- To develop recommendations on whether environmental and resource efficiency issues should be taken into account proactively in fiduciary duties and indicate concrete steps at EU and Member State level to achieve this type of integration.

This present study does not intend to provide a comprehensive overview of fiduciary duties in all EU Member States, but it does aim to provide a good picture of the general state of play in the inclusion of environmental factors into fiduciary duties in the EU.

1.3. Definitions

Institutional investors: Covers the full range of actors that make investment decisions on behalf of beneficiaries including trustees, asset owners and asset managers of public and private pensions, sovereign wealth funds, mutual funds and insurance company reserves, but also banks, investment consultants and other intermediaries.

Fiduciary duties: Fiduciary duties are duties that common law jurisdictions impose upon a person who undertakes to exercise some discretionary power in the interests of another person in circumstances that give rise to a relationship of trust and confidence. In an investment context, fiduciary duties exist to ensure that those who manage other people's money act in the interests of beneficiaries.

Fiduciary: a person or organisation that manages money and other assets on behalf of other people (i.e. the beneficiaries). This could be trustees, pension fund managers, administrators and other asset owners.

Beneficiary: the person or group of people that own the assets managed by a fiduciary. This may include those who stand to receive a benefit (e.g. financial return on investment, pay-outs from a pension or life assurance) under a fund / investment.

ESG issues: Environmental, Social and Governance (ESG) issues are extra-financial aspects of investments that provide information on the sustainability of companies and their activities. ESG issues cover a wide range of individual issues such as greenhouse gas emissions, deforestation, health and safety, human rights, corruption and terrorism-financing. Some investors claim that taking ESG issues into consideration during investment analysis and decision making may offer investors potential long-term performance advantages. Linked with Corporate Social Responsibility (CSR).

Sustainable and responsible investment (SRI): any type of investment process that considers environmental, social and governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact. Synonymous with socially responsible investment, sustainable investment, green investment, etc.

Extra-financial information: information about social and environmental performance that is provided by organisations beyond the requirements for financial reporting. Also referred to as non-financial information in EU documents.³

³ Although EU documents use the term "non-financial information", this is misleading as social and environmental information can be financially relevant and can have financial impacts. The term "extra-

1.4. Scope

In this study the scope of fiduciary duty is limited to those duties related to making investments on someone else's benefit, i.e. institutional investors which include pension funds, mutual funds, insurance companies, banks, sovereign wealth funds and asset managers.

This study focuses on the fiduciary duties related to financial institutions and investment decisions. Whilst it can be discussed whether fiduciary duties are applicable in other areas such as the responsibilities of business managers to their company's shareholders⁴; corporate investments; public sector investments; or, even a country's government's responsibility to current and future citizens of protecting natural resources and the environment⁵; this is not within the scope of this study.

In this study the scope is the sustainable management and use of all types of natural resources (materials, energy, land, water, ecosystem services, etc.) – including their environmental impacts (e.g. climate change, eutrophication, human health, etc.) and future capacity to (continue to) supply resources and other ecosystem services.

Social and governance issues are not the focus of this study, but will also be considered.

1.5. Methodology

This study is based on a desk research and review of the related legal documents and other literature related to fiduciary duty and the integration of environmental and resource efficiency issues in investment decision making. This includes academic studies and reports from governmental organisations, industry associations and NGOs as well as other publicly available documents and statements from institutional investors and related stakeholders.

The study includes a legal analysis of fiduciary duties in the EU and in five Member States: France, Italy, Germany, the Netherlands and Denmark as well as a look at fiduciary duties in Poland and Latvia. The practical interpretation of fiduciary duties in relation to environmental issues among regulators and institutional investors is also investigated. The findings are compared to developments elsewhere, e.g. UK, USA and Canada. In particular, the study relates the state of play in Europe with the conclusions of the UNEP FI Freshfields reports (UNEP FI, 2005) (UNEP FI, 2009).

The literature review was complemented by a series of interviews of representatives of regulatory authorities, institutional investors, finance sector industry associations, academics and NGOs. A list of the interviews conducted can be found in Annex 1 – List of interviews.

financial information" is more appropriate as it covers both financially relevant ESG issues as well as issues that may be considered being more ethical/moral.

⁴ Milton Friedman is often referenced in this regard from his 1970 article in the New York Times magazine: "The Social Responsibility of Business Is to Increase its Profits": *"In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has a direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."*

⁵ For further information on this view, see:

- Sax, J.L. (1970) The Public Trust Doctrine in Natural resource Law: Effective Juridical Intervention, 68 Michigan Law Review
- Wood, M.C. (2013) Nature's Trust. Environmental Law for a New Ecological Age.

The preliminary findings of the study were presented to a group of stakeholders at a meeting organised in Brussels on the 2nd July 2015. The participation list and notes from the meeting can be found in Annex 3 – Stakeholder meeting.

1.6. Organisation of the report

This first chapter (Chapter 1) briefly outlines the context, aim and scope of this study. In the next chapter (Chapter 2) we try to define the notion of fiduciary duties and investigate the related legal framework. Chapter 3 analyses the link between fiduciary duties and environmental and resource efficiency issues and in particular examines the main (actual or perceived) barriers that prevent investors to factor environmental performance (and more largely ESG performances) in their decision making process. Chapter 4 looks into the opportunities and feasibility of including resource efficiency and sustainability more explicitly into fiduciary duties. The options and actions that could be envisioned are also discussed in Chapter 4. Chapter 5 then presents our policy recommendations for improving the conditions for investment investors to consider and further develop environmental and resource efficiency issues in their investment decisions. Finally, Chapter 6 concludes and reflects on the findings of this study.

2. Fiduciary duty and institutional investors

2.1. Definitions of fiduciary duties

An ancient legal concept that has evolved over time

The word '*fiduciary*' comes from Latin verb from '*fidere*' meaning '*to trust*'. '*Fiduciary duty*' is a legal term that refers to the type of duty that a person or organisation, who manages someone else's wealth or property, has in certain circumstances in relation to the owner or beneficiary of that wealth or property. In other words, fiduciary duties are legal obligations that exist in certain situations between one party (the beneficiary) that owns or has the rights to assets that another party (the fiduciary or trustee) manages.

The basic concept of fiduciary duty can be found described as far back as the Code of Hammurabi (ca. 1790 BC) in Babylon in the provisions that set forth the rules for agents entrusted with someone else's property for safekeeping; money for investments or purchases; or, goods for trading or selling (Loveland, 2010). Almost every ancient law across many different civilisations deals with the concept of fiduciary duty, e.g. the Old and the New Testaments, and also Confucius in China, Aristotle for the Greeks and Cicero for the Romans have all discussed fiduciary principles (Aikin & Fausti, 2011). Although the concept of fiduciary duty crosses the boundaries of different fact situations, legal systems and cultures, there is no universal definition of fiduciary duty (Johnson, 2014). The understanding and implementation of fiduciary duties are dynamic and constantly evolving in response to changes in society, the economy and knowledge.

Today, the concept of fiduciary duty is mostly recognised in a common-law system (uncodified), which is based on custom and usage. Countries in continental Europe have civil-law systems (codified) and therefore rely on a comprehensive, codified set of laws (Stewart & Yermo, 2008). Common law jurisdictions tend to operationalize fiduciary relationships through trusts and provide greater interpretive discretion to judges, while civil law countries are likely to use a contractual arrangement with a financial institution or management company and focus more on specific regulatory guidance than principles. This does not mean that fiduciary duty does not exist in civil-law. The concept of fiduciary duty is present in the legislation of every EU Member State as similar specific obligations to institutional investors.

The key elements of fiduciary duty

Fiduciary duties exist to mitigate the information asymmetry (i.e. the knowledge gap) between expert providers of socially important services – such as law, finance and medicine – and the non-expert, beneficiaries of these services (Rostad, 2013). This is accomplished by legally requiring those experts to put beneficiaries' interests first, ahead of their own interests and thereby establishing a relationship of trust and confidence. In the context of investments, fiduciary duties exist to ensure that those, who manage other people's money, act in the interests of beneficiaries. In general, fiduciary duties require a higher standard of performance than those that are typically imposed in contracts, i.e. a fiduciary duty is an obligation to act in the *best interests* of another party. Essentially, this is a relationship of dependency and responsibility, where considerable discretionary power is vested in the fiduciary to act on the beneficiary's behalf and in the beneficiary's best interests, and where the beneficiary is precluded from exercising any control over the fiduciary (Frankel, 1998). Fiduciary duties are the legal principles that protect beneficiaries from abuse by the people that have been delegated to make investment decisions on their behalf (Johnson, 2014).

Fiduciary duties aim to protect the interests of beneficiaries which are traditionally interpreted as ensuring the highest return on investment. This is a protection first and foremost of the beneficiaries in relation to the fiduciaries (i.e. the person or organisation that manages assets for the beneficiary does not act in its own interests or neglects their duties), but also a protection of the fiduciaries against pressure by public or political opinion.

Overall, the most important fiduciary duties are the duty to act prudently and the duty of loyalty, namely to act in accordance with the purpose for which investment powers are granted (Sandberg, 2011):

- **Loyalty:** Fiduciaries should act in good faith in the interests of their beneficiaries and impartially balance the conflicting interests of different beneficiaries. They should avoid conflicts of interest and should not act for the benefit of themselves or a third party.
- **Prudence:** Fiduciaries should act with due care, skill and diligence; avoiding speculative and unduly risky investments; and, invest in a suitably diverse portfolio of investments.

The concept of fiduciary duty may also include other supporting duties such as acting in good faith (e.g. being honest); avoiding conflicts of interest; disclosing all material information fully and completely (e.g. being transparent and accountable); ensuring an informed judgement before acting; controlling investment costs; and, complying with applicable laws (Rostad, 2013) (Johnson, 2014).

A fiduciary who does not follow the above principles of conduct may be held responsible for this including restoring any economic losses that might be a result of the breach of their fiduciary duties.

Fiduciary duties and the investment value chain

Investments allow capital markets to channel funds from those that have money (i.e. providers of funds) to those that are in need of money (i.e. users of funds) (EFAMA, 2015). Capital markets link savers and investors with projects, companies, governments and others that are in need of financing through the investment value chain. While institutional asset owners such as pension funds, mutual funds and insurance companies have a direct fiduciary duty to their beneficiaries to act in their best interests, a large part of assets are managed externally by asset managers through discretionary mandates (see Figure 1). These are also subject to respecting their fiduciary duties.

The investment value chain also has a number of other intermediaries such as investment consultants that provide advice to asset owners and asset managers on long-term investment strategies and plans; stockbrokers that buy and sell stocks and securities for institutional investors; and, ESG rating agencies that provide analyses and ratings for investors. While fiduciary duty is often clearly defined for asset owners and asset managers, the role of the other financial intermediaries is less clear when it comes to fiduciary duties. According to Kay (2012), all investment value chain actors should observe fiduciary standards in their relationships with their clients, but it is currently a challenge to ensure that this is respected by each and every actor in the investment chain.

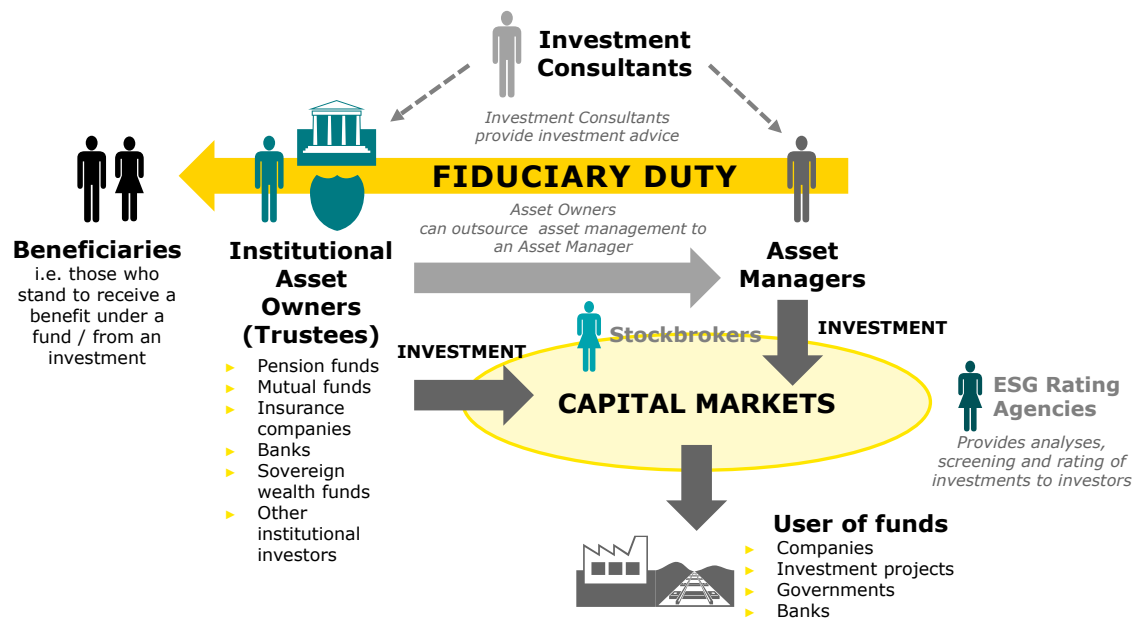


Figure 1: An overview of fiduciary duty and the investment value chain

The extent of fiduciary duty throughout the investment value chain can be first and foremost be seen as the relationship between beneficiaries and institutional investors (i.e. asset owners and asset managers). From a broader perspective, other investment value chain actors such as investment consultants, brokers and rating agencies also have a role to play to ensure that institutional investors live up to their fiduciary duties by providing information and tools to better understand risks and ultimately make sound investment decisions.

What are the “best interests” of beneficiaries?

The ‘best interests’ of the beneficiaries have traditionally been reduced to meaning financial interests (Sandberg, 2011), but financial performance does not cover all interests. For example, if beneficiaries clearly share a moral objection to a particular form of investment, it could be construed as being in their interest that the trust avoids such investments, possibly even at the cost of a lower financial return.

While financial performance is certainly part of fiduciary duty, it does not necessarily define beneficiaries’ best interests. Other interests can be claimed by beneficiaries and the ways and means used to achieve this objective should be considered. Prudence and loyalty suggest that the end does not always justify the means. In fact, loyalty and prudence can both be interpreted at from three perspectives: financial interest; extra-financial interest (i.e. social welfare); and, ethical interest. It is worth noting that the three perspectives are not necessarily aligned and that there is no hierarchy between them.

The concept of fiduciary duty can be argued to extend to include the extra-financial interests of beneficiaries and investors. This is the specific subject of this study: fiduciary duties in the context of integrating environmental and resource efficiency issues into institutional investment. While this is promising for responsible investments, this raises other questions such as how does one ensure that all beneficiaries receive equal treatment and no individual interest is favoured. It is arguably difficult to get a consensus on environmental or ethical issues without some sort of democratic system – and still only the majority of beneficiaries would be satisfied. This and other aspects of fiduciary duties will be investigated in Chapter 3.

First the following sections of this chapter will look into the general legal framework of fiduciary duty regarding institutional investment in different jurisdictions: EU legislation, EU Member States and in selected countries elsewhere.

2.2. UNEP FI and the Freshfields report

Whilst it is agreed that the core element of fiduciary duties is to act in the 'best interests' of beneficiaries, most of the discussion related to the fiduciary duties of institutional investors related to the interpretation of what these 'best interests' are. In response to 'best interests' being apparently interpreted as to solely pursue immediate profit maximisation, a group of asset managers organised under the United Nations Environment Programme Finance Initiative (UNEP FI) together with the law firm Freshfields Bruckhaus Deringer published a report in 2005 that investigated whether the integration of ESG issues in investment decisions was compatible with the fiduciary duties of finance institutions (UNEP FI, 2005). The so-called Freshfields report concluded that there were three types of circumstances where it is argued that taking ESG concerns into account is either permissible or, in fact, obligatory for institutional investors:

1. choosing investments on the basis of their ESG characteristics is argued to be ***permissible when deciding between investments with exactly similar financial characteristics***.
2. taking ESG concerns into account is argued to be ***obligatory when such concerns are financially relevant*** – that is, when a certain company's or industry's ESG performance reasonably can be expected to have an impact on its financial performance or valuation.
3. choosing investments on the basis of their ESG performance is argued to be ***obligatory*** when it is reasonable to think that this actually would be ***supported unanimously by the beneficiaries***.

The UNEP FI Freshfields report was a turning point for many in claiming that integrating ESG issues in investment decisions is clearly permissible in relation to the fiduciary duties of institutional investors – and in some cases even required.

Whilst the Freshfields report justified institutional investors to integrate ESG issues into their investment decision practices, e.g. by following the UN Principles for Responsible Investment (PRI) Initiative, the conclusions of the Freshfields report⁶ have been criticised to be overly optimistic on the extent that fiduciary duties will allow institutional investors to take ESG issues into consideration. Sandberg (2011) points out that whilst it is permissible for institutional investors to take ESG issues into account in practice when making a decision between two investments, it is rare that two investments have exactly similar financial characteristics – there are so many factors that play a role when making investment decisions with regards to return on investment, risk profile, time horizon of the investment, composition of the portfolio, etc. It would be difficult for an investor to ensure that all characteristics of an investment choice has been considered (even though it is their job to try to get as close to these investments' real or underlying characteristics as possible).

Sandberg further makes a point that while some types of ESG performance are financially relevant (e.g. material to the investment decision), this may not be the case for all ESG issues. Although there is growing evidence that integrating ESG issues

⁶ As well as the second follow-up report (UNEP FI, 2009)

into investment decision-making processes is also beneficial to economic performance (Clark, Feiner, & Viehs, 2014), this is a much debated topic (see section 0 for a deeper discussion on this).

Finally regarding Freshfields' third circumstance, Sandberg argues that in the case of multiple beneficiaries, it is difficult to find a consensus among all beneficiaries. While a fiduciary investor may be able to justify investment decisions based on recognised conventions or norms, e.g. banned weapons or human rights, not all beneficiaries of a certain pension fund would agree on the extent to forego maximum returns on all environmental issues. Opinions are dynamic and change with political and public debates. In practice it would be difficult to ensure that investors are always aligned with the wishes of their beneficiaries. Another practical issue is how to fulfil fiduciary duties in relation to any beneficiaries that do not think environmental issues should be taken into consideration in investment decisions, for example, in the case where a majority of beneficiaries of a pension fund agree to divest in fossil fuels.

Ten years after the original review, UNEP FI released a third, follow-up report (UNEP FI, 2015). The report does not tackle the criticisms pointed out by Sandberg but it does make it clear: fiduciary duty is not a barrier to ESG integration for institutional investors. The report goes so far as to claim: *"a failure to consider long-term investment value drivers, which include environmental, social and governance issues, is a failure of fiduciary duty."* The UNEP FI report does however recognise that in reality, fiduciary duty is often interpreted narrowly and conservatively to be solely focused on immediate financial returns by legal advisors and investment consultants.

2.3. Review of legal frameworks: fiduciary duty and integrating ESG issues into institutional investments

When considering the legal aspects of fiduciary duty, it is important to distinguish the decision-making process and the resulting decision (i.e. outcome of the decision-making process). The law is concerned with the decision-making process as an investment decision can only be judged with hindsight (UNEP FI, 2005). The legal framework also acknowledges that portfolios of investments are selected on their overall risk-reward characteristics rather than on the basis of the risks and returns of individual investments. When making investment decisions, asset managers must take into consideration not just the expected **return on investment**, but also the **associated risks, liquidity, capital value** and the **time horizon of the investment**. Investment decisions are made based on the analysis of performance of the overall investment and are regularly reconsidered as the market evolves, e.g. should certain investments be replaced, expanded or diversified in order to achieve the investment objectives?

According to a recent review performed by UNEP FI (2015), there has been relatively little change in the general legal framework of fiduciary duty since 2005 when legal frameworks around the world were reviewed in the first Freshfields report (UNEP FI, 2005). The legal texts related to the fiduciary duties of institutional investors typically contain procedural requirements that mainly serve to ensure that the highest possible risk-adjusted returns of investments are obtained. There are no legal requirements to the minimum investment returns or specific time horizons, nor any prescriptions on the choice of investment strategy that should be used (as long as the duty of loyalty and prudence are respected). In practice, as the legal frameworks for fiduciary duty does not specify these elements in detail, institutional investors often interpret the legal requirements differently. With the exception of bans on investing in some types of weapons such as cluster munitions

and anti-personnel mines, the review of national legal frameworks highlighted that, in most European countries, the inclusion of ESG issues remains driven by voluntary initiatives.⁷

Fiduciary duty in EU legislation

There is no official definition of fiduciary duty at EU level, neither a clear reference to this concept across legal texts. The Directive which best evokes the concept of fiduciary duty of institutional investors is undoubtedly the **Markets in Financial Instruments (MiFID) 2 Directive** (Directive 2014/65/EU). This Directive aims at establishing harmonized legislation for investment intermediaries and trading of financial instruments. In 2007, MiFID 1 (Directive 2004/39/EC) replaced the Investment Services Directive (ISD) adopted in 1993. As a response to the financial crisis, the European Commission revised MiFID 1 and adopted MiFID 2 in 2014, with the aim of making financial markets more efficient, resilient and transparent, and to strengthen the protection of investors.

Without mentioning fiduciary duty directly, Article 24 of MiFID 2 clearly requires investment firms to "*act honestly, fairly and professionally in accordance with the best interests of its clients*". Most other EU legislations targeting the financial industry refer to fiduciary duty in a similar way.⁸

MiFID 2 does not define the so-called 'best interests' and particularly the possibility to include ESG considerations. Similarly, the reference to extra-financial criteria within investment choices is not present either in the following three legal documents:

- the **Alternative Investment Fund Manager (AIFM) Directive** (Directive 2011/61/EU), introducing harmonised rules for managers of alternative investment funds;
- the **European Market Infrastructure Regulation (EMIR)** (Regulation (EU) No 648/2012) which regulates derivatives, central counterparties and trade repositories in Europe; and
- the "**undertakings for the collective investment in transferable securities**" (**UCITS**) **Directive** (Directive 2014/91/EU) which accounts for around 75% of all collective investments by small investors in Europe.

Some EU legal documents do however mention the consideration of ESG criteria. For instance, the Regulation on key information documents for packaged retail and insurance-based investment products (**PRIIPs**) (Regulation (EU) No 1286/2014), introduces a "Key Information Document" (KID) which is a simple document giving key facts to investors in a clear and understandable manner. Article 8 refers explicitly to ESG issues: "*The KID shall contain (...) specific environmental or social objectives targeted by the product*".

More recently, in April 2015, the final text of the regulation on long-term investment funds (European Long-Term Investment Funds, **ELTIFs**) was adopted by the European

⁷ Global ESG Regulatory Mapping: <http://www.unpri.org/areas-of-work/policy-and-research/responsible-investment-standards-codes-and-regulation/>

⁸ Article 21 of AIFM Directive: "*... the AIFM [Alternative Investment Fund Manager] and the depositary shall act honestly, fairly, professionally, independently and in the interest of the AIF [Alternative Investment Funds] and the investors of the AIF.*"

Article 25 of the UCITS Directive: "*In carrying out their respective functions, the investment company and the depositary shall act honestly, fairly, professionally, independently and solely in the interest of the investors of the UCITS.*"

Council. This framework is designed to fund long-term assets and thus acknowledges different considerations than immediate financial returns. This regulation can be considered as an early part of the **Capital Markets Union** (CMU) which aims to create deeper and more integrated capital markets in the 28 Member States of the EU. The Green Paper on Building a Capital Markets Union (European Commission, 2015) identifies green bonds as a sound emerging investment category for *"projects and activities that promote climate or other environmental sustainability related purpose."*

The European Commission launched the CMU Action Plan on the 30th September 2015. Among other actions, the Action Plan aims at *"ensuring an appropriate regulatory environment for long term and sustainable investment"*, which includes *"assessing the cumulative impact of previous regulatory reforms to ensure coherence and consistency"*. The Action Plan reiterates the opportunity of green bonds to direct capital towards sustainable investments.

The **Institutions for Occupational Retirement Provision (IORPs)** Directive (Directive 2003/41/EC), which rules the activities of institutions providing occupational pensions, was being revised at the time of writing of this report. The European Commission's proposal in March 2014 (European Commission, 2014) proposed that environmental considerations were integrated into the risk analysis framework: *"The risk evaluation shall cover (...) a qualitative assessment of new emerging risks relating to climate change, use of resources and the environment"* (Article 29). This may however not make it through to the final version of the adopted text.⁹

By definition, investors are shareholders. The **Shareholder Rights Directive** (2007/36/EC) is also currently being revised and highlights the significant role that institutional investors and asset managers can play (as shareholders) in the corporate governance of companies to improve the long-term financial and non-financial performance of those companies. The European Parliament's proposal contained a provision (Article 3ea) to require Member States to promote long-term shareholding by using one or more incentives such as additional voting rights, tax incentives, loyalty dividends or loyalty shares¹⁰ as well as ensure that institutional investors and asset managers develop a policy on shareholder engagement *"to monitor investee companies, including on their non-financial performance, and reduction of social and environmental risks"* (Frank Bold, 2015), but it is not sure that these provisions will be included in the final text of the Directive.

Finally, the **Directive on disclosure of non-financial and diversity information** by certain large undertakings and groups (Directive 2014/95/EU) requires large companies (more than 500 employees) to *"disclose in their management report, information on policies, risks and outcomes as regards environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors"*. The Directive does not target investors but acknowledges that investors need easy access to extra-financial information regarding the social and environmental impact of businesses in order to reward investments in resource efficiency. The Directive increases the transparency of business behaviour in relation to social and environmental issues and makes it easier for investors to take into these issues into consideration and integrate extra-financial criteria in their valuation models.

⁹ The draft report from ECON Committee's rapporteur, Brian Hayes MEP, published on 27 July 2015 considered to delete the reference to such emerging risks (Amendment 153).

¹⁰ For instance in France, the Florange Act (March 2014) provides for the automatic granting of double-voting rights to any shares held in a registered form by the same shareholder for at least two years, unless two thirds of shareholders vote to overturn it.

Fiduciary duty in EU Member States

With the exception of the common law jurisdictions such as the UK (see Box 2), Ireland and, to a certain extent Malta, the legal texts in civil law jurisdictions in the EU Member States rarely recognise or refer explicitly to 'fiduciary duties' in the context of institutional investors. Instead other similar obligations can be found in civil law texts. These include (UNEP FI, 2005):

- a duty to act in the interests of beneficiaries and typically expressed as to (mainly) either seek profitability or achieve the highest returns. No jurisdiction prescribes a particular level of profitability or financial return. In some jurisdictions the duty is qualified, such as in Germany where non-binding guidance indicates that the profit must be 'sustainable';
- a duty to act prudently expressed in different terms, with jurisdictions using terms such as 'diligently' (Spain), 'professionally' (Italy) or 'prudently' (France) and take into account the risks and liabilities of investments and ensure adequate diversification; as well as,
- other duties in relation to liquidity and in some jurisdictions limits on the types of assets that may be selected for certain types of funds.

Whilst priority must typically be given to the highest possible financial return on investment, no legal framework has been identified in any of the seven Member States analysed in this study that limits institutional investors from taking ESG issues into account in their investment decisions.

Box 2: The UK Law Commission's report on fiduciary duty of investment intermediaries

The UK Government asked the Law Commission to clarify to what extent institutional investors may take account of factors such as social and environmental impact and ethical standards, and evaluate whether fiduciary duties (as established in law or as applied in practice) are conducive to investment strategies in the best interests of the ultimate beneficiaries (UK Law Commission, 2014).

After consulting with stakeholders, the Law Commission concluded that trustees should take into account any factor which is financially material to the performance of an investment, including environmental, social or governance (ESG) factors. The Law Commission also found that trustees may take into account non-financial factors, such as beneficiaries' ethical and quality of life concerns, if the trustees have good reason to think that the beneficiaries would share the concern and the decision does not involve a risk of significant financial detriment to the fund.

Fiduciary duty is never mentioned explicitly in civil law but some legal texts clearly include ESG considerations in the duties of institutional investors. One of the most recent examples is the French Energy Transition Law that was passed in July 2015. Under Article 173, institutional investors shall include in their annual report, and make available to their beneficiaries, information on how their investment decision-making process takes ESG criteria into consideration, and the means implemented to contribute to the financing of the ecological and energy transition (2^o Investing Initiative, 2015).

Similar obligations exist for pension funds and insurers in Germany under the Insurance Supervision Act and the Corporate Pension Act and in Italy under CONSOB's regulations and decisions.

Box 3: The legal framework in Denmark for integrating ESG issues in the investment policy of institutional investors

The **Danish Financial Business Act**¹¹ states that the funds that an insurance company or a pension fund has at its disposition must be invested appropriately and serve the insured, so that there is adequate security for the company at any time to meet its obligations (§ 158). This evokes the fiduciary duty that insurance companies and pension funds should act in the interest of their beneficiaries. An important aspect of the legislation is that it exists to protect institutional investors from political or public pressure to make investments that would be detrimental for their beneficiaries (Forsikring & Pension, 2010).

The **Danish Financial Supervisory Authority** (Finanstilsynet) has previously interpreted that the law places an obligation on insurance companies and pension funds to invest with regards to the highest returns. In a note from the 7th July 2000, the Danish FSA did not find that the two following situations were in line with the law:

1. New investments, where the management consciously makes an investment that will not achieve the highest returns, or the management knows with great probability that the highest returns will not be achieved.
2. New investments, where the management knows that self-chosen costs in relation to selection and / or verification, e.g. compliance with environmental legislation corresponding to (at least) Danish requirements, will entail that the highest returns will not be achieved.

While the legal framework in Denmark seems to be restrictive in relation to social and environmental considerations in investments, the Danish FSA clarified that the responsibility of the investment strategy of pension funds and insurance companies, including ethical investments, rests with the management. The law *"does not prevent management to consult with shareholders / pension fund members prior to the investment strategy. The responsibility for the investment strategy - and the obligation and the right to make decisions - however rests alone with the board and management."* (Pensionsmarkedsrådet, 2007). The Danish insurance and pension industry organisation, Forsikring & Pension, published legal guidance that stated that the Danish FSA does not see a problem that investments are made with ESG considerations as long as the condition of highest returns is fulfilled (Forsikring & Pension, 2008). This is evident in practice; the majority of the largest Danish institutional investors have a responsible investment policy. Over 90% of assets under management in Denmark are subject to some form of responsible investment policy – one of the highest in the EU. Recently, the Danish Financial Supervisory Authority has said that they will not intervene if an institutional investor excludes certain companies or sectors (Politiken, 2014).

But despite these laws and regulations, controls from the regulators are quite weak. For example, the German financial market authority, BaFin, performs some checks on the mutual funds claiming ESG integration but the analysis is only based on how risks are being managed and the implications for the overall risk profile of the fund – not what ESG criteria are applied in investment decisions.

Besides certain statutory provisions of public pension funds and sovereign wealth funds, there are no general provisions that require institutional investors to integrate ESG issues into their investment decisions. Except for France, no upcoming legal changes regarding ESG in investments were identified in any of the Member States investigated. The applications of fiduciary duties were investigated in detail in selected Member States – see Annex 2 – Country fiches.

¹¹ Bekendtgørelse af lov om finansiel virksomhed (LBK nr 182 af 18/02/2015)

State of play of the inclusion of environmental factors into fiduciary duty outside of the EU

The United States is one of the countries where the integration of ESG issues in the investment decisions of institutional investors has been slow to develop. The United States has a (uncodified) common-law system, which is based on custom and usage, and determined by decisions of the courts. The legal framework that institutional investors must respect is based on the 'modern prudent investor rule', which directs trustees *"to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested"* (Harvard College v. Amory, 1830). The rule has been incorporated in the main federal laws, including the Employee Retirement Income Security Act (**ERISA**), the Uniform Prudent Investor Act (**UPIA**) and the Uniform Prudent Management of Institutional Funds Act (**UPMIFA**). The rule is not prescriptive and does not explicitly address sustainable investment practices. The Federal regulator issued interpretive guidelines in 2008 in order to clarify the standards imposed on ERISA fiduciaries (US Department of Labor, 2008). In the case of an investment policy that favours 'green' companies, *"the plan's fiduciaries may not simply consider investments only in green companies. They must consider all investments that meet the plan's prudent financial criteria."*

Canada and Australia (both common-law countries) have not made significant changes in their legal frameworks regarding fiduciary duty since 2005 apart from some guidance on how the consideration of ESG issues can be integrated into investment strategies and the disclosure of this (UNEP FI, 2015). Since 2011, the Australian Securities and Investments Commission requires financial product issuers to disclose how ESG criteria are incorporated. In Canada, changes have been at the provincial level and the state of Ontario now requires pension funds to disclose information about whether ESG factors are incorporated into their investment policies and procedures.

South Africa introduced a voluntary code known as the Code for Responsible Investing in South Africa (**CRISA**) and claiming, inter alia, the incorporation of ESG issues into investment process. The country went further by targeting pension funds by law (Pension Funds Act 24 of 1956 amended in 2011): *"[The fiduciary duty] supports the adoption of a responsible investment approach (...). Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social and governance character"* (Preamble).

In Brazil (a civil-law jurisdiction), the Corporations Law (Law Nr. 6,404/1976) has established additional fiduciary duties for investors that are controlling shareholders in a company by requiring them to exercise their shareholder power to promote the well-being of the other shareholders and of the community. The Brazilian Monetary Council enacted in 2009 **Resolution 3.792** according to which closed pension funds are required to state whether it will follow social and environmental principles or not.

Japan introduced structural reforms to boost the economy and released seven voluntary **Principles for Responsible Institutional Investors** (The Council of Experts Concerning the Japanese Version of the Stewardship Code, 2014) *"to promote sustainable growth of companies through investment and dialogue"*. On a 'comply or explain' basis, institutional investors are invited to disclose their stewardship responsibilities.

2.4. Fiduciary duties in practice: facts & figures in the European asset management industry

This section looks at the asset management industry in the European Union and its current practices in relation to fiduciary duty. It provides some key figures and describes briefly the current main challenges for the sector in the context of fiduciary duties.

Keys facts & figures

In Europe, total assets under management (AuM) reached EUR 16.5 trillion in 2013 (EFAMA, 2015). The European share of all AuM worldwide is slightly more than 30%. The biggest player in the world is unquestionably the United States with about EUR 23 trillion under management (46%).

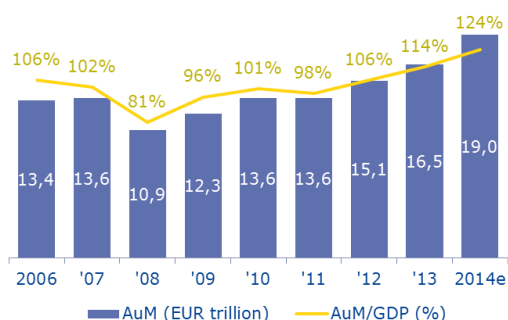
In the EU, total AuM have been steadily rising since 2008 and are expected to reach EUR 19 trillion in 2014. The market counted 3,300 asset management companies and employed 90,000 people directly at the end of 2013. The United Kingdom, France and Germany are the top players with respectively 37%, 20% and 10% of market share. A report (Hagendorff, 2014) estimates that European asset managers hold 23% of outstanding European debt securities or 32% of the value of European bank lending.

Most importantly, institutional clients represent the largest client category in the European asset management industry, accounting for 74% of total AuM in Europe. Most institutional investors use asset managers to manage their assets based on mandates.

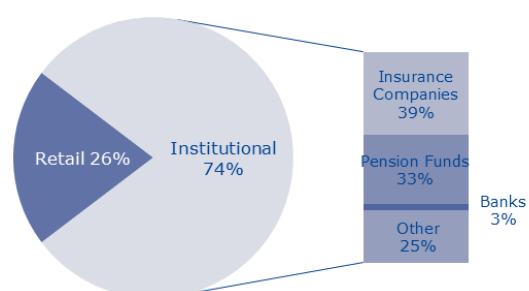
Most clients are institutional (EFAMA, 2015)



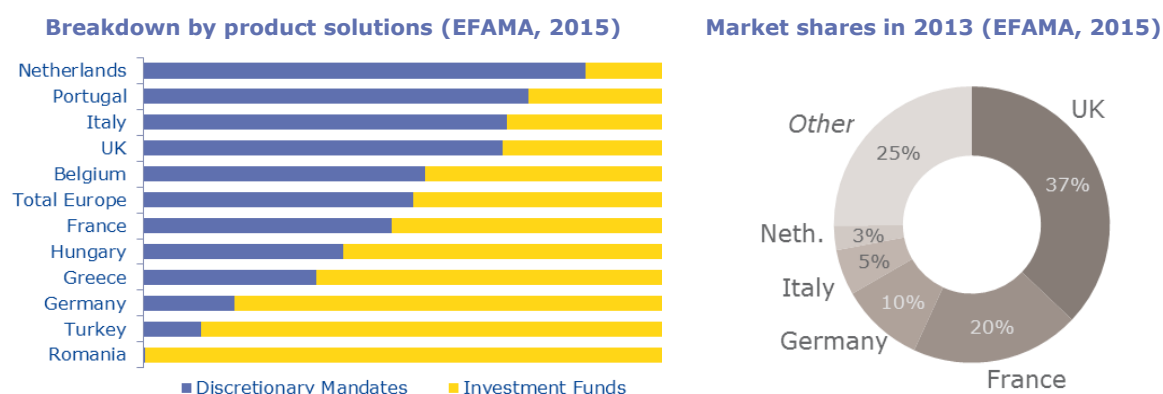
Trends of AuM in Europe (EFAMA, 2015)



Breakdown by client category (EFAMA, 2015)



The AuM can be managed in two ways: through discretionary mandates or through investment funds. Institutional asset owners such as pension funds and insurance companies entrust their money to asset managers through discretionary mandates with a clear set of rules and principles, on a segregated basis and separate from other clients' assets. The assets of retail investors are often managed through investment funds (pools of assets with specified risk levels and asset allocations, into which one can buy and redeem shares). Even if, globally, discretionary mandates account for half of total AuM, it is important to note that the split between discretionary mandates and investment funds varies a lot across European countries. The vast dominance of discretionary mandates in certain countries like the Netherlands reflects the important role played by occupational pension schemes.



Except for the UK, the region is characterized by concentrated fund markets with the top 5 players accounting for over two-third of assets in most countries. In several European countries, subsidiaries of banking or insurance companies dominate the asset management business. But more recently, independent asset managers' have started to make a mark. The following tables list the leading asset managers and pension funds in the EU.

Table 1: The top 10 in the EU asset management industry

Top 10 asset managers (Towers Watson, 2014)			Top 10 pension funds (Towers Watson, 2014)		
1	Allianz Group		ABP		
2	AXA Group		PFZW		
3	BNP Paribas		ATP		
4	Deutsche Bank		Alecta		
5	Amundi		Bayerische Versorgungskammer		
6	HSBC Holdings		Royal Dutch Shell		
7	Natixis Global Asset Mgt		Fondo de Reserva Seguridad		
8	Legal & General Group		PFA Pension		
9	Prudential		Metaal/tech. Bedrijven		
10	Generali Group		BT Group		

Major trends and their impacts on fiduciary duty

The asset management industry will face a certain number of changes in the future (EY, 2014a). The industry is going through a paradigm shift. Following the global financial crisis and in response to the demographic shift, capital preservation has become the new mantra. Double-digit investments returns will be exceedingly rare and the firms that fail to adjust will face severe challenges to continued profitability and growth. An intense competition between players will result in more focus on transparency, convergence and costs.

Another consequence of the financial crisis is the development of regulatory requirements regarding comprehensive risk management, supervisory and compliance policies and procedures. In Europe, Directives such as UCITS, AIFM, Basel III (the Capital Requirements Directive (Directive 2010/76/EU)) and the EMIR, but also MiFID 2, PRIIPs, MAD II (the Market Abuse Directive), AMLD (the Anti-Money Laundering Directive) and the proposal for a Financial Transaction Tax (FTT) all contribute to forming a complex and concentrated period of regulatory reform for institutional investors. Most importantly, the new regulatory environment will require even greater

reporting requirements for financial institutions. Most regulatory requirements focus on sources and retrieval of data held by the companies that financial institutions invest in, as well as data held by external service providers on behalf of those companies. In parallel, the level of disclosure and transparency has been extended to data that once was considered confidential or proprietary.

It is expected that these challenges will make asset managers concentrate on their core competencies: namely business development, portfolio management, client service and compliance. Outside of these key areas, most non-core functionalities will come under review for outsourcing, offshoring, shared service solutions or, at the very least, cost cutting and downsizing, in favour of the implementation of technology-supported process improvement. Products and distribution channels will also be highly impacted. Success in the post-crisis era will depend on offering new, more customized products (e.g. dedicated sustainable funds) to meet the needs of investors increasingly focused on capital preservation.

According to a poll of European chief operating officers (CEOs) and heads of investments (EY, 2014), Europe is still focused on regulation and cost containment. European-based financial firms spend more than 50% of their operations budgets on compliance-related functions, as they must deal with local country and EU regulations layered on top of global legal requirements. This regulatory burden may have been a barrier for some institutional investors to further integrate ESG issues in their investment decisions.



Figure 2: Which of the following is the primary driver(s) of changes in your operating model? (EY, 2014c)

All respondents of the poll noted that market growth is a key driver for change (improving margins, creating new differentiated products and developing new distribution channels) but European financial firms still face considerable regulatory challenges requiring continued prioritization of compliance spending and less focus on growth.

Given the ensuing regulatory response, it comes as no surprise that risk management is the primary objective of institutional investors' target operating models. Stronger risk management is both a response to recent regulation and an effort to avoid costly operational errors. As regulators have not included ESG risks in their requirements, this has not been among the primary objectives of institutional investors.



Figure 3: Which of the following best describes the overall objective of your target operating model? (EY, 2014c)

Investor confidence does not appear to be the main objective of asset managers. Nevertheless, ensuring that institutional investors live up to their fiduciary duty means tackling many challenges: reporting, data management, distribution channels, products, etc. The core spirit of fiduciary duties is still protecting clients' and beneficiaries' best interests. The following chapter explores how asset managers could or should reinterpret their fiduciary duty in the light of their business challenges by developing sustainable and responsible investments.

Current financial markets and risk environments are influencing the understanding of fiduciary duty today (Johnson, 2014):

- Worldwide growth of the assets managed by institutional investors and their corresponding influence on the economy.
- A series of economic crises in the past years.
- Demonstrated unreliability of assumptions underlying current investment practices that resulted in the 2008 financial crisis.
- Emergence of climate change as a threat to long-term economic stability and recognition that environmental degradation and resource depletion can affect economic productivity.

The last two points are further detailed in the next chapter.

3. Fiduciary duties and the integration of environmental factors in the investment decisions

Over the past decade there has been much discussion on the benefits and limitations of including environmental, social and governance (ESG) issues in investment decisions. The question of integrating ESG issues in relation to fiduciary duties has been a particular focus.

The previous chapter showed that ESG integration in the investment decisions of institutional investors is allowed as part of the EU and national legal framework related to fiduciary duties – and sometimes even encouraged. This chapter first discusses the pros and cons in considering ESG integration as aligned with fiduciary duty. It then looks at the current practice in interpreting sustainable and responsible investments as part of a fiduciary duty. The chapter will then review how the asset management industry has implemented responsible investment strategies so far in the EU.

3.1. Arguments for including environmental and resource efficiency factors as part of fiduciary duties

This section gives a summary of the main pros and cons regarding the inclusion of ESG criteria within portfolio management strategies: can consideration of environmental and resource efficiency factors be considered as part of the fiduciary duty of institutional investors?

The legal obligations related to fiduciary duty relate to the investment decision-making process. Yet, beneficiaries (and other stakeholders) are more concerned about the final investment decisions and their results. The arguments for including environmental and resource efficiency factors into fiduciary duties can be seen from two dimensions: the financial interest and the moral case, as illustrated in the following sections.

The first challenge, which has played a dominant role in the responsible investment literature, is to reconcile ESG integration with financial performance. This is the main challenge with the 'conventional' interpretation of fiduciary duty. The key point of debate is the relevance and proof of the financial materiality of ESG issues. Large financial institutions are 'universal owners': they typically have diversified investments across asset classes, sectors and geographies with long time horizons (UNEP-FI & PRI, 2011). They manage a large amount of assets that represent a significant share of the economy and therefore should adapt their actions to promote a prosperous, sustainable future. Reducing their investments' exposure to the risk of externalities is one of their core mandates (i.e. duty of prudence).

The second challenge is linked to the values of beneficiaries: some of them may wish that their values are reflected in their investment portfolios, be that based on religious views, international norms, institutional codes of conduct, legislative requirements, perception of controversial business activities, political pressure, etc. It would be part of institutional investors' fiduciary duty (i.e. the duty of loyalty) to include these considerations in investment decisions. Depending on how the 'best interests' of beneficiaries are defined, investment strategies that respect the specific wishes of beneficiaries may even allow for some diminution of financial returns in order to achieve certain ethical or social benefits (Richardson, 2007). For instance, a group of investors could forego a maximum financial return by requiring the asset manager to take into account other interests based on ethical values (exclusion of certain sectors for example).

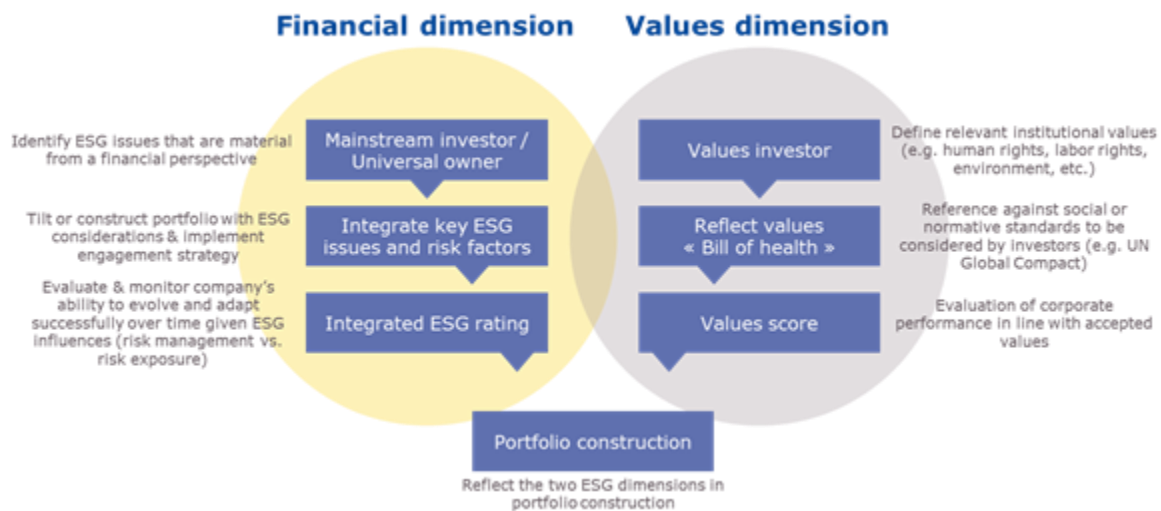


Figure 4: The two dimensions of ESG integration (MSCI ESG Research, 2011)

Certain ideas and beliefs (preconceived or not) prevent asset owners and asset managers from fully integrating ESG criteria in their overall management approach (KPMG, 2014). The following sections will discuss the main critiques and debates around the two dimensions presented in Figure 4.

Critique 1: “The integration of ESG factors in investment decisions is in contradiction with the Modern Portfolio Theory”

Modern Portfolio Theory (MPT) relates to the evaluation of investments not in isolation, but rather by their contribution to the performance objectives and risk profile of the entire portfolio. Briefly, MPT is a mathematical formulation of the concept of diversification of assets in a portfolio, in which higher risk demands higher returns. According to MPT, portfolio risk is reduced by investing in multiple non-correlated asset classes, thereby maximizing risk-adjusted returns.

MPT is widely used in financial institutions and considered the industry standard. Based on this theory, most opponents argue that the application of extra-financial considerations to the investment process result in lower investment returns because of the reduced number of investment opportunities. Taking into account extra-financial factors would therefore generate lower expected risk-adjusted returns.

While being the standard approach, the MPT approach is not without shortcomings and its underlying economic assumptions, including that markets are fully efficient and investors are entirely rational, are rarely met in reality. In fact, market failures are numerous and no market player has access to the full set of relevant information and investors do not always act rationally based on that information. MPT never applies in its pure form. The efficient market hypothesis is a truism: true by definition, not by observation (Investment Leaders Group, 2014).

At the same time, the current practices of investors (based on MPT theory) are not systematically inconsistent with sustainable investing strategies and the incorporation of ESG factors into investment decision-making. Portfolios are often focusing on certain zones: a monetary zone like the euro zone, a specific market such as emerging countries or a product like commodities, buildings, etc. Such portfolios are very common in the asset management industry, yet, they are de facto reducing the investment universe. ESG integration is not different, it is building portfolios based on another filter.

But some significant biases exist. For institutional investors and asset managers, 'risk-adjusted returns' often refer solely to the volatility risk of an index and not to ESG risks. This reference to indices and benchmarks is a problem itself (see Box 4) but, as stated in Chapter 2, an increasing number of asset managers are seeking to go beyond alpha (the traditional way to measure a portfolio manager's performance, i.e. the excess return of the fund relative to a benchmark market index). In this context, the integration of long-term environmental and resource efficiency factors have been identified as a promising leverage (EY, 2015).

Back to the link between ESG criteria and financial returns, a comprehensive review of the empirical literature questions the premise that SRI strategies automatically imply a reduced financial return. The following three meta-analyses appear to be insightful:

From the Stockholder to the Stakeholder. How sustainability can drive financial outperformance

Based on more than 190 academic studies, industry reports, newspaper articles, and books:

University of
Oxford &
Arabesque
Partners
2014

- 90% of the studies on the cost of capital show that sound sustainability standards lower the cost of capital of companies.
- 88% of the research shows that solid ESG practices result in better operational performance of firms.
- 80% of the studies show that stock price performance of companies is positively influenced by good sustainability practices.

Based on the economic impact, it is in the best interest of investors and corporate managers to incorporate sustainability considerations into their decision making processes. Active ownership allows investors to influence corporate behaviour and benefit from improvements in sustainable business practices.

Sustainable investing, establishing long term value and performance

Based on 160 studies, research papers literature reviews & meta studies

Deutsche
Bank Climate
Change
Advisors
2013

ESG factors reduce companies' cost of capital and improve corporate financial performance (market and accounting). However, most studies show mixed or neutral results regarding RI fund returns. Deutsche Bank therefore concludes:

"There are superior risk adjusted returns for investors, but managers need to take the right approach toward sustainable investing in order to capture these. For corporations, these are important results but the implication of lower cost of debt and equity capital must surely make this a key issue for any CFO not just CEO."

Does Socially Responsible Investing Hurt Investment Returns?

Royal Bank of
Canada Global
Asset
management
2012

Based on studies, RI indices, RI funds and hypothetical portfolios

"The chief finding of this research is that socially responsible investing does not result in lower investment returns. This is an important finding because it provides support to individual investors and trustees of institutional funds that they can pursue a program of socially responsible investing with the expectation that investment returns will be similar to traditional investment options."

In addition to these meta-analyses, recent studies tend to confirm a positive relation between the inclusion of extra-financial factors and financial returns. For example, studies from De & Clayman (2014) and Hoepner (2013) show clearly that asset managers are increasingly able to take into account ESG issues and provide better returns than traditional funds (Deutsche Bank, 2012).

Box 4: Indices & benchmarks in asset management

Mutual funds can be either indexed (i.e. passively managed) or actively managed by a professional, based on research, judgment and experience. In both cases, benchmarks are systematically used to assess the financial performance: in the first case, the portfolio is intentionally constructed to match or track the components of a market index; and in the second case, the benchmark market index is used to evaluate manager's performance (the so-called alpha). As a consequence, indices play a key role in the financial industry: they are widely seen as 'market proxies' when evaluating the performance of asset managers. Drawing on Modern Portfolio Theory, which suggests that holding the market portfolio represents an optimal investment strategy, the majority of equity investors use these indices to manage their diversification.

Since the whole industry is using the same indices, the duty to invest prudently may contribute to an excessive focus on benchmark-relative performance and investors are developing herd behaviour (Share Action, 2012). The problem is that most indices reflect the current economy and do not take into account long-term trends that ESG issues are capable of capturing: *"index-relative investment is hugging a real-time index made up of real-time prices reacting to short-term real-time events rather than to reasonable future scenarios"* (Investment Leaders Group, 2014). Worse still, it appears that benchmarks can introduce a bias in their representation of the world: a study by the 2° Investing Initiative (2° Investing Initiative, 2014) shows that, from a sector perspective, equity indices significantly over-weight energy intensive sectors relative to the real economy. While the indices do not integrate a long-term perspective, they may also lead to fostering a carbon-intensive economy.

Many alternative indices are emerging in order to tackle these challenges: FTSE4Good Index, Dow Jones Sustainability Indices, MSCI ESG Indexes, etc. In response to the growing concern in climate change, some index providers have been introducing fossil fuel free indices. For instance, MSCI launched the MSCI Global Fossil Fuels Free Exclusion Indexes, citing a "response to a clear demand from assets owners". FTSE, meanwhile, has been tracking a fossil-fuel free index version of its FTSE Developed Index since 2010. Such indices are increasingly playing an important role in influencing companies' corporate social responsibility (CSR) strategy, as they are willing to be included in such indices. The issue is that most asset managers and institutional investors are still focused on measuring their performance in relation to traditional indices.

Critique 2: "Environmental issues are not material for companies and investment portfolios"

The financial materiality of ESG issues is a subject of major debate in responsible investment. While governance issues are generally recognised in most investment decisions, the debate is typically related to the relevance of social and environmental issues (typically externalities to companies and investments, i.e. costs or benefits that are not reflected in market prices which affects a third party in society) in investment decisions.¹²

Yet, the argument or business case for including environmental and resource efficiency more explicitly in investment decisions can be compelling. Global population growth

¹² While this study is focused on the inclusion of environmental and resource efficiency issues in the investment decisions of institutional investors, social issues such as working conditions, health, equality and inclusion are often not systematically considered either

and rising incomes will increase the consumption of natural resources such as energy, water, food, land and materials beyond the planet's carrying capacity (UNEP, 2011a). This may lead to severe environmental degradation and resource depletion in many regions of the world. Some 1.1 billion people worldwide already lack access to water, and a total of 2.7 billion find water scarce for at least one month of the year (WWF, 2015). Our current patterns of production and consumption lead to negative externalities such as climate change, ground water pollution, soil erosion, flooding, deforestation and biodiversity loss (see Table 2). Environmental degradation and resource depletion is a real threat to future economic productivity.

Table 2: Annual environmental costs for the global economy in 2008 and projections for 2050 (IISD, 2014)

Environmental impact	External costs in 2008 (USD billions)	External costs relative to global GDP in 2008	Projected external costs in 2050 (USD billions)	Projected external costs relative to global GDP in 2050
GHG emissions	4,530	7.54%	20,809	12.93%
Water abstraction	1,226	2.04%	4,702	2.92%
Pollution SOx, NOx, PM, VOCs, mercury	546	0.91%	1,926	1.20%
General waste	197	0.33%	635	0.39%
Natural resources				
<i>Fish</i>	54	0.09%	287	0.18%
<i>Timber</i>	42	0.07%	256	0.18%
Other ecosystem services	Not available (N/A)	N/A	N/A	N/A
Pollutants and waste				
TOTAL	6,595	10.97%	28,615	17.78%

Source: PRI Association and UNEP Finance Initiative, 2010

Among the above-mentioned risks, one of the most critical is undoubtedly climate change. The potential impacts of climate change include macro-economic impacts (such as the expected reduction in productivity and economic growth in many countries around the world), direct physical impacts (flood and storm risks) and impacts of policy measures directed at reducing greenhouse gas (GHG) emissions from power generation, large industrial sources, transport and other economic sectors.

There is a consensus in the international community on the overarching objective of limiting the global temperature increase to 2°C in order to avoid crossing the threshold into "dangerous climate change"; achieving this would be incompatible with the projected amount of fossil fuels that can be burnt unabated (McGlade & Ekins, 2015). In the absence of negative emissions technologies, the global carbon budget for the second half of the century would only be 75 Gt CO₂ to have an 80% probability of hitting the 2°C target (Carbon Tracker & The Grantham Research Institute, LSE, 2013). This is equivalent to just over two years of GHG emissions at current levels.

In this context, The issue of stranded assets has attracted increasing attention for the last couple of years, particularly in relation to the idea that climate change policy could induce stranded assets if governments live up to their commitments to keep global warming below 2°C.

The investment consequences of this may include dramatic reductions in the value of particular assets, such as conventional coal-fired power stations that are no longer permitted to operate because of constraints on their GHG emissions.

From an investment decision-making perspective, environmental and resource efficiency issues can be financially material to either investment returns or risks. Investment returns may diminish with lower productivity due to natural resource constraints or environmental degradation, but may also be an opportunity for economic growth for companies specialising in environmental goods and services as well as resource efficient companies that will benefit from a competitive advantage of being able to produce more with less resources (Flachenecker & Rentschler, 2015). Investment risks can appear due to the physical risks related directly to environmental pollution and the supply of natural resources, but also indirectly through (future) environmental regulation that increases compliance costs or simply restricts certain investments (e.g. the use of certain substances in products). This too could in turn be seen as new investment opportunities for companies whose business model allows them to mitigate the (resource related) risks. For instance, investing in stocks that provide water treatment can hedge the risk related to water supply.

Asset managers rarely build their portfolio strategies on resource efficiency, with the exception of certain dedicated thematic funds (e.g. climate, environment or sustainability themed funds – see the next section 0), unless they are specialised asset managers. However, since resource scarcity involves long-term risks, investors may gradually take these into account in their investment decisions.

After all, the debate concerning the financial materiality of environmental and resource efficiency factors is about investment beliefs and whether a convincing business case can be built around resource efficiency (Urwin & Woods, 2009). Not all environmental issues can be said to be material to investments – particularly for environmental issues where regulation is not strong or is not enforced adequately (see Critique 4 below). Once the financial materiality is linked to an ESG factor, there is no debate about the necessity to take it into account as part of a fiduciary duty. So far the court cases on breaches of fiduciary duty have been related to investors NOT taking financially material issues into consideration¹³. There are no examples of court cases where taking material issues into consideration when making investment decisions have been contested. In general, it can be argued that if an institutional investor systematically considers ESG factors in their investments, it means that they are taking their risk analysis seriously (EY, 2014b).

The investment time horizon often determines whether a business case can be made for environmental issues. Often the environmental and resource-efficiency risks and opportunities are only thought to be relevant when considering long-term investments. What is often not considered, particularly in the case of pension funds and sovereign wealth funds, is that beneficiaries also include future generations. Institutional investors often do not know how to integrate the 'best interests' of these future generations in their investment strategies and decision-making processes. The United Nations Climate Chief Christina Figueres told at the at the 2014 Investor Summit on Climate Risk that *"fiduciary responsibility needs to grasp the intergenerational reality: namely that unchecked climate change has the potential to impact and eventually devastate the lives, livelihoods and savings of many, now and well into the future."*

¹³ The recent ruling (24th June) of the Hague District Court (a group of Dutch citizens (Urgenda) versus the Dutch Government) can serve as an example. The Hague District Court ruled that the Dutch Government must take more action than they do to reduce the greenhouse gas emissions in the Netherlands and it must do more to avert the imminent danger caused by climate change in view of its duty of care to protect and improve the living environment.

Critique 3: “ESG information is not reliable and can lead to risky interpretations” / “The costs outweigh the benefits”

ESG-related disclosure by companies (e.g. CSR reports and extra-financial reporting) may be limited and non-yet standardized. ESG analysts are still struggling to compare investments across sectors. Nevertheless, the amount of policy and regulation in relation to ESG-related information published by companies has markedly increased (UNEP, GRI, KPMG & the Centre for Corporate Governance in Africa, 2013) and a series of international standards, tools and experts are gradually ensuring a better reliability of ESG data.

First, the regulatory framework is significantly driving more extra-financial information to be reported by the companies and the requirements are becoming more and more stringent. In the EU, the Directive 2014/95/EU on disclosure of non-financial and diversity information will require large companies (public interest entities listed or not) to disclose ESG information in their annual report from 2017. Such regulations are already in place in some European countries such as in France (with the Grenelle 2 Act), in Germany, in Italy and in Denmark. Some other countries like the Netherlands did not proactively implement a mandatory scheme but will do so in the coming years in order to comply with Directive 2014/95/EU.

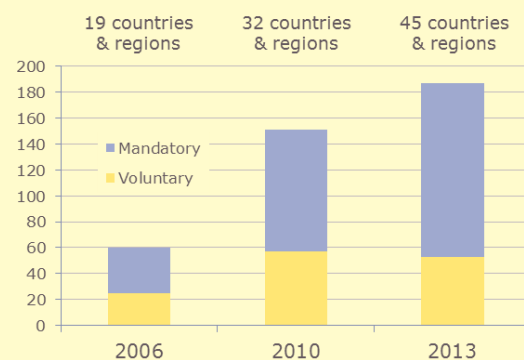
As underlined in the third edition of the UNEP & GRI report “Carrots and Sticks”, the amount of financial policy and regulation has markedly increased in the world (UNEP, GRI, KPMG & the Centre for Corporate Governance in Africa, 2013). This includes a notable increase in the number of mandatory reporting measures. In 2006, 58% of policies were mandatory; now, more than two thirds of the 180 policies in the 45 reviewed countries are mandatory. This increasing transparency facilitates the data access that is needed for ESG investment analysis, but the report notes also that while the volume of CSR reports has increased, report quality, the disclosure of information relevant to investors and comparability of reports still need to be improved.

Even stock exchanges are pushing for more transparency on ESG performance. The Sustainable Stock Exchanges (SSE) Initiative was set up with the UN to promote more sustainable capital markets.

Alongside the regulatory framework, many initiatives aim to standardize reporting processes and ESG data. The quality of the data available and disclosed by companies is yet far from sufficient and comparable, but remarkable progress has already been made. One of the main findings from the survey of institutional investors conducted by EY (2014) is that there is a real need to improve extra-financial information, to make sure that it is: relevant, consistent, comparable, balanced, linked to the organisation’s financial performance and reliable - and potentially verified by a third-party. The table

Box 5: More and more ESG data

A study from UNEP, Global Reporting Initiative, KPMG & the Centre for Corporate Governance in Africa (2013) provides an overview of global developments in policy and regulation for ESG data reporting. The 2013 edition notes an increasing emphasis on a combination of complementary voluntary and mandatory approaches to organizational disclosure:



The gradual integration of organizational performance data is on the rise, with attempts to combine corporate governance, financial and sustainability reporting.

below summaries some of the most remarkable initiatives (short descriptions come from the websites):

	<p>Global Reporting Initiative (GRI)</p> <p>GRI is an international independent organization that helps businesses, governments and other organizations understand and communicate the impact of business on critical sustainability issues. GRI provides the world's most widely used standards on sustainability reporting and disclosure.</p>
<p>Standards</p>	<p>Sustainability Accounting Standards Board (SASB)</p> <p>SASB's mission is to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors. SASB has developed sustainability accounting standards for more than 80 industries in 10 sectors.</p>
<p>Tools</p>	<p>Many tools have been and still are developed in order to allow financial companies to integrate ESG issues in their decision-making process. Most of them are addressing climate change and carbon emissions. For instance, Bloomberg introduced in response to the issue of "stranded assets" a first-cut tool called Carbon Valuation Tool that helps illustrate the potential impact of stranding on a company's earnings and share price. Trucost, Inrate, South Pole Carbon, Profundo or Carbon Tracker Initiative have also built their models. Often, companies are working with consulting firms in order to customize their own tool: CAMRADATA with Bank of America Merrill Lynch or Carbon 4 with Mirova for example.</p>
<p>In parallel, other initiatives are taking the lead to engage the financial industry to measure and disclose the carbon footprint and exposure of their investments:</p> <ul style="list-style-type: none"> ▪ Montreal Carbon Pledge: Supported by the PRI and UNEP FI, signatories of the Montreal Carbon Pledge commit to measure and publicly disclose the carbon footprint of their investment portfolios on an annual basis. It materialises the debates on how CO₂ emissions can be integrated in investment decisions. ▪ Portfolio Decarbonisation Project: In continuation to the Montreal Carbon Pledge, asset managers and asset owners can also commit to decrease the carbon exposure of their portfolios by joining the Portfolio Decarbonisation Project. <p>Last but not least, the financial community has at its disposal more and more dedicated service providers who can assist the asset managers to analyse and interpret extra-financial information:</p>	
<p>ESG rating agencies</p>	<p>Rating agencies provide ESG data, company ratings and analyses and specific tools to the asset managers (mostly ESG research departments).</p> <p>The leading ESG rating agencies in the EU-27 include Vigeo (France), MSCI ESG Research and GMI Ratings (US), EIRIS (UK), Oekom (Germany), Inrate (Switzerland) and Sustainalytics (Netherlands).</p>
<p>ESG Metrics</p>	<p>When rating agencies are providing both data and analysis, some companies are focusing on providing large sets of data. By leveraging market forces (including 822 institutional investors), the Carbon Disclosure Project (CDP) has incentivized thousands of companies across the world to measure and disclose their environmental information. CDP holds the largest collection globally of self-reported climate change, water and forest-risk data.</p>

Other ESG metrics include **Asset4** (Thompson Reuters) on carbon emissions or the **Aqueduct Water Risk Atlas** (Coca-Cola and World Resources Institute) on water.

RI Indices

Most RI indices are established by ESG rating agencies, based on their own ESG analysis and stock-picking methodology. These indices can be used as a basis to compare the performance of RI funds or even to build RI index funds.

There are more than 200 RI indices in the world, including the FTSE4Good Index or the Dow Jones Sustainability Index (see **Box 4** for more details).

Broker research

Brokers from investment banks set up dedicated research team in order to provide to their clients ESG insights.

Based on the Extel survey (2014), the best known pan-European brokerage firms on RI and sustainability include Kepler Cheuvreux, Societe Generale, Bank of America Meryll Lynch, Exane BNP Paribas or Natixis.

The flow of ESG information is completed by a broader network of sustainability professionals, including academics, non-profit organisations, journalists, consultants, etc.

The available information does not yet cover all ESG issues adequately and the efforts to enrich ESG analyses should continue, especially with regards to resource efficiency. For instance, the Climate Disclosure Standards Board (CDSB) published a framework for reporting environmental information and natural capital in order to "*help organizations prepare and present environmental information in mainstream reports for the benefit of investors*".¹⁴

Another step is now to sort (by relevance), prioritize (based on materiality) and interpret (through analysis) such rich information so that investors can handle the right quantity and the right quality of data. There is a debate on whether ESG information should be standardized or not (one of the points of discussion during the Stakeholder Meeting - see Annex 3 – Stakeholder meeting). Given the amount of information already available, a key need for the future is to develop skills and competencies in dealing with ESG information along the entire investment value chain.

Section 3.3 provides an analysis of the types of environmental and resource efficiency related information and indicators that are currently used among investors.

Critique 4: "The moral dimension is not of concern for investors" / "It is impossible to get all beneficiaries to agree on ESG issues"

The previous sections showed that ESG integration can be financially material and can reveal complementary threats to institutional investors, which allows asset managers and the investment analysts to integrate new risks in their valuation models. This is not just about maintaining an image of responsibility; ESG issues can deeply affect the business model of various sectors. For instance, climate change, water scarcity and land degradation are real risks for the agricultural sector; climate policies threaten the oil industry; the mining industry needs to deal with diminishing reserves of raw materials; and, retailers must readjust their relations with the supply chain, etc. There will however be ESG issues where no business case can be made for financial materiality. This is partly because the current pricing approach (based on benchmarks,

¹⁴ <http://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital>

volatility and risk adjusted returns) does not capture the long-term risks. In these instances, the integration of some ESG may 'only' be down to moral judgement.

The first 'responsible' funds emerged on the basis of morality. Islamic banking appeared as early as the 1500s. Here investments must comply with Islamic law (or Shariah). Even today, many responsible investment funds are based on the exclusion of 'immoral' industries or 'sin stocks' such as tobacco, weapons, gambling, pornography, alcohol, etc.¹⁵ Beyond the immediate and direct financial return, ESG criteria may also indirectly protect the interests of beneficiaries. One could argue that a pension fund for medical doctors might not be in favour of investing in tobacco. But a situation that threaten the environment could also arise: it would be understandable that a pension fund of coal miners would want to continue investing in coal and perhaps even withdraw investments in industries competing with coal. Here the integration of ESG issues plays a dual role in helping fiduciaries make investment decisions, on one side, revealing whether there are any issues related to investments that would be against the interests of beneficiaries; and, on the other, informing of the potential opportunities and threats of investments.

It must be mentioned that sometimes moral considerations can be financially relevant and can also negatively affect the quality of life: investing in carbon intensive industries could contribute to climate change and indirectly cause natural disasters with huge impacts on either the pensioners themselves or their local communities. Often the consideration of future generations, as discussed earlier, is thought to be a question of morality.

The moral considerations highlighted above may not be directly financially material but they have indirect impacts either from a financial or a broader well-being perspective that many beneficiaries would be able to acknowledge. In the case where some beneficiaries may have explicit demands to an investment strategy based on moral grounds, the argument pointed out by Sandberg (2011) remains valid: while members of a pension may agree to divest in fossil fuels, it would be difficult to reach a consensus among all beneficiaries on all ESG issues, e.g. job creation or water management (The Guardian, 2015). There have

Box 6: Fossil fuel divestment, a growing movement

Beginning over thirty years ago, the divestment movement campaigned against apartheid in South Africa. Investors can be put under pressure from public divestment campaigns. For example, the Fossil Free campaign (<http://gofossilfree.org/>) is asking financial institutions to divest from all coal, oil and gas companies. The project was launched primarily on moral grounds: *"Divestment isn't primarily an economic strategy, but a moral and political one"* (Fossil Free, 2015).

Altogether, some 200 investors have made a commitment to apply the Fossil Free initiative's recommendations within five years, and forty-or-so have already set up an exclusion policy (Novethic, 2015). In May 2015, French bank Credit Agricole said it would no longer finance coal mining as lenders grow increasingly uneasy about funding coal due to environmental concerns (Reuters, 2015). In Denmark, the largest pension fund, PFA, has excluded tar sands companies in their investments and in March 2015, PKA, the fourth largest pension fund, decided to exclude over 30 coal mining companies from their investment universe (Guardian, 2015). Also recently Norway's sovereign wealth fund agreed to sell US\$900 billion (EUR 794 billion) worth of shares in firms that mine coal and tar sands.

¹⁵ Even though according to some studies, sin stocks are delivering a significant and positive abnormal stock market performance (Hong & Kacperczyk, 2009) this is challenged by new evidence. Hoepner & Zeume (2014) demonstrate that investing in sin stocks is neither in the best interest of the beneficiary from a broader well-being perspective (tobacco for instance is a well-known risk factor for many diseases), nor from a financial perspective.

been different movements to divest over the past few decades, which have been taken up by institutional investors, but this has mainly been related to social issues, e.g. apartheid in South Africa, human rights and child labour. Recently there is a growing movement for divesting in fossil fuels (see Box 6). If agreed a trustee, e.g. a pension fund, can establish a clear mandate for investment and all the intermediaries must take this into account.

But whatever the demands of beneficiaries and asset owners, one can consider that intermediaries themselves have a moral duty to invest responsibly. Markets are not moral, neither immoral, they are amoral. However, the people working in capital markets have their own moral/ethical values. Morality and markets are by their nature bound together (Investment Leaders Group, 2014). By evaluating the market value of a company, a financial analyst will review many interpretable pieces of information and will come out with a different valuation than another analyst. Analysts arrive at different judgments, which involve often ethical values. The same applies to the integration of ESG issues: "By virtue of the protections and authorisations it is granted by the public in its license to operate, by its influential role in the financial system, and by the fact that how money is invested in the economy determines, among other things, whether the economy serves its public and works in a way to preserve the natural capital we depend on, large asset owners and asset managers have a responsibility to avoid systemic risk in the financial system and economy" (Investment Leaders Group, 2014).

3.2. State of play of the inclusion of environmental factors in the investment decisions of institutional investors

A quick outlook of responsible investments in the EU

Many, if not most, asset managers have defined policies for responsible investments in the EU. Over 1,380 asset owners, investment managers and service providers have signed the United Nations-supported Principles for Responsible Investment (PRI) Initiative. Signatories are committed to put the Six Principles into practice, including incorporating ESG issues into investment analysis and decision-making processes (see Figure 1). In the European Union, 431 asset managers and 158 pension funds have signed the PRI. The PRI Initiative is largely driven by the biggest financial institutions and has become a standard (most of the top asset management companies in the EU listed in Table 1 are signatories).



Figure 5: The UN PRI Six Principles for responsible investment

Asset managers offer various strategies and methodologies to responsible investment to their institutional clients. As part of its consultancy services, Mercer (2015) tracks the progress of ESG integration of more than 6,000 investment management strategies worldwide. As a result, definitions and figures vary significantly according to the sources used. The investment strategies are different and vary in the extent of ESG integration. Eurosif, a pan-European sustainable and responsible investment membership organisation, distinguishes between four types and seven distinct strategies for sustainable and responsible investment (SRI) – see Figure 6.



Figure 6: Four types and seven strategies to sustainable and responsible investment (Eurosif, 2014)

Most institutional investors have SRI policies and, by signing the Principles for Responsible Investment (PRI), have to disclose their investment decision-making process. Nevertheless, the final impact on investment decisions is rarely disclosed and the actual investment decisions still do not seem to result in wide spread long-term sustainable investments.

According to the Global Sustainable Investment Alliance (GSIA, 2015), 58.8% of total managed assets in Europe in 2014 were subject to some form of SRI strategy, where ESG, in combination with financial considerations, guide the selection and management of investments.¹⁶ Eurosif (2014) estimates that the integration of ESG factors in investment strategies covered assets in the EU-27 with a value of EUR 16.8 trillion in 2013.¹⁷ This was a significant increase between 2011 and 2013 (+22%).

¹⁶ This does not necessarily mean that the investments were sustainable, just that ESG issues were considered during the investment decision-making process.

¹⁷ The Eurosif study only provides detailed information of SRI strategies in 12 EU Member States (and Switzerland). It does not have detailed information for all EU Member States. There may be double counting in this estimate as multiple SRI strategies can be applied – this is why the GSIA estimate of 58.8% is lower

Most of these assets were from institutional investors: 97%. Retail investors represent only 3% of the total assets.

Of the Member States that were investigated in this study, Denmark is among the countries in Europe with the highest uptake of SRI among institutional investors (over 90% of assets under management in Denmark are subject to some form of responsible investment policy). SRI is common and developing well in France, Germany, Italy and the Netherlands. SRI is slowly being developed in Poland, while it is almost non-existent in Latvia.

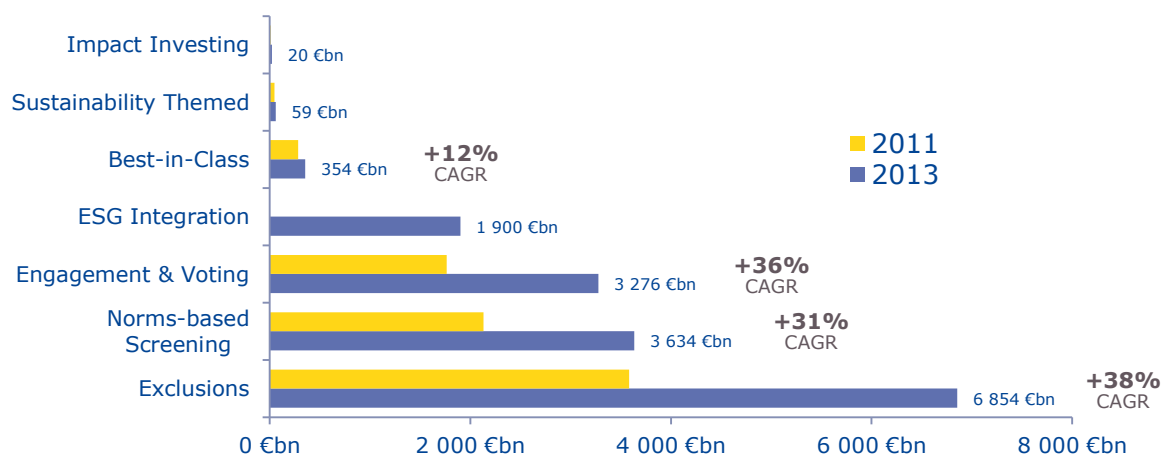


Figure 7: Responsible investments across 13 European countries and growth from 2011 to 2013, amounts shown in million EUR (Eurosif, 2014)

The adoption of SRI strategies are growing but not all at the same pace. The market is currently dominated by an exclusion approach: beyond those required by law (mainly Cluster Munition and Anti-Personnel Landmines), they represented about 41% of total European SRI professionally-managed assets in 2013. In contrast, a sustainability-themed approach to investments, covering a wide range of issues from climate change and energy efficiency to forests and water, has traditionally been one of the more minor SRI strategies used across Europe.

Even across EU Member States, the breakdown between RI strategies varies: Denmark or Netherlands rely mostly on exclusion when France focuses on best-in-class strategies.

Focus on environmental and resource efficiency issues

Environment issues are rarely considered alone in SRI but together with social and governance issues. Analysts and portfolio managers weight these issues differently according to the sector or the region, but typically governance issues are the most common to integrate in investment decisions. Governance factors are already considered in most conventional investment decisions. The Sustainability Themed investment strategy, which is one of the least used (representing EUR 59.0 billion), can however have a specific focus on the environmental and resource efficiency issues.

KPMG (2015) recently identified 337 environmental themed mutual funds with a total value of assets of EUR 31.8 billion domiciled in Europe, Cayman Islands and Bermuda

than what might be expected from the total value of assets under management reported by EFAMA (EFAMA, 2015).

in 2014. The environmental themed funds are focused mainly on carbon emissions, renewable energy and climate change, but also on water and forestry issues (see opposite). About 40% of the environment themed funds were not been specified. Most of the environmental themed funds are Luxembourg-domiciled (45%).

Some asset managers are significantly exposed on certain types of funds. For instance, Pictet owns 46% of AuM in water funds and BlackRock 24% of AuM in climate change funds. It is important to note that the data availability was very limited for climate change and forestry funds.

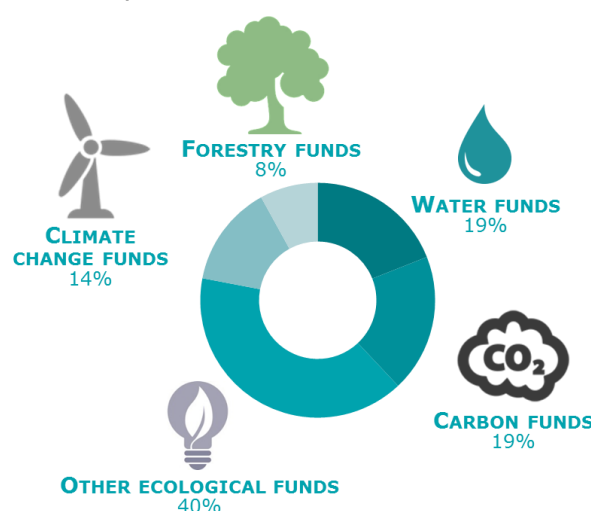


Figure 8: Share of environmental themed funds in % of AuM in Europe (KPMG, 2015)

There are emerging investment products and initiatives that focus specifically on resource efficiency. For example, Osmosis, an Irish investment manager, has developed an investment tool based on resource intensity.¹⁸ Based on publicly disclosed data, Osmosis selects the most resource efficient from each sector of the economy. The Natural Capital Coalition is working with the World Business Council for Sustainable Development (WBCSD) and a broad field of experts to define a protocol for a standardised framework for businesses to measure and value their direct and indirect impacts and dependencies on natural capital.¹⁹ The Natural Capital Protocol is thought to help financial institutions and investors with clear guidance on the qualitative, quantitative and monetary valuation of natural capital impacts and dependencies.

The inclusion of environmental factors in investment decisions in practice

In practice, most of the main institutional investors in the EU integrate ESG factors in their investment strategies and decisions as part of their fiduciary duty. This conclusion has been acknowledged by the professionals interviewed during this study. Most institutional investors recognise that responsible investment is often financially advantageous and can be implemented by various methods that comply with duties of prudence and loyalty (PwC, 2015). The issue is rather to what extent are environmental and resource efficiency (and other ESG factors) actually taken into consideration in the institutional investors' investment decisions.

¹⁸ <http://www.osmosisim.com/investment-strategies/the-model-of-resource-efficiency/>

¹⁹ <http://www.naturalcapitalcoalition.org/natural-capital-protocol/developing-the-protocol.html>

One interviewee in the study pointed out on the issue of respecting the best interest of all beneficiaries, it may not be possible to reach an agreement on individual investment decisions, but it helps to be transparent in the analysis of ESG factors and the investment decision-making process. Some pension funds consult their beneficiaries on their best interests (Unipension, 2012), but maintain that it is up to the pension fund to define the investment policy (see Box 7). Divesting and excluding some types of investment are permitted if there is general support from the beneficiaries and this does not affect the ability to achieve the highest possible returns.

Box 7: The integration of ESG factors in investment decisions of institutional investors in Denmark

Most of the asset managers in Denmark take ESG factors into consideration because they believe this to be financially relevant. There are however different approaches to responsible investment policy. Some policies are just based on avoiding investments in companies that breach recognized conventions, standards and norms in, for example, human rights. Others perform their own thorough analyses to determine whether certain sustainable and responsible investments are compatible with their obligation to ensure long-term financial returns and risks. Based on their analyses, which takes into consideration both financial and ESG factors, some institutional investors may decide whether to exclude certain types of investment or engage in active ownership.

For example, PKA, the fourth largest pension fund, decided to exclude over 30 coal mining companies from their investment universe (PKA, 2015). The companies that were blacklisted generate more than 90% of their business from coal. For companies where 50-90% of their business comes from coal, PKA will engage with their management to encourage them to reduce their involvement in coal. The decision was based on both climate concerns and financial risk, but in the end depends on whether other investments can be made without compromising financial returns and risk.

In another case, members of six other pension funds representing €32 billion voted recently on divesting from coal, tar sands, Arctic and deepwater oil and gas exploitation (Guardian, 2015). Although members of three of the funds voted in favour, it is still up to the board of the pension funds to decide and take responsibility for their own investment policy (Politiken, 2015). The boards of pension funds said that they will continue to consider ESG issues in their investment decisions, but not change their investment policy. Divestments will only be done if the long-term financial returns and risks are not compromised.

A recent global survey (EY, 2014b) shows that ESG integration differs a lot across institutional investors. About two-thirds of investors either conduct little or no review of the extra-financial information or rely on their own personal ideas about the data.

Question: Which of the following statements best describes how you and your investment team evaluate ESG disclosures that relate to the environmental and social aspects of a company's performance?

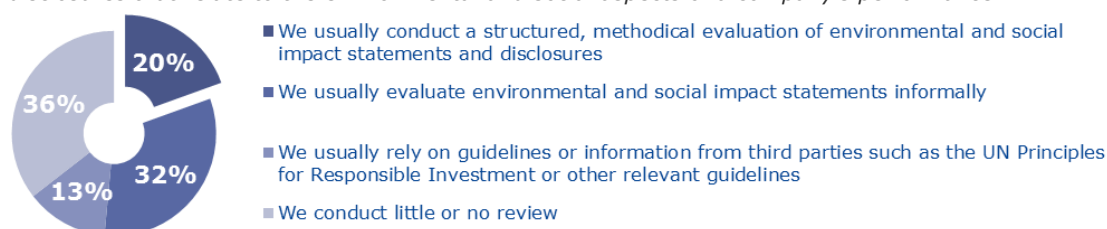


Figure 9: Inclusion of extra-financial criteria (EY, 2014b)

It appears that a majority of investors (9 out of 10) has found that ESG performance information played a pivotal role at least once in their decision-making in the last 12

months. This demonstrates that the analysis of ESG issues can no longer be dismissed as a niche approach to investment but the consideration of such criteria is not equal along the investment decision-making process:

Question: How frequently do you take ESG information into account in the following stages of your investment decision-making?

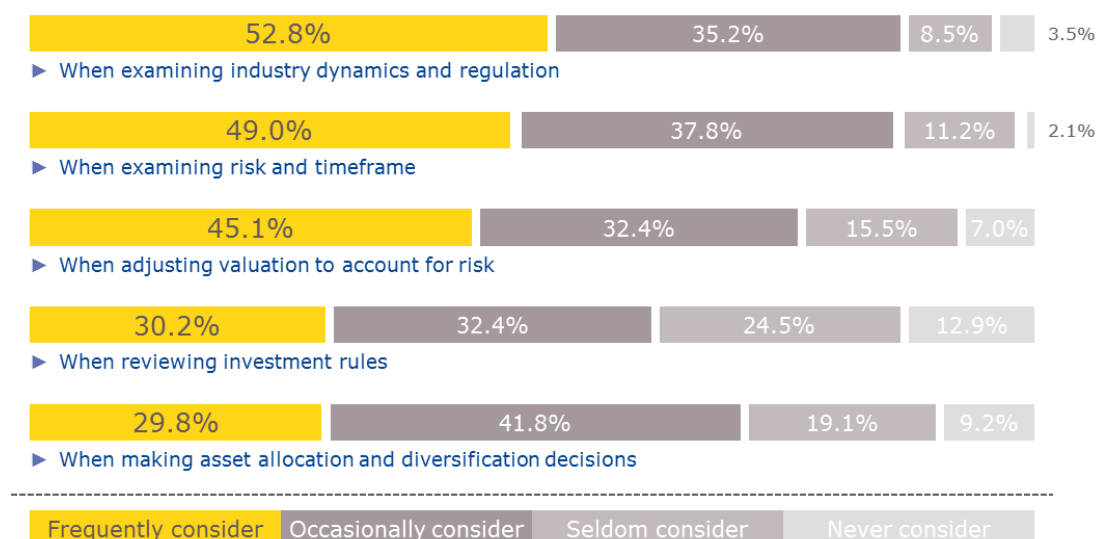


Figure 10: Inclusion of extra-financial criteria (EY, 2014b)

The integration of ESG factors into the investment decisions of institutional investors seems to be already widespread in practice. While most investors recognise that ESG information can be relevant for both financial returns and risks, fiduciary duty provides institutional investors the mandate to decide for themselves to what extent environmental and resource efficiency issues should influence their investment strategy and specific investment decisions. The following section provides insight to what kind of ESG information is used by asset managers and investment consultants.

3.3. Environmental and resource efficiency related information and indicators used in investments

In order to be able to properly integrate environmental and resource efficiency considerations into investment decisions in the context of fiduciary duties, it is important to have access to reliable information about the environmental impacts and natural resource related risks of the investment in question. Depending on the investment strategies, different types of information and data are required to assess the materiality of an environmental or resource issue for a specific sector; the level of risk of the investment; and, its link with financial gains. This section reviews the most common types of ESG indicators that are reported on by companies and used by institutional investors, how they can be used and also considers the wide range of measurement and assessment methods, by reviewing approaches for calculating an asset's climate impact, one of the most commonly used environmental indicators.

ESG Indicators

A survey of investors and analysts with sustainable development expertise assessed and ranked key sustainable development KPIs used by asset managers and investment consultants, based on the analysts' views of their importance, frequency of reporting, economic importance, availability of quantitative data, trends and benchmarking (Hesse, 2015). The study resulted in a cross-sector listing of major

sustainable development KPIs, grouped by theme. The figure below shows the percentage of indicators associated with each major theme. As can be seen, protection of the environment represents nearly half of the key indicators, with a relatively equal split across the other four themes – sustainability, development, employees and other scopes. The detail of the KPIs included in each category and their relative importance can be found in the table below.

Figure 11 : Key categories of sustainable development KPIs (Hesse, 2015)

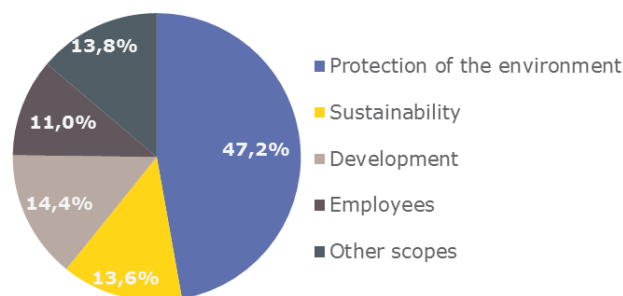


Table 3: Detail of cross-sector listing of major development KPIs (Hesse, 2015)

Theme	Sustainable development KPIs
Protection of the environment	<ul style="list-style-type: none"> - 22.4%: Energy and greenhouse gas efficiency of production / products / services / distribution - 11.6%: Proportion of products with "Design for Environment" / Eco- or Fairtrade-Label - 4.8%: Audit coverage of the environmental management system / environmental impact assessment and its performance - 4.4%: Emissions / usage of hazardous / toxic non-carbon-pollutants - 2.0%: Water efficiency / quality - 1.2%: Protection of biodiversity / usage of genetic modified organisms - 0.8%: Usage of sustainable raw materials
Sustainability	<ul style="list-style-type: none"> - 8.0%: Proportion of products / services, which systematically integrate sustainability issues - 5.6%: Codices for marketing ethics (especially integration of sustainability topics)
Development	<ul style="list-style-type: none"> - 9.6%: Audit coverage of ILO labour standards in-house and in the supply-chain - 4.8%: Access to products / services in developing countries
Employees	<ul style="list-style-type: none"> - 5.0%: Health and safety performance / accidents and fatality rate – also partly in use phase of the products - 3.2%: Employee turnover - 1.2%: Employee satisfaction - 1.2%: Training - 0.4%: Diversity management performance
Other scopes	<ul style="list-style-type: none"> - 4.0%: Customer satisfaction - 3.2%: Quality and safety performance - 2.8%: Research and development performance - 1.6%: Sustainable remuneration systems - 1.2%: Bribery, corruption, money-laundering, tax-evasion - 0.5%: Disclosure of lobbying activities and litigation provisions - 0.5%: Exposure to controversial weapons

The study also considered sector-specific indicators, which can vary largely. For example, according to the study, for the Textiles, Apparel & Luxury Goods sector, the International Labour Organization's (ILO) labour standards are of primary importance, whereas for the Media sector, ethics are the prime concern and for the Energy sector greenhouse gas (GHG) emissions of crucial importance. This is probably linked to the sector-specific materiality issues and major risks, e.g. in the Energy sector GHG

emissions are directly linked to the use of fossil fuels and energy efficiency, besides being subject to carbon taxes or emission trading schemes.

Reporting frameworks such as the Global Reporting Initiative or KPIs for ESG provide an indication of key indicators by theme or sector. ESG rating agencies and other organisations, such as RobecoSAM, Oekom research, MSCI and Sustainalytics, among others, also define key ESG KPIs and then review corporate information and formulate rankings or ratings, often by sector.

While a range of ESG indicators exist and are reported on, some are more relevant for certain types of responsible investments strategies than others. Table 4 provides examples of relevant indicators for each type of major investment strategy.

Table 4: Alignment of relevant ESG indicators with different responsible investment strategies (based on (Eurosif, 2014) and (Hesse, 2015))

Responsible Investment Strategy	Description	Relevant indicators
Sustainability themed investment	Investment in themes or assets linked to the development of sustainability. Thematic funds focus on specific or multiple issues related to ESG.	<ul style="list-style-type: none"> - Existence of policies, targets and initiatives in place to develop sustainability - Proportion of products / services, which systematically integrate sustainability issues
Best-in-Class investment selection	Approach where leading or best-performing investments within a universe, category or class are selected or weighted based on ESG criteria.	<ul style="list-style-type: none"> - Sector-specific indicators (energy for heavy industry, labour standards for textile industry, etc.)
Norms-based screening	Screening of investments according to their compliance with international standards and norms.	<ul style="list-style-type: none"> - Implementation of environmental management system / environmental impact assessment and its performance - Audit coverage of ILO labour standards in-house and in the supply-chain
Exclusion of holdings from investment universe	An approach that excludes specific investments or classes of investment from the investible universe such as companies, sectors or countries.	<ul style="list-style-type: none"> - Presence in sectors related to defence, arms, tobacco, alcohol, etc.
Integration of ESG factors in financial analysis	The explicit inclusion by asset managers of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources.	<ul style="list-style-type: none"> - Governance organisation and policies - Environmental performance (CO₂, energy consumption) - Social performance (labour standards, employee training and engagement)
Engagement and voting on sustainability matters	Engagement activities and active ownership through voting of shares and engagement with companies on ESG matters. This is a long-term process, seeking to influence behaviour or increase disclosure.	<ul style="list-style-type: none"> - Number and types of exchanges with stakeholders - Activities and initiatives in place to address sustainability concerns
Impact investment	Investments made into companies, organisations and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market-to-market rate, depending upon the circumstances.	<ul style="list-style-type: none"> - Broader social and environmental impacts of the company (job creation, energy access, food security, etc.)

Types of ESG information

We can classify available ESG information as coming from three major sources, see the table below.

Table 5: Classification of types of ESG information

Reporting source	Document source	Type of information
Corporate reporting and communications	Annual report, registration document, company website, brochures	Strategy and policies, performance indicators, targets and next steps
Rating agencies and indices	Published listing of index or ranking by theme or sector	Rankings or ratings
Other sources	Press releases, third-party websites, blogs	Company news, stakeholder perspectives, current or past company issues

These different sources of information are not always usable in the same way – quantitative and qualitative information from corporate reporting and communications can be used directly to assess ESG risks and opportunities. However, rankings or ratings are difficult to use for making a detailed analysis since the assessment leading to their elaboration is not always public. Other sources can serve to indicate potential risk areas and provide stakeholder views, thereby putting in perspective corporate reporting and communications.

The key objective of reviewing corporate ESG information is to identify potential risks and opportunities, above and beyond potential issues which could be identified by studying a company's financial performance. These risks and opportunities could be both short and long-term and also impact the company's financial performance. However, the relevant information to be reviewed can vary largely based on what is material (or most relevant/important) for a company – this varies by sector of activity, location of activities, nature of the workforce involved, etc. A survey among institutional investors around the world (EY, 2014b), showed that industry or sector-specific information and KPIs together with information on expected future performance and links to ESG risks are the types of extra-financial information that are most useful for their investment decisions (see Figure 12). Companies own disclosure on what ESG factors are most material to their business and integrated reports that connect ESG issues to financial performance was also considered useful information.

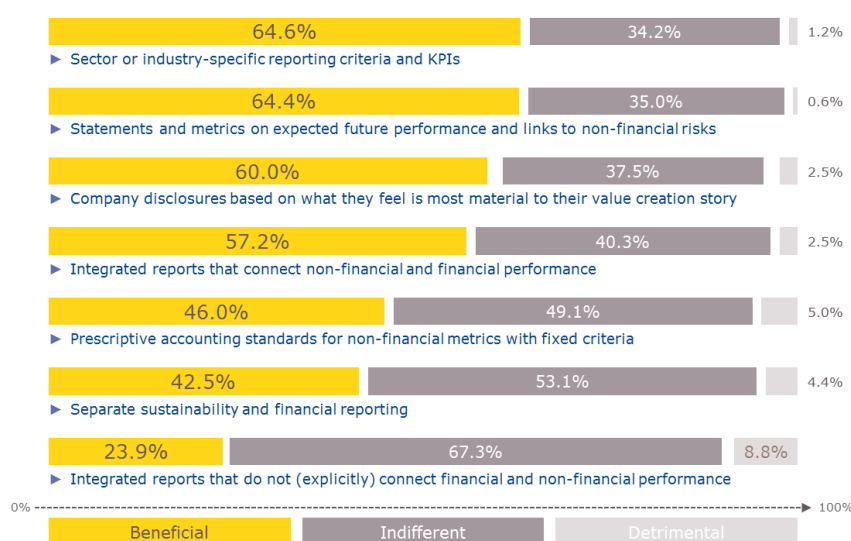


Figure 12: The type of ESG information that institutional investors find most useful for investment decision-making (EY, 2014b)

Furthermore, not all information which could ideally be studied by financial analysts is available from companies; in this case analysts can use proxies or make assumptions in relation to average performance. Data or information may be important, but not sufficiently disclosed by companies, as most reporting is voluntary and material issues vary largely by sector and other corporate characteristics.

A recent study by the S&P Dow Jones Indices reviewing the level of transparency of companies' ESG disclosures indicated an average level of transparency of 45 (out of 100). This level varied by theme – with corporate governance at 81, environmental issues at 40 and social concerns at 33.20 These figures also varied largely across regions.

Generally, the amount, and especially the quality of ESG information available for making investment decisions has improved over time due to the development and consolidation of ESG research firms. However, a challenge to effectively integrating ESG information into investment decisions is its perception as being over long-term timeframes or as difficult to measure in comparison to short-term financial data traditionally used for investment decisions.

There is a need to improve ESG information and indicators so that they are useful for institutional investors (EY, 2014b). Ideally ESG information should be:

- **relevant** and preferably linked to the organisation's financial performance
- **consistent** over time using the same methodology
- **comparable** within sectors or investment portfolios
- **balanced** giving a full picture of performance
- **reliable** – potentially verified by a third-party

An increasing number of fund managers use an ESG integration approach, via the explicit inclusion of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and relevant research and information. This could create greater pressure on companies to report relevant

²⁰ S&P Dow Jones Indices (2014) An In-Depth Study on Sustainability Transparency Practices Around the Globe.

information and could lead to the decreasing costs to obtain high quality information on financially material ESG information. However, despite a greater consideration of ESG information in investment decisions, there remains a large disparity in the methods used by investors to do so.

A related issue is the need to have an agreed set of indicators for measuring the social and environmental impact of including ESG criteria into an investment decision. While some standards exist (Impact Reporting and Investment Standards - IRIS) most approaches are heterogeneous. With the introduction of standards there is also the question of auditing or certification to ensure an effective standardisation in indicator and information use.

Box 8: Approaches for measuring environmental impact

To provide an example of the difficulties faced with understanding and using ESG information and data, we will briefly consider methodologies used by different organisations for assessing carbon and climate change-related impacts (and resulting risks and liabilities). These methodologies are used in the context of calculating risk for what are known as 'stranded assets.' Carbon and climate-indicators are considered here as they are some of the mostly commonly used environmental indicators for measuring and assessing companies' or assets' ESG performance.

Stranded assets are environmentally unsustainable assets in an investment portfolio experiencing premature write-offs, downward revaluations or that are converted to liabilities because of current and emerging risks such as potentially 'unburnable' fossil fuel reserves, decreasing clean technology costs, increasing water scarcity and intensifying 'polluter pays' regulations. These risks are rarely factored into company valuations which results in over-exposure to unsustainable assets throughout financial and economic systems. Certain notation and rating agencies have started to develop approaches to calculate this type of risk and integrate it into their portfolio analysis. These approaches involve analysis at both a company and a portfolio level.

A review performed in this study of five approaches used by Bloomberg, ET Index, MSCI, South Pole Group and Trucost revealed that there is no consensus on how to measure the risk of stranded assets: e.g. who should be measuring (the company in question, the rating agency, or calculation via a third party approach), how the inputs and calculations should be verified (peer-reviewed, for example), or the standards to be used for calculation or emission factors. Data sources used are typically reported (by the company in question), but for some are computed in parallel, or estimated based on overall sector performance. While all approaches cover scope 1, 2 and 3 GHG emissions²¹, peer review is only used in two of the five approaches reviewed. Different standard calculations approaches are used – for example based on the GHG Protocol, using only publically available data, or applying propriety LCA approaches or an input-output model. The level of transparency on the source data used and the calculations undertaken vary as well. Asset classes consider typically cover at least fixed income assets, with some also covering debt instruments, real estate and infrastructure and a broader range of banking and investment activities.

3.4. Summary

The analysis of the legal framework in Chapter 2 showed that the inclusion of environmental and resource efficiency issues in the investment decision-making process of institutional investors is not considered a breach of fiduciary duties in the EU or any of its Member States as long as the basic elements of fiduciary duty are

²¹ The GHG Protocol categorizes emissions into three broad scopes: Scope 1 (all direct GHG emissions, i.e. from sources that are owned or controlled by the reporting entity); Scope 2 (indirect GHG emissions from consumption of purchased electricity, heat or steam); and Scope 3 (other indirect emissions, such as the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, etc.).

respected, i.e. aiming for the highest possible financial return on investment and acting in a professional and prudent manner. This chapter looked at the practical application of fiduciary duty and found that, while most institutional investors already integrate ESG factors in their investment strategies and decisions as part of their fiduciary duty, there are certain perceptions regarding the integration of ESG issues that may limit the extent environmental factors define investment decisions and fiduciary duties, e.g. the degree that environmental and resource efficiency risks are considered material and valued; the risk that a certain sustainable and responsible investment strategy will compromise financial returns and risk; as well as the quality of ESG information.

4. Analysis of the opportunity and feasibility of including resource efficiency and sustainability more explicitly into fiduciary duties

The previous chapter demonstrated that in practice the inclusion of environmental and resource efficiency issues in the investment decision-making process is not a breach of fiduciary duties in the EU as long as the basic elements of fiduciary duty are respected. The issue identified was rather the limited extent that environmental and resource efficiency factors define investment decisions and fiduciary duties. This chapter will analyse the opportunities for improving the conditions for institutional investors to consider and further develop environmental and resource efficiency issues in their investment decisions.

Based on the analysis performed in this study, the challenge is not just about considering changes to the legal framework related to fiduciary duty, but on what actions could be taken to further develop and advance the integration of environmental and resource efficiency issues in investment decisions. The following sections look at a wide range of policy actions that could be proposed to encourage the inclusion of ESG factors more explicitly in institutional investors' investment decisions.

4.1. Legal requirements to integrate sustainability criteria in fiduciary duties

One approach to ensuring that the ESG issues are taken into account in the investment decisions of institutional investors would be to make it a legal requirement as part of their fiduciary duties (including the similar obligations that exist in EU and the Member State legislation). This is similar to what the European Commission had proposed in the recent revision of the IORPs Directive: "*The risk evaluation shall cover (...) a qualitative assessment of new emerging risks relating to climate change, use of resources and the environment*" (see section 2.3 – review of fiduciary duty in EU legislation).

As the obligations of fiduciary duty relate to the investment decision-making process and not the final investment decision, this would mean that institutional investors would have to demonstrate that certain ESG factors were considered during the investment decision-making process. Such a requirement would however not change the basic discretionary power of fiduciaries to make their investment decisions as before, e.g. investors could still conclude that based on their professional judgement, the ESG issues assessed in the risk evaluation were not found to be relevant or have sufficient importance. This is demonstrated by the amount of institutional investors in the EU that claim to be investing responsibly, but without signs that their actual investment decisions are more long-term or sustainable.

Most of the experts consulted in the course of this study were not in favour of legal changes or requirements to the fiduciary duties of institutional investors for two reasons:

- first, it would make investors understand ESG integration as a 'compliance' issue and not as a fiduciary duty (i.e. following the duty of loyalty and prudence), which establishes confidence that trustees act professionally and use their expert knowledge and judgement. A discretionary approach allows institutional investor to act proactively, rather than reactively;

- second, there is a perception of already too many or even conflicting regulations: investors are already struggling with the existing legal framework, which is difficult to comply with.

Respondents to a European Commission consultation on long-term financing in 2013 (European Commission, 2014) were divided about the need to revisit the definition of fiduciary duty. Some argued that defining fiduciary duty at the EU level would be complex due to the diversity of legal traditions. Rather than revisit the concept, emphasis should be put on promoting a better understanding of its current scope. Other respondents proposed *"that fiduciary should include a requirement to analyse the sustainability of companies in which investments are made, disclosing the voting policy, or having an obligation to disclose asset managers' cost and performance fees"* (European Commission, 2014).

A pragmatic way forward could be to propose a statutory clarification for institutional investors that would clearly define that a wider range of ESG related factors *may* be considered when making investment decisions (Share Action, 2012). This would clarify and correct any flawed interpretations of fiduciary duties (see section 4.3). It can be discussed if this would best be done at a national Member State level or developed as a common EU definition that would clarify fiduciary duty in relation to long-term and sustainable investments.

Such a statutory clarification would free trustees to exercise their professional judgement about what will serve their beneficiaries' best interests, but this alone would not necessarily lead to any change. As there are many different approaches to sustainable and responsible investment, and different degrees to taking ESG factors into consideration, institutional investors could claim to be following responsible investment principles in their investment strategies, but still continue to make investment decisions as before.

4.2. Incorporation of environmental considerations in the statutory provisions of public funds

Another action that could be considered is to revise the statutory provisions of individual public pension funds and sovereign wealth funds and define how assets should be invested. Some pension funds already include restrictions on certain types of investments, as in Belgium²², and could even emphasise environmental and social considerations in their investment policies, as in Sweden²³ and South Africa²⁴. Such obligations would need to be carefully assessed in order to ensure that this does not compromise the ability of pension funds and others to fulfil their primary objective to provide adequate pensions for their (current and future) beneficiaries. The risk with defining specific mandates for public funds is that it could lead to constant change following current political or public debates.

A more ambitious action to ensure the integration of ESG issues in investments would be to set legal requirements for institutional investors to consider the sustainability

²² Exclusion of investments in landmines, cluster munitions and depleted uranium weapons

²³ Public Pension Funds act: Obligation to take environmental and ethical considerations into account without relinquishing the overall goal of a high return on capital.

²⁴ Regulation 28 of its Pension Fund Act. The revised regulation states that a pension fund and its board must comply with a series of principles including "appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an ESG character."

performance of their investments or to even meet certain independently set sustainability benchmarks such as the carbon footprint of a portfolio (Richardson, Keeping Ethical Investment Ethical: Regulatory Issues for Investing in Sustainability, 2009) (Sandberg, 2011). Here again the ability of the public funds to fulfil its primary objective should not be jeopardised.

Rather than 'hard' legal requirements, it might be more effective to consider 'softer' policy instruments that engage, enable and encourage the investment community in the practical aspects of taking ESG issues into consideration in an adequate manner, such as set out in the following.

4.3. Policy briefs and guidance documents explaining fiduciary duty

Some legal advisers and investment consultants still interpret fiduciary duty in a narrow and conservative manner, i.e. as solely focusing on the highest financial returns through short- and medium-term investments (UNEP FI, 2015). A fairly simple action would be an official guidance document that clarifies the extent to which ESG issues can be included in the fiduciary duties of institutional investors and provide examples of what the best practices of sustainable and responsible investment are. This would help remove any doubt that institutional investors and intermediaries might have regarding the integration of ESG factors in their investment decisions.

A common EU (or even international) interpretation and understanding of fiduciary duties may be helpful for institutional clients that are international and asset managers that operate across many different countries. This however would be difficult to do as fiduciary duty is not expressed explicitly in the legal frameworks of all jurisdictions.

Instead it would be easier and more appropriate that national financial authorities or other regulatory bodies clarify the national legal aspects of integrating ESG issues into fiduciary duties in published policy briefs and guidance documents as has been done in Denmark and the UK. Such documents could explain how the regulatory bodies interpret the fiduciary duties of institutional investors and therefore ensure that all institutional investors, and the entire investment value chain, have an official reference document on the subject.

4.4. Raising awareness to engage beneficiaries

Institutional investors rarely refer to their fiduciary duties in their daily work and most beneficiaries have often no idea of the concept - or how their savings and investments are linked to sustainable development. If beneficiaries were more aware of responsible investments and the investment decisions made by institutional investors, fiduciary duty could become a stronger leverage for resource efficiency and sustainable development. Institutional investors' key information documents (KID) and marketing brochures could be required to disclose mandatory extra-financial information on the performance

Box 9: French labels for responsible investment

France already has several labels to promote responsible investment but the French Government recently announced the creation of two new labels backed by French authorities: one is a general "SRI Label" and the other is specifically dedicated to environmental funds: "Energy Transition and Climate Label". Both will aim at facilitating the visibility of such funds for final beneficiaries.

of their investments. This would be best set at EU level. It is also important to not just think about what information should be disclosed, but whether it is understandable, e.g. make it easier for beneficiaries to understand their own pension statements. This could efficiently lead the beneficiaries to push for a broader inclusion of ESG issues in investments. Another approach to raising awareness could be to establish a label for sustainable and responsible investments that would be easily recognisable by beneficiaries and trustees and require asset owners to fulfil certain criteria (see Box 9). While it would be good to promote national sustainable investment labels, if common criteria can be defined it would be more effective and efficient to have a common EU label. Another way would be to require fiduciaries to consult with their beneficiaries and give them the opportunity to express their 'best interests' and opinion on ESG consideration, e.g. voting on investment strategies for pension fund members, or appoint representatives of beneficiaries to the boards of directors of investment institutions (Sandberg, 2011). The UK Law Commission found that trustees may consider the views of their beneficiaries, when making their investment decisions, but are not required to do so (UK Law Commission, 2014). Professional pension funds could let their beneficiaries vote on resolutions on how to invest, e.g. academics, civil engineers and architects in Denmark recently voted in favour of divesting from fossil fuels (The Guardian, 2015). The trustees and management boards of funds would still maintain the responsibility of any investment strategy, but it would be obliged to be transparent and explain its investment strategy to its beneficiaries.

4.5. Incentives for responsible and long-term investments

The Commission's communication on long-term financing of the European economy set out a range of measures to stimulate ways of unlocking long-term financing. The recently finalised European Long-Term Investment Funds (ELTIFs) regulatory framework will allow investors to put money into companies and infrastructure projects for the long term. ELTIFs should have particular appeal to investors such as insurance companies or pension funds which need steady income streams or long term capital growth.

Another emerging investment category with potential to provide further access to sustainable finance are green bonds. The proceeds of green bonds are directed towards projects and activities that promote climate or other environmental sustainability related purposes. The rapid growth in this market is being assisted by a market-driven standardisation process that takes into account criteria for green bond selection developed by, among others, the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development. Market participants are currently developing voluntary guidelines, known as 'Green Bond Principles' (International Capital Market Association, 2015), which recommend transparency and promote integrity in the development of the green bond market by clarifying the approach for issuing green bonds.

Although most institutional investors have responsible investment policies, the level of ambition and interest to further advance the consideration of environmental and resource efficiency may be limited. According to the stakeholders in this study, many of the top management teams of asset management companies seem to not be convinced of the benefits of integrating ESG issues in their day-to-day activities. By integrating economic incentives (e.g. tax deductions), responsible investments could be strengthened. Compensation criteria could include objectives in terms of RI portfolios or ESG impacts. Alternatively, tax incentives could be given to investment companies that demonstrate adequate consideration of environmental and social issues (Sandberg, 2011).

One should be cautious when providing economic incentives as these could distort the market (e.g. monopolies, network effects, incomplete markets, etc.). Before implementing a tax incentive one should make sure that the criteria for being eligible to the tax incentive are clearly defined and can be easily verified. At present it is difficult to determine what an “adequate consideration of environmental and social issues” is, given the many different responsible investment strategies and the lack of verification that institutional investors are actually doing what they claim to be doing.

Another type of incentive could be to reward long-term investments, as discussed under the revision of the Shareholder Rights Directive. For example, France has introduced its Florange law which gives those who have held stock for more than two years double-voting rights unless a two-thirds majority votes for one-share-one-vote; and Italy has approved a law that allows companies to give double voting rights to shareholders that own shares for at least two years. While stakeholder incentives such as additional voting rights, tax incentives, loyalty dividends and loyalty shares, could provide the means to influence how companies are run, this would first require that institutional investors are engaged and committed to ensuring that companies become more sustainable.

Another negative incentive would be to consider holding investors liable for the poor ESG performance of the companies they have invested in.

4.6. Ensuring that ESG issues are considered throughout the investment chain

Most institutional investors invest through intermediaries such as asset managers. It can however be a challenge to ensure that fiduciary duties are coherent throughout the asset management value chain. Some countries such as the UK have stewardship codes (see Box 10) for investment mandates which allow specific investment strategies and criteria to be specified to external investment managers. Stewardship codes enhance the transparency throughout the investment chain.

Box 10: The UK Stewardship Code

In 2012, the UK Financial Reporting Council published a ‘comply or explain’ Corporate Governance and Stewardship Code that aims at *“enhancing the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns to shareholders”*. In particular, under Principle 4, signatories are committed to engage with companies, including on ESG matters.

Similar codes and initiatives exist at national, European and International level (Eurosif, 2013).

Asset managers are already required under the UCITS Directive and AIFM Directive to set up a voting policy and to report to their clients, including on the exercise of voting rights. The revision of the EU Shareholder Rights Directive includes a proposal for disclosure obligations for institutional investors and asset managers on how their investment strategy is aligned with the profile and duration of their liabilities and how it contributes to the medium to long-term performance of their assets. The advantages of an EU supported Stewardship Code should be investigated.

The leading institutional investors that are engaged in sustainable and responsible investment also make it explicit in their bids what they expect of asset managers when it comes to taking ESG factors into account. Asset managers need to follow similar investment approaches and demonstrate that they have necessary skills and methodologies to do this, if they want to win the contract. At the moment asset owners rarely disclose the specifications in their request for proposal for asset management contracts. Requiring asset owners to disclose their request for proposals would be a simple way to make it more transparent how the inclusion of ESG factors is

part of the fiduciary duties throughout the investment value chain. This would also encourage competition among asset owners regarding their competencies in dealing with ESG issues.

4.7. Ensuring better ESG information for investors

Most European countries have implemented or are implementing legal frameworks to oblige companies to report on the extra-financial performance of their activities following the EU Directive on disclosure of non-financial and diversity information by certain large undertakings and groups (Directive 2014/95/EU). The Directive has tasked the European Commission to develop non-binding guidelines, including general and sectoral key performance indicators, which should cover at least land use, water use, greenhouse gas emissions and the use of materials. Yet, ESG information is not the same everywhere and cannot be readily compared: definitions vary across countries and not all companies are reporting ESG data on the same perimeter. To convince all investors to include extra-financial criteria in their models and decision-making tools, ESG information data should ideally be relevant and linked to financial performance, consistent, comparable, balanced and reliable. It may be a while before this is achieved. The Commission is currently developing and piloting a common voluntary methodology to measure the life cycle environmental performance of companies and other organisations.²⁵

While the intent is right, it is debatable that a standardised methodology or a defined set of ESG indicators will ever provide asset managers with all the relevant and updated information that they need in order to make informed sustainable investment decisions. It may be difficult to find the right balance between the need for a wealth of information and a limited set of standardised information. At the end of the day, it is the institutional investor's investment belief and professional judgement that should determine what ESG issues are relevant and what information is needed to be able to make their decision on the potential investment risks.

That said, there is certainly scope in improving the availability and quality of information of the ESG performance of investments. Currently, the many different data sources and indicators used in ESG can be confusing. In general, materiality should be a guiding principle in order to narrow down what information is required to assess the potential risks associated with an investment.

4.8. Providing institutional investors with the right skills and competences

Finally, another measure that could promote a broader inclusion of ESG issues in investment decision is that analysts and asset managers are better equipped with tools, skills and competences to assess ESG issues and their relevance to investment decisions. Most investors have never been formally trained in responsible investment. A way to enable further inclusion of ESG aspects in investment decisions would be to include this in all financial education and training.

²⁵ http://ec.europa.eu/environment/eussd/smgp/oef_pilots.htm

4.9. Overview

Table 6 provides an overview of the main barriers regarding the inclusion of environmental and resource efficiency issues into fiduciary duties identified in this study and suggestions for potential action.

Table 6: List of identified barriers to institutional investors integrating environmental and resource efficiency factors in their investment decisions and potential action

Barriers, causes and potential actions

1. Interpretation that fiduciary duty should focus on maximising financial returns with emphasis on short-term performance without taking wider social and environmental issues into consideration in investment decisions	
 cause	- Narrow interpretations of fiduciary duty based on conservative advice provided by legal advisors and investment consultants
 action	- Statutory provisions in the legal framework related to fiduciary duty requiring that relevant ESG factors taken into consideration when making investment decisions - Financial authorities providing guidelines on the inclusion of ESG factors into fiduciary duties
2. Asset managers and other intermediaries in the investment value chain do not take social and environmental issues into consideration	
 cause	- Fiduciary duties are not passed on to asset managers and other intermediaries - Asset management contracts focus on financial performance without specifying that ESG factors should be taken into consideration.
 action	- Disclosure of tender specifications for asset management contracts - Stewardship codes that clearly specify what sustainable and responsible investment strategies are to be applied in asset management and to what extent ESG factors should be taken into consideration
3. Social and environmental performance and risks are not recognised or valued by investors	
 cause	- Social and environmental impacts are externalities - Weak social and environmental protection policies and / or enforcement - Investment beliefs and business cases do not link social and environmental issues with financial performance and investment risks
 action	- Measuring the social and environmental impacts of investments - Integrating the social and environmental costs into the market price - Stronger social and environmental policy and enforcement
4. Trustees do not define the ‘best interests’ of beneficiaries in relation to social and environmental issues	
 cause	- Beneficiaries are not aware or engaged in how their money is invested - Trustees do not consult with beneficiaries - Difficult to reach a consensus among multiple beneficiaries
 action	- Disclosure on sustainable and responsible investment strategies and measure their environmental performance - Raise awareness and engage beneficiaries in how their money is invested by informing and consulting with them - Provide representation or platforms for beneficiaries to express their ‘best interests’ in relation to investment strategies

Barriers, causes and potential actions

5. Focus on the short and medium-term perspective



- Financial regulation with medium-term capital and liquidity requirements
- No consideration of future generations as beneficiaries



- Incentives for long-term investments

6. Complexity and quality of ESG information



- The available ESG information is not always material, consistent and reliable and it does not allow comparisons to be made



- Standardised ESG information
- Providing more relevant and better quality ESG information

7. Lack of skills and competences to integrate wider social and environmental issues into investment decisions



- Insufficient training
- Existing tools and valuation models are not able to take into account ESG information



- Provide ESG related training
- Develop investment decision-making tools and valuation models that are able to take into account the (long-term) risks based on ESG information

5. Policy recommendations

This study has investigated the state of sustainable and responsible investment of institutional investors in the context of their fiduciary duties and the inclusion of environmental and resource efficiency issues. While this study is not based on a proper assessment of policy actions, it does propose some immediate recommendations for policy action that would be effective and would further develop and advance the integration of environmental and resource efficiency issues in investment decisions of institutional investors in the EU.

As this study did not find any legal issues related to the inclusion of financially relevant ESG factors into the fiduciary duties of institutional investors, the recommendations aim at engaging, enabling and encouraging the entire investment community in the practical aspects of taking ESG issues into consideration in their investment decision process.

This study recommends that:

- **National financial authorities with support from the European Commission provide official guidance and interpretation** of fiduciary duties and the extent to which institutional investors may include ESG issues into their investment strategies and decisions. This is to provide a reference document and put beyond doubt the question of ESG issues and fiduciary duties.
- **Disclosure of sustainable and responsible investment policy is mandatory for all institutional investors** – including if they do not have such a policy in place (i.e. 'comply or explain').
- **Monitoring and verification ensures that institutional investors are indeed applying their sustainable and responsible investment policy as they claim.** Many institutional investors benefit from being perceived as sustainable investors without doing anything. If institutional investors have a sustainable and responsible investment policy, they must also demonstrate that they have internal controls in place to ensure that the policy is adequately applied. External verification by a third party could be introduced in the case of PRI signatories or when benefiting from a recognised sustainable and responsible investment label or certificate.
- **Institutional investors are encouraged to inform and consult their beneficiaries** to ensure that their 'best interests' are understood. This includes that beneficiaries are made more aware and are encouraged to be more engaged in the investment decisions of fiduciaries, as well as trustees and administrators of funds are also made more aware of the environmental and social issues related to investments and the best interest of beneficiaries;
- **Institutional investors measure the environmental and social impacts of their investments** to track that they are actually contributing to a resource-efficient economy. This requires that tools and models have to be developed in order to value the environmental and social impacts and benefits of investments.
- **The regulatory requirements for institutional investors are balanced from a short and long-term perspective** in relation to the regular reporting on their financial performance and capital and liquidity requirements. This includes that financial regulations should be consistent with climate, environmental and resource efficiency policy, e.g. the 2°C target for climate change.

- **Stewardship codes are developed for asset managers and intermediaries** to increase transparency and clarify that fiduciary duties and the inclusion of ESG factors should be respected throughout the investment chain
- **Research is supported regarding measurement and quantification of ESG-related impacts and risks of investments** including tools and valuation models that are able to take into account ESG information.
- **The quality of ESG data and information is improved** in order to be relevant, consistent, comparable, balanced and reliable.

All of the above recommendations need to be examined more closely and assessed in relation to their practical application and potential negative consequences.

6. Conclusion

Fiduciary duty has been traditionally interpreted narrowly as focusing solely on maximising the financial returns often through short- and medium-term investments. Today, 10 years after the first UNEP FI Freshfields report (UNEP FI, 2005) on the integration of environmental, social and governance (ESG) issues into fiduciary duties and the UN supported Principles of Responsible Investment (PRI) initiative²⁶, the inclusion of environmental and resource efficiency issues in the investment decision-making process of institutional investors is not considered a breach of fiduciary duties in the EU or any of its Member States, as long as the basic elements of fiduciary duty are respected, i.e. aiming for the highest possible financial return on investment and acting in a professional and prudent manner.

The study investigated the inclusion of environmental and resource efficiency issues into the fiduciary duties related to financial institutions and investment decisions: pension funds, mutual funds, insurance companies, banks, sovereign wealth funds and asset managers. This study has looked at the state of play on the inclusion of environmental and resource efficiency issues into fiduciary duties across the EU and in seven Member States in particular. It examined the arguments for and against including sustainability issues into the fiduciary duties of institutional investors. Social and governance issues are not the focus of this study but were also considered. Based on a number of identified barriers for institutional investors to integrate environmental and resource efficiency factors in their investment decisions, different policy actions for how ESG issues could be more explicitly integrated into investment decision-making was proposed and discussed.

While the term fiduciary duty might not exist in all Member States, similar concepts regarding duty of loyalty and prudence exist in EU and national legislation. It is clear that the inclusion of financially relevant environmental factors in the investment policies and decision-making process of institutional investors is compatible with the existing legal framework related to fiduciary duties in all jurisdictions across the EU – as long as it is relevant to financial returns and the management of risk. Beyond financial returns and risks, it is possible to exclude / divest in certain investments if all beneficiaries agree.

This study does not see a need for legal changes in relation to fiduciary duty, but there is still scope to further develop and advance the integration of environmental and resource efficiency issues in the investment decisions of institutional investors. The issue is rather to provide clear guidance that puts beyond doubt that the inclusion of ESG factors is not only permissible, but possibly also good practice. The consideration of ESG issues can be seen as being prudent both from a financial and legal perspective.

There are many things that can be done to engage, enable and encourage institutional investors and its intermediaries in the practical aspects of taking ESG issues into consideration in their investment decision process. The study finds that as the legal framework regarding fiduciary duty is not an obstacle, the focus moving forward should be on advancing the integration of ESG in investment decisions of institutional investors.

Fiduciary duty and long-term investments are not the same thing. The highest financial returns can be achieved through short-term gains. The current financial regulatory framework, in particular the capital and liquidity requirements, does not

²⁶ www.unpri.org

encourage long-term investments. More measures, such as those proposed in the European Commission's communication on long-term financing, are needed to balance short and long-term perspectives.

It is recognised that not all environmental and resource efficiency issues are material to financial returns and risks. Often this is because current environmental regulatory framework and enforcement is not strong enough. This results in market failures where the costs of environmental pollution and resource depletion remain externalities. Many of the risks associated with environmental issues are related to regulations. If environmental regulation and its enforcement were more stringent this may change how environmental issues were taken into account in investment decisions.

In general governance issues are already well adopted in investment decisions. Social and environmental issues are less recognised to be financially relevant. The long-term risks of environmental degradation and resource depletion are not considered in current valuation models and investment decision-making tools. Resource efficiency factors are more recognised as they are typically directly linked with financial performance or business opportunities.

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Annex 1 – List of interviews

The following professionals have been interviewed in the context of the study:

Name	Organisation	Headquarter	Activity
Maurizio Agazzi	CEO at Fondo Cometa	Italy	Asset owner
Ole Buhl	Head of ESG at ATP	Denmark	Asset owner
Hugues Chenet	Scientific Director at 2° Investing Initiative	France	NGO
Davide Dal Maso	Director at Forum per la Finanza Sostenibile	Italy	Industry association
Camilla de Ste Croix	Senior Researcher at ShareAction	UK	NGO
Laurent Degabriel	Head of Investment and Reporting Division at ESMA	EU	Regulator
Philippe Desfossés	CEO at RAFF	France	Asset owner
Edouard Fernandez-Bollo	General Secretary ACPR	France	Regulator
Paulo Gemelgo	Head of Legal Division for Asset Management at AMF	France	Regulator
Andreas Hoepner	Associate Professor at Henley Business School	UK	Academic
Piet Klop	Senior Advisor for Responsible Investment at PGGM	Netherlands	Asset owner
Søren Larsen	Head of SRI at Nykredit	Denmark	Asset manager
Manuel Lewin	Head of Responsible Investment at Zurich Insurance Company Ltd.	Switzerland	Asset owner & manager
Manuela Mazzoleni	Head of Operations & Markets at Assogestioni	Italy	NGO
Olivier Millet	President of the ESG Committee at AFIC	France	Industry association
François Passant	Executive Director at Eurosif	EU	Industry association
Barbara Evans Pomfret	ESG Product Manager at Bloomberg LP	US	ESG data provider
Joakim Sandberg	Associate Professor at the University of Gothenburg	Sweden	Academic
Uldis Upenieks	CEO at "CBL Asset Management" IPAS	Latvia	Asset manager
Harald Walkate	Head of Responsible Investment at Aegon Asset Management	Netherlands	Asset manager
Mike Wilkins	Managing Director of Infrastructure finance at Standard & Poors	UK	ESG data provider

Annex 2 – Country fiches

For the five Member States that are studied in depth in the report, the country cases are designed according to the same layout (see below). For the short cases on Latvia and Poland, the layout has been simplified.

<i>Chapter</i>	<i>Description</i>
<i>Financial market characteristics</i>	<i>Types of financial products and actors, as well as broader application, if relevant.</i>
<i>Definition of fiduciary duty</i>	<i>Local translation of the concept of fiduciary duty.</i>
<i>Legal framework for fiduciary duties</i>	<i>What are the statutory provisions / legislation? Who regulates? Who is subject to it? How is it regulated / interpreted?</i>
<i>Overview of duties</i>	<i>Types of actors on the market, including market authority obligations imposed on them via fiduciary duty</i>
<i>Controls and sanctions</i>	<i>If information is available: How does the national statutory provisions / legislation on fiduciary duty affect the institutional investors, intermediaries and investment consultants and their investment decisions?</i>
<i>Integration of environmental and resource efficiency considerations in investment decision making</i>	<i>If information is available: Current practices and trends in fiduciary duty and environmental considerations (including RI) Percentage of total assets held managed with an RI approach or considering environmental factors, trends for the future, any legal or non-legal initiatives in place Main barriers to integrating environmental considerations into financial markets and fiduciary duty Types of barriers and possibility for removing them</i>
<i>International, national, sectoral and individual initiatives</i>	<i>If information is available: Actions required for clarifying the link between sustainability and fiduciary duty Action, actors involved, timeline, potential difficulties</i>
<i>Recent / future developments</i>	<i>If information is available: Emerging expectations of new entrants or stakeholders related to fiduciary duties and environmental considerations Support for integration of environmental considerations and current norms for application, level of consumer and actor sensibility to the issue</i>
<i>People interviewed</i>	<i>Interviews carried out during the study</i>
<i>References</i>	<i>Publications & websites</i>

Striking conclusions for each country have fed the main body of the report.

Disclaimer:

The information and views set out in this study are those of the author(s) and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission's behalf may be held responsible for the use which may be made of the information contained therein.

Denmark



Summary

Danish institutional investors manage assets with a value of around EUR 866 billion. Over 90% of investments with Danish institutional investors are covered by policies for responsible investment and the signatories of PRI²⁷ represent 55% of total assets under management. In general, most Danish pension funds believe that responsible investment provides the highest returns on the long-term. ESG screening, such as value-based and norm-based screening, continues to be the most widely used responsible investment tool among the largest Danish institutional investors (Dansif, 2014).

According to the Danish Financial Business Act, life insurance companies and pension funds are obliged to make investments that ensure pension savers the highest possible returns taking into considerations the risks, as well as to ensure adequate diversification of investments by asset type and individual asset. Fiduciary duty in Denmark means that insurance companies and pension funds should act in the interest of their beneficiaries – the legislation also exists to protect institutional investors from political or public pressure to make investments that would be detrimental for their beneficiaries.

The Danish Financial Supervisory Authority (Finanstilsynet) does not see a problem that investments are made with ESG considerations as long as the condition of highest returns is fulfilled. What is not clear is how much of the investments may be excluded based on ESG. The Danish Financial Supervisory Authority has also clarified that the responsibility of the investment strategy of pension funds and life insurance companies, including ethical investments, rests with the management. Institutional investors, mutual funds and listed financial businesses must also report on their CSR. The Danish financial sector is subject to reporting requirements for social responsibility corresponding to the requirements of the Financial Statements Act. In 2013 a new requirement was introduced into the law making it mandatory for businesses to also expressly account for their policies for respecting human rights and for reducing their climate impact. Danish businesses are free to choose whether or not they wish to work on CSR. However, the statutory requirement means that the businesses must account for their policies on CSR, or state that they do not have any.

Most of the asset managers in Denmark take ESG factors into consideration because they believe this to be financial relevant. There are however different approaches to responsible investment policy. Some policies are just based on avoiding investments in companies that breach recognized conventions, standards and norms in, for example, human rights. Others perform their own analyses to determine whether certain sustainable and responsible investments are compatible with their obligation to ensure long-term financial returns and risks. Based on their analysis, some pension funds such as PKA have decided to divest from coal, while others prefer to engage with the fossil fuel companies through active ownership to address climate change. Even though members of pension funds are willing to forego maximum financial returns of their investments based on environmental and ethical concerns, the pension

²⁷ In 2013, six major Danish pension funds (ATP, Industriens Pension, PensionDanmark, PFA Pension, PKA and Sampension) decided to leave the PRI Initiative due to concerns about the governance of the PRI organisation. (<http://www.unpri.org/whatsnew/pri-responds-to-danish-signatory-delistings/>). All the pension funds still support responsible investments.

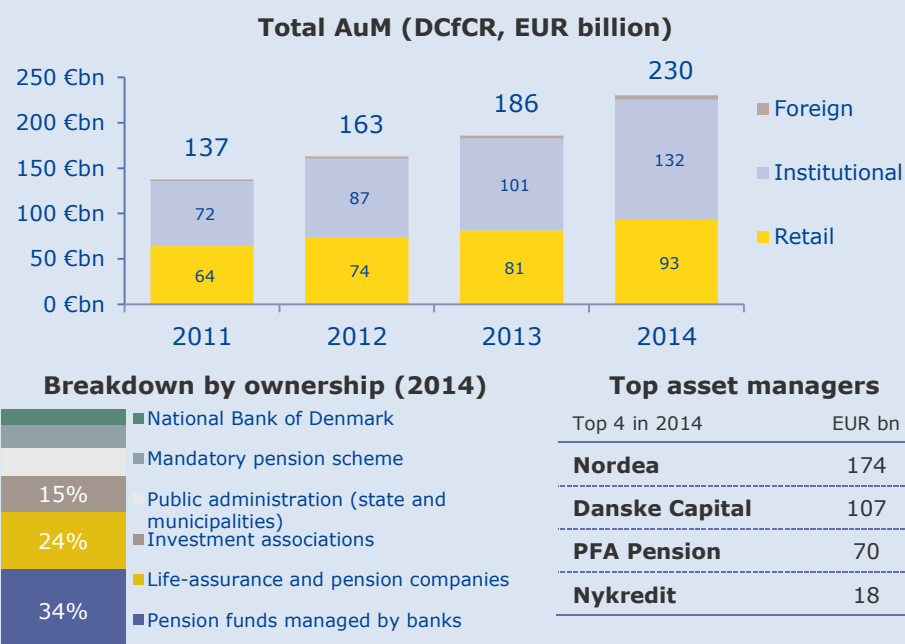
funds maintain that long-term financial returns and risks are not compromised in their investment decisions.

Unipension (a pension fund for academics) consulted their members in a survey in 2012 regarding their investment decisions. The survey showed that Unipension's members supported responsible investments and that they would even forego maximum return, if necessary. Recently members of three pension funds voted in favour of divesting from fossil fuel, but this does not change that it is still up to the board of the pension funds to decide and take responsibility for their own investment policy (Politiken, 2015).

Assurance and pension companies usually publish exclusion lists on their websites or in connection with annual reporting on responsible investments activities. A few pension companies do not publish regular exclusion lists. However, it is usually possible to have these supplied on request.

Financial market attributes

There is no full and precise statement of total Danish investments. There are only statements for individual players, but these cannot just be added together as some large assets would be double counted.



Danish institutional investors manage assets with a value of around DKK 6,445 bn (EUR 866 bn) – estimate for 2012 based on the statement of Danish financial assets issued by the National Bank of Denmark.

Definition of fiduciary duty

According to the Danish Financial Business Act (Lov om Finansiell Virksomhed), §§ 158-159, life insurance companies and pension funds are obliged to make investments that ensure pension savers the highest possible returns taking into considerations the risks, as well as to ensure adequate diversification of investments by asset type and individual asset (Pensionsmarkedsrådet, 2007).

The following terms are commonly used to refer to fiduciary duty:

- Tillidsforpligtelser (= "trust obligations")
- Betroet ansvar (= "delegated responsibility")

*Legal
framework
for fiduciary
duties*

FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY

In the **Danish Financial Business Act** - specifically for insurance companies and pension funds - there is a requirement how capital should be placed, and it is from the traditional understanding of fiduciary duties where the highest possible return, taking into account the risks, must be the immediate investment criterion. With the way the law is formulated, the funds must be invested "appropriately and serve the insured" bearing in mind that the company's liabilities must always be met.

Fiduciary duty means that insurance companies and pension funds should act in the interest of their beneficiaries - the legislation also exists to protect institutional investors from political or public pressure to make investments that would be detrimental for their beneficiaries (Forsikring & Pension, 2010).

Financial markets are supervised by the **Danish Financial Supervisory Authority** (Finanstilsynet). The Danish Financial Supervisory Authority (FSA) does not see a problem that investments are made with ESG considerations as long as the condition of highest returns is fulfilled (Forsikring & Pension, 2008). What is not clear is how much of the investments may be excluded based on ESG.

According to the FSA, the law only allows ESG considerations to be taken into account in investment decisions in the first two circumstances:

1. Investments already made
2. New investments, where the management is aiming for the highest return either by choosing or excluding investments
3. New investments, where the management consciously makes an investment that will not achieve the highest returns, or the management knows with great probability that the highest returns will not be achieved
4. New investments, where the management know that self-chosen costs in relation to selection and / or verification, e.g. compliance with environmental legislation corresponding to (at least) Danish requirements, will entail that the highest returns will not be achieved.

While the legal framework in Denmark seems to be restrictive in relation to social and environmental considerations in investments, the Danish FSA clarified that the responsibility of the investment strategy of pension funds and insurance companies, including ethical investments, rests with the management.

In their decision of 10 October 1997, the Danish FSA clarified that the responsibility of the investment strategy of pension funds and life insurance companies, including ethical investments, rests with the management. The law *"does not prevent management to consult with shareholders / pension fund members prior to the investment strategy. The responsibility for the investment strategy - and the obligation and the right to make decisions - however rests alone with the board and management."* (Pensionsmarkedsrådet, 2007).

	<p>There is no Danish law that prevents institutional investors to invest in unethical companies as long as the companies are legal (Forsikring & Pension, 2010).</p> <p>EXTRA-FINANCIAL DISCLOSURE</p> <p>On 16th December 2008, the Danish parliament adopted "Act amending the Danish Financial Statement Act (Accounting for Corporate Social Responsibility (CSR) in large businesses)". The aim of the law is to encourage businesses to take an active position on CSR and communicate this to the outside world. The statutory requirement is part of the first National Action Plan for Corporate Social Responsibility (May 2008). The law requires large businesses in Denmark to account for their work on CSR. In 2013 a new requirement was introduced into the law making it mandatory for businesses to also expressly account for their policies for respecting human rights and for reducing their climate impact. Danish businesses are free to choose whether or not they wish to work on CSR. However, the statutory requirement means that the businesses must account for their policies on CSR, or state that they do not have any.</p> <p>Institutional investors, mutual funds and listed financial businesses must also report on their CSR. The Danish financial sector is subject to reporting requirements for social responsibility corresponding to the requirements of the Financial Statements Act. <u>Paragraph 98</u> of the Act states that if a trustee has policies for RI, then these must be made public. There are no formal requirements or detail reporting requirements.</p>
<i>Overview of duties</i>	<p>Pension fund managers:</p> <ul style="list-style-type: none"> ▪ Investment decisions must be based on highest possible return, taking into account the risks; ▪ Funds have to be invested in an appropriate and, for the insured, 'expedient' way; ▪ There must be adequate security that the company at any time can fulfil its obligations. <p>Insurance companies:</p> <ul style="list-style-type: none"> ▪ Investment decisions must be based on highest possible return, taking into account the risks; ▪ Funds have to be invested in an appropriate and, for the insured, 'expedient' way; ▪ There must be adequate security that the company at any time can fulfil its obligations; ▪ Must have assets whose total value at any time is at least equal to the value of its total technical provisions; ▪ Ensure diversification (no excessive reliance on a particular asset class, investment market or a particular investment).
<i>Controls and sanctions</i>	<p>The Danish Financial Statement Act supervises whether individual investments comply with the relevant enterprise's investment policy and guidelines. When the Danish FSA makes an on-site inspection, among other things it checks whether the board of directors has prepared the investment policy it should according to legislation. The Danish FSA also checks whether, on the basis of this policy, the board</p>

	<p>of directors has issued written guidelines to the executive board. However, the Danish FSA does not conduct systematic supervision of whether specific investments comply with the policies and guidelines.</p>
<p><i>ESG integration in investment decision making</i></p>	<p>According to a survey of ten Danish investors (all signatories of UN PRI), most of the investors take ESG into consideration (Bang-Olsen, 2012). This is mostly because it is believed to be financial relevant. There are a few exceptions. Some investors believe that ESG performance does not affect the value in neither way, positive or negative. All of the investors do therefore use ESG information in investment decisions and all of the ESG policies are built on international recognised conventions and other quasi laws. Even if PRI recommends their signatories to investigate their beneficiaries' views, most of them do not. Only one signatory has done so with the effect that the pension fund integrates a high degree of ESG. Some do have a positive approach to RI with selection of investments because of their positive ESG characteristics.</p> <p>Almost all of the biggest Danish financial institutions are signatories of the UN PRI. Financial companies can fulfil the Danish legal requirements of CSR by publishing their UN PRI reporting (BEK1310 § 132, stk. 6).</p> <ul style="list-style-type: none"> ▪ Over 90% of investments with Danish institutional investors are covered by policies for responsible investment, where companies are screened for whether they produce weapons covered by international conventions (Oslo & Ottawa) (DCfCR, 2014). Regarding pension funds over 99% are covered by policies against investment in weapons covered by international conventions. ▪ PRI represents 55% of the assets under management in Denmark (Dansif, 2014). 44 of the 50 largest institutional investors in Denmark have a Responsible Investment policy. These 44 investors represent 99% of the combined assets under management. According to a survey done by Dansif, 24% of the survey respondents say that the UN Guiding Principles are fully integrated into the investment process, while 48% say they are to some extent integrated. ▪ Screening, such as value-based and norm-based screening, continues to be the most widely used responsible investment tool for ESG incorporation among the largest Danish institutional investors. Integration is becoming more widely used for listed equity, but it is used in combination with screening and not alone (Dansif, 2014). ▪ Assurance and pension companies usually publish exclusion lists on their websites or in connection with annual reporting on responsible investments activities. A few pension companies do not publish regular exclusion lists. However, it is usually possible to have these supplied on request. ▪ The CEO, CIO and/or an investment committee have the main oversight of Responsible Investment, but board members have increasingly oversight responsibility too. The implementation is driven by dedicated ESG staff and portfolio managers. ▪ In general, most Danish pension funds believe that RI provides the highest returns on the long-term.

*International,
national,
sectorial and
individual
initiatives*

PROMOTION & AWARENESS

- DanSIF: company's objective is to spread and exchange experiences among its members (institutional investors but also other organisations) as well as to facilitate a diversified debate on ESG.

PRIVATE INITIATIVES

- ATP: in 1997 the Supervisory Board of ATP (the largest pension fund in Denmark based on a collective agreement) decided that in order for it to maximise its returns it should take ESG aspects into consideration. ATP has been a signatory of UN PRI since the beginning (2006). ATP organises information events where some of ATP's members can vote and express their opinion, but the objective is rather to let ATP explain their decisions.

ATP in Denmark has set up their own clean energy fund and are inviting other pension funds to join them (OECD, 2013). Pension Denmark make their own direct project equity or debt investments or are investing in clean energy funds run by third parties (OECD, 2013).

- Unipension: the pension fund for academics has 97,000 members and manages DKK 100 bn (EUR 13 bn) of assets. A survey among their members in 2012, showed that they supported responsible investments and that they would even forego maximum return, if necessary (Unipension, 2012).
- Danske Bank: its RI policy is based on avoiding investments in companies that breach recognized standards and norms in, for example, human rights. This is taken as a proxy for their beneficiaries' opinion. RI is however not a driver for higher returns for Danske Bank.
- Fossil fuel divestment: Denmark's largest pension fund, PFA, has excluded tar sands companies in their investments. In March 2015, PKA, the fourth largest pension fund, decided to exclude over 30 coal mining companies from their investment universe (PKA, 2015). The companies that were blacklisted generate more than 90% of their business from coal. The decision was based on both climate concerns and financial risk. For companies where 50-90% of their business comes from coal, PKA will engage with their management to encourage them to reduce their involvement in coal. Exclusion of investments based on ESG criteria (i.e. divesting) depends on where other investments can be made without compromising financial returns and risk.
- Fossil fuel divestment: Members of six other pension funds representing €32 billion voted recently on divesting from coal, tar sands, Arctic and deepwater oil and gas exploitation (Guardian, 2015). Although members of three of the funds voted in favour, it is still up to the board of the pension funds to decide and take responsibility for their own investment policy (Politiken, 2015). The Danish Financial Supervisory Authority has said that they will not intervene if an institutional investor excludes certain companies or sectors (Politiken, 2014).

<i>Recent / future developments</i>	<p>Discussions about bans against investments in weapons subject to the conventions (DCfCR, 2014).</p> <p>The Danish Council for Corporate Responsibility (Rådet for Samfundsansvar) recommends that the sector associations (DCfCR, 2014):</p> <ul style="list-style-type: none"> ▪ Enhance voluntary measures by institutional investors by following the UN-backed Principles for Responsible Investment, including principle no. 6 on reporting and principle no. 5 on cooperation in order to implement policies for responsible investments. ▪ Share knowledge about policies for responsible investments, including on screening and exclusion (e.g. publishing which enterprises are excluded because of their activities regarding weapons subject to the conventions as well as reasons for the specific exclusion.)
<i>People interviewed</i>	<ul style="list-style-type: none"> ▪ Ole Buhl, Head of ESG at ATP, Denmark's largest pension and social security provider. ▪ Søren Larsen, Head of RI at Nykredit, one of Denmark's leading financial services companies with activities ranging from mortgage, retail and investment banking to insurance, leasing and fixed income trading and asset management.
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- www.nationalbanken.dk Central bank of Denmark



France

Summary

France is one of the biggest markets for asset management in Europe. As a result, the debate about responsible investing emerged quite early in the industry and the legal framework is among the most supportive in the EU.

The French financial markets regulator, the AMF, does not refer explicitly to the “fiduciary duties” of French investors. Nevertheless, the ideas of that concept are widely echoed in legal texts, highlighting the primacy of customers’ interest, transparency, fairness, integrity, diligence, etc. Besides those texts, the AMF published also positions/recommendations among which two are dealing with the need to be transparent when dealing with Responsible Investment funds.

France has been one of the first countries to require by law French companies to disclose ESG information and to have this information verified by a third party. But extra-financial disclosure does not only apply to companies: with the Monetary and Financial Code, funds must also state in their annual report the ways in which their investment policies take into account criteria for meeting ESG goals. A new law adopted in July 2015 requires institutional investors to disclose their policy toward climate change. In addition, two national labels have been launched in order to give more visibility to RI funds: the first on broad RI funds and the second on thematic funds in connection with the energy transition.

On top of these regulations, soft law has also a key role in the development of RI in France: the Transparency Code from Eurosif, AFG and FIR is now a standard in the industry and several labels market transparency for investors (Novethic, Finansol, CIES). Many organisations are prompting discussions and fuelling the debates.

The French asset management industry relies mostly on institutional investors and these are boosting ESG integration by setting specific policies or by demanding ESG expertise in their tender. On the other hand, the retail market is still low for sustainable investments. Overall, the RI market reached EUR 223 billion in 2014 but in parallel, more and more investors are partly taking into account ESG issues. The primary strategy for RI is by far best-in-class, almost 90% of the total.

Professionals in the French asset management industry are proactive toward ESG integration. Among the signatories of the Portfolio Decarbonisation Project, 2 out of 5 asset managers (Amundi and Mirova) and 2 out of 9 asset owners (RAFP and FRR) are French. Also, some market players are highly taking part in the debates on the impacts of climate change for the financial industry.

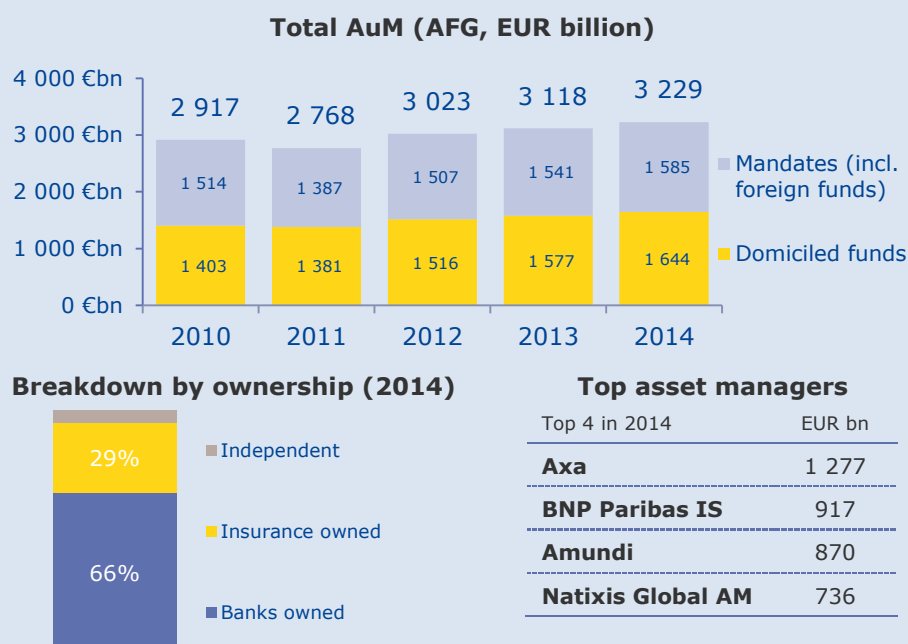
Financial market attributes

MUTUAL FUNDS

In France, when individual or institutional investors delegate the management of their savings or capital to a financial intermediary (generally an asset management company), two forms can be distinguished:

- Portfolio management or individual management under a mandate from an individual, company or institutional investor;
- Collective management through a collective investment scheme such as a mutual fund or a unit trust.

More than **600 asset managers** manage more than **EUR 3 trillion of assets** on the financial markets.



There are two main types of schemes in the country, which are distinguished solely on the basis of their legal structure:

- The **Société d'Investissement à Capital Variable (SICAV)**, or open-end investment companies, which is incorporated as a legal person like any other company. The investors own shares in the SICAV, which are issued as and when subscription orders are received.
- The **Fonds Communs de Placement (FCP)**, or unincorporated common fund, where investors own units in the fund.

RETIREMENT & WORKPLACE SAVINGS

On top of the basic pension, the workforce benefits from mandatory supplementary schemes: **ARRCO** and **AGIRC** for the private sector, **RAFP** and **IRCANTEC** for the public sector. The French State created in 2001 the *Fonds de Réserve pour les Retraites (FRR)*, a buffer fund that aims at "building up reserves to help ensure the long-term future of eligible retirement plans".

In parallel, private sector employees can invest in company savings plans, such as an employee savings plan (**PEE**), an intercompany saving plan (**PEI**) or a collective retirement savings plan (**PERCO**). In mid-2014, AUM totalled EUR 111 billion, including EUR 10 billion in PERCO. Nearly 188,000 companies of all sizes offered PERCOs to their employees and 1,755,000 of them had already made a contribution.

Last but not least, another funded scheme is the individual pension plan (**PERP**), which is a life insurance policy that comes with major tax breaks. PERPs are open to everyone and provide a defined annuity on retirement.

<p><i>Definition of fiduciary duty</i></p>	<p>The reference to a “fiduciary duty” is not commonly used in France:</p> <ul style="list-style-type: none"> ▪ Responsabilité/Devoir/Obligation fiduciaire (= “fiduciary duty”) ▪ Déontologie, éthique des affaires (=“(business) ethics”) ▪ Règles de bonne conduite (= “code of conduct/ethics”) <p>In 1989, the Commission des opérations de bourse (forerunner, with the Conseil des marchés financiers and the Conseil de discipline de la gestion financière, of the Autorité des Marchés Financiers) published a report on “ethics” (déontologie) in the financial markets.</p> <p>Today, the Autorité des Marchés Financiers (AMF) which regulates participants and products in France’s financial markets, refers to a “Code of conduct” and, for its part, the French Asset Management Association (AFG), alludes to a “Code of Good Practice”.</p> <p>In all concepts, fiduciary duty is based on self-regulation in the financial industry. Two cardinal principals emerge: the primacy of the customer’s interest and market integrity.</p> <p>These principles entail an obligation to ensure proper disclosure and transparency in relation to customers, prevent and manage conflicts of interest, treat all customers equally, control employees’ transactions, and prevent money laundering.</p>
<p><i>Legal framework for fiduciary duties</i></p>	<p>FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY</p> <p>In France, financial markets are regulated by the Monetary and Financial Code and by the Commercial Code.</p> <p>Article L.541-8-1 of the Monetary and Financial Code states that financial investment advisors must act honestly and fairly in the best interests of their clients.</p> <p>In application of these codes and of its own General Regulation (AMFGR), the <i>Autorité des Marchés Financiers</i> (AMF) regulates, authorises, monitors and, where necessary, conducts investigations and issues sanctions. In addition, it ensures that investors receive material information, and provides a mediation service to assist them in disputes.</p> <p>The AMFGR regulates all participants and products on French financial markets, including what stands as their fiduciary duty:</p> <ul style="list-style-type: none"> ▪ Undertakings for the collective investment in transferable securities (UCITS) and mandates portfolio managers (articles 313-18 et seq. and 314-1 et seq.); ▪ Alternative Investment Fund (AIF) managers (articles 318-12 et seq. and 319-1 et seq.). <p>In parallel, through the decision of the AMF Board, the AFG’s Code of Ethics have become a standard which now applies to the entire asset management industry, including AFG’s members, non-member asset management companies and other investment service providers managing portfolios on behalf of third parties.</p> <p>EXTRA-FINANCIAL DISCLOSURE</p> <p>Rules and regulations do not state on the inclusion or not of ESG criteria within fiduciary duty. Nevertheless, the three legislations previously mentioned are all pushing for more transparency regarding ESG information.</p>

Monetary and Financial Code:

- article L.541-8-1 states that financial investment advisors must make inquiries of their clients before offering any advice concerning their knowledge of, and experience in, investment matters, as well as their financial situation and their investment objectives, so as to be able to recommend to them transactions, instruments and services which are appropriate to their situation.
- article L.533-22-1 states that UCITS and the management companies shall mention in their annual reports and documents dedicated to the information of the investors how ESG issues are taken into account in their investment policies. They shall spell out the nature of the criteria used and the way they apply the criteria in accordance with the presentation rules defined in article D533-16-1. In addition, they shall mention the way they use their voting rights related to the financial instruments concerned.
- article L.214-164 provides that the regulation of AIFs shall precise the ESG issues that the management company must comply with. Moreover, the annual report of the fund shall be accountable of their application.
- article L.214-12 has been modified by the Grenelle 2 Act (12 July 2010) so that open-ended investment companies and management companies must state the ways in which their investment policies take into account criteria for meeting social, environmental and quality-of-governance goals. They shall stipulate the nature of the criteria and how these criteria are applied. They shall indicate how they exercise the voting rights attached to the financial instruments that result from these choices.

AMF positions:

- Position n°2007-19 is the first position from the AMF dealing with the integration of extra-financial criteria. It focuses on UCITS and AIF that declare themselves to be compliant with Islamic law, or Shari'ah. The selected extra-financial criteria must comply with all prevailing regulatory and statutory requirements. For example, criteria based on the race or religion of the managers of the companies invested in by the fund cannot possibly be admitted because they violate public policy principles.
- Recommendation 2011-05 invites the UCITS managers to describe the extra-financial criteria they use, into: the Key Investor Information Document (KIID); the annual reports; the website of the management company; the prospectus; any document that presents the investment policies. There are no other legal or regulatory requirements to include ESG matters in investment policies. Nevertheless, it is a common practice in the asset management industry for RI funds.

Commercial Code: the NRE Law in 2001 (article 116) and then the Grenelle 2 Act in 2010 (article 225) amended the article L.225-102-1 so that companies (public and private, listed but also unlisted if larger than 500 employees) disclose ESG information and have them verified by an independent third party.

<p><i>Overview of duties</i></p>	<p>In its General Regulation, the AMF refers to the conduct of business rules and highlights the primacy of the client's interest and market integrity.</p> <p>For all collective investment scheme (CIS) management activity, investment services providers shall:</p> <p>1° ensure that the unit holders and shareholders of the same CIS are treated fairly;</p> <p>2° refrain from placing the interests of any group of unit holders or shareholders above the interests of any other group of unit holders or shareholders;</p> <p>3° apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market;</p> <p>4° ensure that fair, correct and transparent pricing models and valuation systems are used for the CIS they manage, in order to comply with the duty to act in the best interests of the unit holders and shareholders. Management companies must be able to demonstrate that the CIS portfolios have been accurately valued;</p> <p>5° act in such a way as to prevent undue costs being charged to the CIS and its unit holders or shareholders;</p> <p>6° ensure a high level of diligence in the selection and ongoing monitoring of investments, in the best interests of CIS and the integrity of the market;</p> <p>7° ensure they have adequate knowledge and understanding of the assets in which the CIS are invested;</p> <p>8° establish written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the CIS are carried out in compliance with the objectives, investment strategy and risk limits of the CIS;</p> <p>9° when implementing their risk management policy, and where it is appropriate after taking into account the nature of a foreseen investment, to formulate forecasts and perform analyses concerning the investment's contribution to the CIS portfolio composition, liquidity and risk and reward profile before carrying out the investment. The analyses must only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.</p>
<p><i>Controls and sanctions</i></p>	<p>The AMF supervises UCITS managers, AIF managers and mandates portfolio managers. This Authority does not conduct systematic supervision of whether specific investments comply with a manager or a trustee's policies and guidelines. However, the AMF performs several random and/or scheduled controls of entities concerning their commercial practices. In this context, the AMF can control the integrity of the statements included in marketing materials (including the validity of ESG statements).</p>
<p><i>ESG integration in investment decision</i></p>	<p>ASSET MANAGERS</p> <p>According to Novethic, pure RI products reached EUR 223 billion in 2014 (+31% compared to 2013) and ESG integration (i.e. financial valuation of ESG issues and implementation of some ESG constraints)</p>

making	<p>was methodically applied on EUR 356 billion of assets (+22%).</p> <p>Primary strategy for RI products is by far best-in-class. It represents 90% of total assets. Strategies are often combined, for instance by adding norm-based exclusions to a best-in-class strategy.</p> <p>ESG integration for its part is largely boosted by insurance companies that want to use ESG analysis, but not as systematically as they would with an SRI fund.</p> <p>ASSET OWNERS</p> <p>Most of institutional investors are defining RI policies to be implemented in their dedicated mandates. Insurers account for two thirds of responsibly invested assets in France.</p> <p>FRR's assets (<i>Fonds de Réserve pour les Retraites</i>) reach EUR 36.3 billion as of 31 December 2013. The FRR launched its first RI RFP in 2003 and drafted a RI strategy for the period 2005-08 and for the period 2008-12. The FRR particularly focuses on the competencies regarding ESG evaluation when assessing its investment managers. Currently, the 2013-17 socially responsible investment strategy is based on four core objectives:</p> <ul style="list-style-type: none"> ▪ Expanding the integration of ESG factors into asset management; ▪ Conducting social responsibility (protecting the reputation of the FRR by excluding controversial companies and tax havens from investments); ▪ Exercising the FRR's voting rights; ▪ Contributing to research on Responsible Investment and supporting international initiatives. <p>This strategy relies on the FRR's RI Principles, based on four main areas: Human rights, Labour standards, Environment and Anti-corruption.</p> <p>AGIRC and ARRCO do not include RI strategies. Nevertheless, RAFP (EUR 15.3 billion of assets as of end 2013) and IRCANTEC (EUR 8.7 billion as of end 2014) both signed the PRI and adopted a 100% RI approach. RAFP, one of the world's largest public pension funds in terms of members, even announced in September 2014 that it was working with Amundi on a methodology aimed at significantly reducing the carbon footprint of a EUR 750 million portfolio.</p>
International, national, sectorial and individual initiatives	<p>CODES</p> <ul style="list-style-type: none"> ▪ <u>Eurosif – AFG – FIR Transparency Code</u>: all French retail RI funds must adhere to this code, elaborated by the French Asset Management Association (AFG), the European Sustainable Investment Forum (Eurosif) and the French SIF (FIR). The Code is meant to make RI fund policies easier to understand and to establish a common, unified set of best practices for transparency. As of 30 March 2015, 308 funds managed by 42 asset managers have signed the Transparency Code. <p>LABELS</p> <ul style="list-style-type: none"> ▪ <u>Novethic RI Label</u>: Novethic is a research centre specialised in responsible investment. It launched in 2009 the first European label for RI funds. The label promotes the integration of ESG criteria (ESG analysis of at least 90% of the portfolio), transparency and extra-financial reporting. In 2014, 111 funds were certified against

	<p>the Novethic RI Label.</p> <ul style="list-style-type: none"> ▪ Finansol Label: the Label was introduced in 1997 to promote impact investing. The two main criteria are solidarity (5-10% of the fund's assets must be invested in social businesses and the remaining must respect ESG criteria) and transparency. More than 130 funds are labelled. ▪ CIES Label: the <i>Comité Intersyndical de l'Épargne Salariale</i> (CIES) which promotes company saving plans designed a Label since 2002 to encourage sustainable investments. As of 30 June 2014, 15 funds have been certified. <p>PROMOTION & AWARENESS</p> <p>In addition to the organisations previously mentioned, those below are also contributing to raise the awareness of</p> <ul style="list-style-type: none"> ▪ French Observatory for Social Responsibility (ORSE): ORSE is a membership non-profit organisation studying and promoting CSR, including responsible finance and sustainable investment via the ORSE Finance Club. About 30 of its members are financial institutions. ▪ Paris EUROPLACE: the organization in charge of promoting and developing the Paris financial marketplace. It launched in 2007 the financial cluster FINANCE INNOVATION which is built around five areas for action, including the promotion of sustainable social and environmental innovation in finance. It published in 2013 10 Principles to develop a sustainable finance in Europe.
Recent / future developments	<ul style="list-style-type: none"> ▪ Public RI Labels: since 2012, the French government has developed the idea of a public RI Label. In September, two labels have been launched: one dedicated to the funds marketed as "SRI funds" and another to the investment funds that aim at financing the energy transition. ▪ Law for an energy transition: on July 22, France has passed the Energy Transition Law including the text on mandatory climate impact and carbon / climate risk reporting for institutional investors (article 48). Institutional investors shall include in their annual report, and make available to their beneficiaries, information on how their investment decision-making process takes ESG criteria into consideration, and the means implemented to contribute to the financing of the ecological and energy transition. The decree has not been issued yet by the time this report was finalised.
People interviewed	<ul style="list-style-type: none"> ▪ Edouard Fernandez-Bollo, General Secretary at the <i>Autorité de contrôle prudentiel et de résolution</i> (ACPR) which is responsible for supervising the banking and insurance sectors in France. ▪ Paulo Gemelgo, Head of Legal Expertise, Operational Policy and Complex Management in the Asset Management Department of the <i>Autorité des Marchés Financiers</i> (AMF) which regulates participants and products in France's financial markets. ▪ ▪ Philippe Desfossés, CEO at ERAFP which is the main French public service additional pension scheme. ▪

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- www.amf-france.org Financial markets regulator
- www.afg.asso.fr French Asset Management Association
- www.novethic.fr Media and research centre on RI

Germany



Summary

German institutional investors manage assets with a value of around EUR 1.3 trillion. Although German institutional investors have been relatively slow to commit to the UN Principles of Responsible Investment, when counting sustainable and responsible investments in the broader sense, over 70% of investments are covered. Best-in-Class and Exclusions are the most popular strategies.

In the context of investment decisions, there is no legal term equivalent to fiduciary duty in Germany. Duties of investors are set forth in the general rules of conduct as well as the investment principles and comprise the provision of services with the necessary expertise, care and diligence in the interest of the investor as well as requirements for the security of investments. The law for investment funds reads as follows: the investment management company when discharging its responsibility acts independently from the depository and in the sole interest of investors.

On a federal level, supervisory authorities are the Federal Financial Supervisory Authority (BaFin) and the German Bundesbank, which are in most cases responsible for both the granting of licences (with respect to investment management companies, only BaFin is responsible) as well as the ongoing supervision of fiduciary duties.

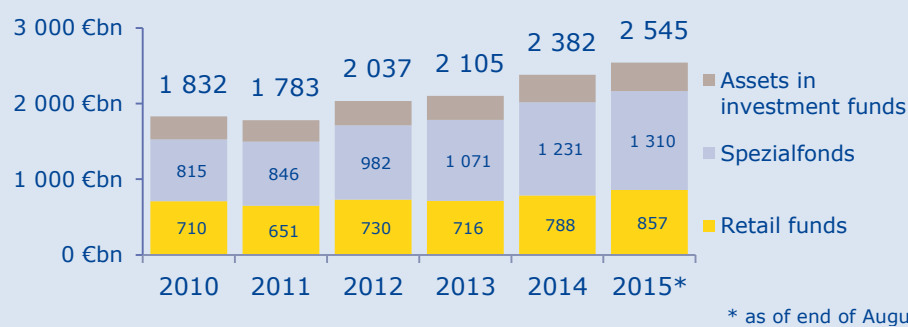
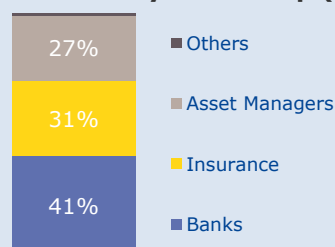
Under German legislation, the integration of ESG issues into investment policies is principally not required by law, but permitted under the condition that other mandatory investment principles are respected. In some cases, however, institutional investors must inform about how they consider ESG issues when making investments.

ESG issues are expressively included in several legal texts:

- There is an obligation to report on ESG criteria for pension funds, direct insurance companies, pension companies, and companies providing contracts for private retirement provisions according to the law for the certification of contracts for private retirement provisions.
- According to the German Commercial Code, large companies and groups have to include non-financial performance indicators in their status report or group management report, insofar as this information is relevant for the understanding of the business performance.
- The BaFin explicitly takes into account reputational risks in its Minimum Requirements for Risk Management.
- The German Sustainability Code drafted by the German Council for Sustainable Development is a framework of reporting compliance with sustainability.
- The BVI Guidelines on responsible investment contain a voluntary self-commitment, obligating its members to take measures independently to adequately include general accepted principles on sustainability in the investment process.

Financial
market
attributes**MUTUAL FUNDS**

German investment companies manage a total of about EUR 2,545 billion (70 % of the German GDP) of which more than 50% can be attributed to institutional investors²⁸. The latter manage assets with a value of around EUR 1,310 bn (institutional funds) based on an estimate of the German Investment Funds Association (August 2015).

Total AuM (BVI, EUR billion)**Breakdown by ownership (2014)****Top asset managers**

Top 4 in 2014	EUR bn
Allianz	1 800
DWS / DeAWM	1 000
Union Investment	232
DekaBank	220

CORPORATE AND PRIVATE PENSIONS

The German pension system is based on a three-pillar model. The first and most dominant form of pension is the **statutory scheme** (gesetzliche Rente): it makes up 81 % of all pension benefits and is the largest social insurance system. The second and third pillars are **corporate and private pensions** which account respectively for 6 and 12 %.

Definition of
fiduciary duty

The following terms apply when dealing with fiduciary duty in German:

- Treuepflicht (= "duty of loyalty")
- Treuhänderpflicht (= "duty of the fiduciary")
- Treuhänderische Pflicht (= "fiduciary duty")

Legal
framework
for fiduciary
duties**The German Capital Investment Code (Kapitalanlagegesetzbuch – KAGB)**

The German Capital Investment Code is the statutory basis for managing both open-ended and closed-ended funds and transposes the EU AIFM Directive. It entered into force in 2013 and replaced the previous German Investment Act (*Investmentgesetz*). The Code lists the general Conduct and Organisational Rules for German regulated capital management companies (*Kapitalverwaltungsgesellschaft* –

²⁸ This figure assumes that institutional investors only invest in institutional funds. In practice, they also invest in retail funds; however, there are no exact numbers available.

KVG).

The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin)

The German Federal Financial Supervisory Authority is responsible for the supervision of banks, financial services institutions and insurance undertakings. Deutsche Bundesbank is sharing supervisory duties with BaFin regarding the supervision of banks (but not investment management companies or insurance undertakings). It is an independent federal institution under the supervision of the Federal Ministry of Finance. The responsibilities of the Financial Supervisory Authority are mainly stipulated in the **Law on the Federal Financial Supervisory Authority (Finanzdienstleistungsaufsichtsgesetz, FinDAG)**. Further relevant legal statutes are the **German Banking Act (Kreditwesengesetz, KWG – for asset managers)**, the **KAGB (for investment management companies)**, the **German Securities Trading Act (Wertpapierhandelsgesetz, WpHG – for asset managers)**, the **German Insurance Supervision Act (Versicherungsaufsichtsgesetz, VAG – for insurance undertakings, which may be institutional investors)** and the **Capital Requirements Regulation (Kapitaladäquanzverordnung, CRR – for investments by banks)**.

For the interpretation of the KAGB's conduct rules (see above), the BaFin uses the **Provisions of the German Regulation specifying the Conduct and Organisational Rules of the KAGB (Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsregeln nach dem KAGB – KAVerOV)** and the European Commission's Delegated Regulation.

The BaFin explicitly takes into account reputational risks in its **Minimum Requirements for Risk Management (MaRisk)**. The latter specifies the requirements set out in section 25a of the German Banking Act (*Kreditwesengesetz – KWG*) with regard to the risk management of credit institutions.

Relevant for investment management companies are the minimum requirements for risk management for investment management companies²⁹ where reputation is also mentioned (sec. 4.1.2.d).

The German Bundesbank (Deutsche Bundesbank)

Besides BaFin, the Deutsche Bundesbank is also responsible for the supervision of banks and financial institutions. The Deutsche Bundesbank is a direct federal legal entity governed under public law. The responsibilities of the Deutsche Bundesbank are mainly stipulated in the **Law on the German Bundesbank (Gesetz über die Deutsche Bundesbank – BBankG)**

The German Securities Trading Act (Wertpapierhandelsgesetz – WpHG)

The German Securities Trading Act is the statutory basis for providing investment services (*Wertpapierdienstleistungen*). The Act contains general rules of conduct for investment services undertakings, e.g. the provision of services with the necessary expertise, care and diligence in the interest of its clients (section 31, para. 1, no. 1 WpHG). Details

²⁹ https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Rundschreiben/rs_1005_wa_invmarisk.html

of such rules of conduct are stipulated in the Investment Services Conduct and Organisation Regulation (*Wertpapierdienstleistungs-Verhaltens- und Organisationsverordnung* – WpDVerOV).

In line with the AIFMD and UCITS Directive, these rules only apply to investment management companies with respect to the services of investment advice, safe-keeping and administration in relation to shares or units of collective investment undertakings reception and transmission of orders in relation to financial instruments.

The German Commercial Code (*Handelsgesetzbuch* - HGB)

According to the Accounting Law Reform Act (*Bilanzrechtsreformgesetz*) of 2004, the German Commercial Code (*Handelsgesetzbuch*) requires all companies since the financial year 2005 to include non-financial performance indicators (such as information on environmental issues and employee matters) in their year-end report (section 315, para. 1, sentence 4 HGB – group management report – and section 289, para. 3, section 267, para. 3 HGB – status report for large corporations).

The German Corporate Governance Code (*Der Deutsche Corporate Governance Kodex*)

The German Corporate Governance Code (*Corporate Governance Kodex*) presents essential statutory regulations for the management and supervision of German listed companies and contains, in the form of recommendations and suggestions, internationally and nationally acknowledged standards for good and responsible corporate governance. Companies have to explain to investors in case they do not adhere with the recommendations.

The Commission of the Code (*Regierungskommission Deutscher Corporate Governance Kodex*) reviews the code at least once a year in order to assess if it still reflects the best practice of good corporate governance or if it should be adapted.

The German Stock Corporation Act (*Aktiengesetz*)

According to section 161 of the German Stock Corporation Act (*Aktiengesetz*), listed corporations have to declare on an annual basis to which extent they comply with the recommendations of the German Corporate Governance Code. The statement is called declaration of compliance (*Entsprechenserklärung*). It must be made permanently available to shareholders and other interested parties on the company's website.

Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – VAG) & Corporate Pension Act (*Gesetz zur Verbesserung der betrieblichen Altersversorgung* – BetrAVG)

The Insurance Supervision Act (*Versicherungsaufsichtsgesetz*) is the relevant legal framework for all insurance companies. Corporate pension is regulated by the Corporate Pension Act (*Gesetz zur Verbesserung der betrieblichen Altersversorgung*).

Under the VAG, the obligation to report on ESG criteria includes:

- pension funds (Pensionsfonds)(section 115, para. 4 VAG),
- direct insurance companies (Direktversicherungen) (section 10a, para. 2 in conjunction with Annex D in conjunction with section 115, para. 4 VAG),
- and pension companies (Pensionskassen) (section 118b, para. 1 in

	<p>conjunction with section 115, para. 4 VAG).</p> <p>Law for the certification of contracts for private retirement provisions (<i>Altersvorsorgezertifizierungsgesetz - AltZertG</i>)</p> <p>The law for the certification of contracts for private retirement provisions (<i>Altersvorsorgezertifizierungsgesetz</i>) determines that companies have to annually report on whether they include ESG criteria in their products (section 7a, para. 1, sentence 2 AltZertG).</p> <p>Pension Fund Investment decree-law (<i>Pensionsfonds-Kapitalanlage VO</i>)</p> <p>It outlines pension funds' investment principles (see below).</p>
<p><i>Overview of duties</i></p>	<p>Pension fund managers:</p> <p>Pension funds' investment principles outlined in the Pension Fund Investment decree-law (<i>Pensionsfonds-Kapitalanlage VO</i>):</p> <p>Ensure that</p> <ul style="list-style-type: none"> ▪ The highest possible security and profitability are guaranteed ▪ There is sufficient liquidity ▪ And adequate spread of risks is guaranteed ▪ Investments are managed professionally to guarantee compliance with investment principles <p>Insurance companies:</p> <p>Outlined in the VAG and very similar to the ones for pension funds - including:</p> <ul style="list-style-type: none"> ▪ implementing adequate risk management and internal control procedures (section 64a VAG); ▪ highest possible security and profitability are guaranteed (section 54, para. 1 VAG); ▪ there is sufficient liquidity (section 54, para. 1 VAG), ▪ and adequate spread of risks (section 54, para. 1 VAG)). <p>For the investments of insurance undertakings, the German Investment Regulation (<i>Anlageverordnung - AnlV</i>) contains further requirements, such as the obligation to invest with due exercise and care (section 1, para. 2, sentence 1 AnlV).</p> <p>Mutual fund managers:</p> <p>The duties were outlined in the previous Investment Act (managing funds with the care of prudent businessman for the collective benefit of the investors) that was replaced by the German Capital Investment Code ("KAGB"). In particular, the duties are now outlined in section 26, para. 1 KAGB (manage investments in the sole interest of its investors), section 27 (conflicts of interests), section 28 (general organisational requirements), section 29 (risk management) and section 30 (liquidity management).</p> <p>Investment services undertakings (<i>Wertpapierdienstleistungsunternehmen</i>):</p> <p>The German Securities Trading Act contains general rules of conduct for investment services undertakings, e.g. the provision of services with the necessary expertise, care and diligence in the interest of its clients (section 31, para. 1, no.1 WpHG). Details of such rules of conduct are stipulated in the Investment Services Conduct and Organisation Regulation (<i>Wertpapierdienstleistungs-Verhaltens- und</i></p>

	<i>Organisationsverordnung – WpDVerOV).</i>
<i>Controls and sanctions</i>	<p>The Federal Financial Supervisory Authority (<i>BaFin</i>) – partly together with the German Bundesbank (<i>Deutsche Bundesbank</i>) – is responsible for the supervision of the financial industry (such as banks, financial service institutions, insurance undertakings and capital investment companies). Supervision is exercised through the obligation to have a license as well as through ongoing supervision. Sanctions comprise discretionary measures, formal administrative actions (e.g. ceasing of business operations, administrative fines).</p> <p>BaFin also performs checks for mutual funds when claiming ESG integration or when marketing “environmental funds”. The authority analyses the reports and looks at the portfolios with ECB investment statistics.</p>
<i>ESG integration in investment decision making</i>	<p>In the German-speaking countries, the UN PRI were long unknown – still in 2009, very few investors were among the PRI signatories. Today, the asset volume managed by signatories in the German-speaking countries represents 15% of the total PRI volume (Handelsblatt, 2014). In Germany, the number of signatories per category is as follows: 18 asset owners, 24 investment managers, 12 professional services partners (PRI, 2015).</p> <p>The German market of sustainable investments in the narrow sense (i.e. negative/positive screening) reached a volume of EUR 127.3 bn in 2014, corresponding to an increase of 9% compared to the previous year. Investment funds account for EUR 15.2 bn of the market (FNG, 2015).</p> <p>When adding sustainable investments in the broader sense (simple screening with one or two exclusion criteria, engagement and integration), the total market amounts to EUR 1.97 tn.</p> <p>Among seven key factors for the development of a sustainable investment market, German financial providers assign fiduciary duty the sixth position (FNG, 2015):</p> <ol style="list-style-type: none"> 1. Demand from Institutional Investors 2. Demand from Retail Investors 3. Legislative 4. External Pressure (NGOs, Media, Trade Unions) 5. International Initiatives 6. Notion of Fiduciary Duty 7. Materiality
<i>International, national, sectorial and individual initiatives</i>	<p>CODES & STANDARDS</p> <ul style="list-style-type: none"> ▪ <u>Deutscher Nachhaltigkeitskodex (DNK)</u>: the German Sustainability Code was drafted by the German Council for Sustainable Development (RNE) and was adopted on 13 October 2011. It is to be voluntarily applied by German businesses and organisations. Section 161 AktG (according to which listed corporations have to declare on an annual basis to which extent they comply with the recommendations of the German Corporate Governance Code, see above) is not applicable. The DNK is a framework of reporting compliance with sustainability. It contains 20 criteria, on the basis of which German businesses and organisations can show their commitment to sustainability by disclosing how they comply with

	<p>the criterion, or explain why they do not ("comply or explain"). The criteria are quantifiable, comparisons with other businesses and organisations are therefore possible. Criteria no. 11 to 13 deal with the environment, especially the use of natural resources, resource management and the volume of greenhouse gas emissions.</p> <ul style="list-style-type: none"> ▪ BVI Guidelines on responsible investment: The BVI Guidelines on responsible investment as drafted in November 2012 contain a voluntary self-commitment, obligating its members (capital management companies as well as foreign asset managers and fund providers related to the German market) to comply with soft law such as codes and to profess themselves to sustainability only in accordance with generally accepted principles (e.g. Exclusion criteria, positive lists, Best-in-Class-approach). <p>PROMOTION & AWARENESS</p> <ul style="list-style-type: none"> ▪ Forum Nachhaltige Geldanlagen (FNG): FNG is the industry association promoting sustainable investment in Germany, Austria, Liechtenstein and Switzerland. It has over 150 corporate members and is a founding member of the European umbrella organisation Eurosif. As of 8 July 2015, FNG has implemented the FNG label for sustainable mutual funds. The methodology is based on Eurosif's Transparency Code and FNG's Sustainability Profiles. The label methodology of the label comprises two sections to be audited: minimum requirements and grading system. The auditor is Novethic, France.
<i>Recent / future developments</i>	<p>In 2012, the Ministry of Consumer Protection of the Länder suggested the establishment of a mandatory consumer label for sustainable investments but currently, there is no political discussion of this issue in Germany. FNG has implemented such a quality label for mutual funds (see above).</p>
<i>People interviewed</i>	<ul style="list-style-type: none"> ▪ Dr. Thomas Neumann, Head of Investment Supervision for mutual funds at BaFin, the Federal Financial Supervisory Authority. ▪ Dr. Julia Backmann, Vice President at the German Investment Funds Association BVI
<i>References</i>	<p>Publications</p> <ul style="list-style-type: none"> ▪ FNG - Forum Nachhaltige Geldanlagen (2015), Marktbericht Nachhaltige Geldanlagen – Deutschland, Österreich und die Schweiz ▪ Eurosif (2011), Corporate Pension Funds & Sustainable Investment Study ▪ Handelsblatt (2014), Nachhaltige Investments – Business Briefing n°11 ▪ Umweltbundesamt (2013), Wege in die ökologische Kapitalmarktpolitik – Policy Paper im Rahmen des Vorhabens „Umweltschutzorientierte Weiterentwicklung des Kapitalanlage- und Investmentrechts“ <p>Websites</p> <ul style="list-style-type: none"> ▪ www.bvi.de German Investment Funds Association ▪ www.forum-ng.org Promotion of RI in Germany/Austria/Switzerland ▪ www.bafin.de Federal Financial Supervisory Authority

Italy



Summary

Institutional investors in Italy managed assets equivalent to a value of EUR 745 billion at the end of 2014. Institutional investors are now leading the Italian sustainable and responsible investment (SRI) market, with pension funds and foundations each covering 44% of the institutional market. The SRI approach that is typically followed is a prudent one, with the initial implementation of 'soft' ESG integration strategies and then the progressive introduction of other SRI strategies as Exclusions, Norms-based screening and Engagement.

The Commissione Nazionale per le Società e la Borsa (CONSOB) is the public authority responsible for regulating the Italian financial markets. Pensions funds are regulated by the Commissione di Vigilanza sui Fondi Pensione (COVIP).

The Italian Civil Code (article 1176) raises fiduciary duty topic highlighting the fact that it is expected the debtor shall use the diligence of a "good father of a family". In performing obligations inherent to the exercise of a professional activity the diligence shall be evaluated in consideration of the nature of the activity carried out.

The principles of fiduciary duty is also addressed in other pieces of legislation, e.g. the criteria and investment limits of the pension funds resources and the rules on conflict of interest (Ministerial Decree no.703 of 1996); general provisions and rules of conduct for investment and provisions on ethical or socially responsible financing (CONSOB Regulation no. 11522 (1998 – amended in 2007)); and, more specifically in respect of insurance reserves (Code of Private Insurance (Legislative Decree n. 209 of 7 September 2005)).

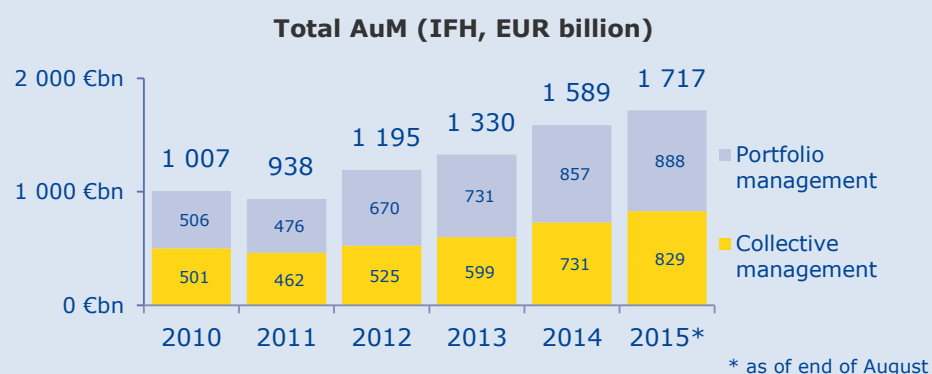
Although there is no specific legislation in Italy that prevents the integration of ESG issues into investment decision-making, the principle of maximising return for the beneficiaries prevails as the guiding principle for fund managers. On the other hand, if the objectives of the fund concerned explicitly state that ESG is to form part of the investment criteria, fund managers must take such issues into consideration. The 2011 Law on the Ratification and Implementation of the Oslo Convention excludes investments in landmines and cluster munitions.

Since 2005 pension funds must disclose whether and to what extent ESG factors influence their investment decisions and the exercise of their voting rights in their communication and in their annual reports. If used, it is mandatory for pension funds to communicate on the ethical, environmental and social criteria used in the statement of investment principles. In 2013, Assogestioni, the Italian association of asset managers, published a stewardship code for institutional investors that entrust to third parties the management of their assets, and are requested to share with their managers certain decisions on how to interact with the companies in which they invest.

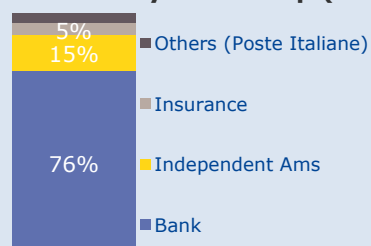
Financial market attributes

At the end of 2014, the size of the Italian market of asset management products exceeded EUR 1.6 billion, equivalent to more than a third of household financial assets and 85% of GDP. The breakdown by product type shows the prevalence of portfolio management services on a discretionary basis (mandates from institutional and retail clients represent respectively 48% and 7% of the total), followed by collective management products (opened and

closed mutual funds represent respectively 42% and 3% of the total). In 2013, assets under management grew by about 135 billion (+11%), thanks to new savings (+62.6 billion) and an important market effect (+6%, equivalent to more than 75 billion). 2013 results have more than offset the outflows recorded in 2011-12 and 2013 is the best result in terms of funds and portfolio management since full statistics are available on the Italian market as a whole.



Breakdown by ownership (2014)



Top asset managers

Top 3 in 2014	EUR bn
Generali	480
Intesa Sanpaolo	280
Pioneer / Unicredit	201

MUTUAL FUNDS & INSURERS

Insurance companies' reserves in Italy may be managed by the insurance company itself; alternatively, they may be managed on behalf of the insurance company by fund managers.

Investment funds and self-managed investment companies (SICAVs) – equivalent to mutual funds – also play an important role in the Italian investment landscape.

The major actors of the Italian asset management market belong to **groups: Generali (42% of total assets), Intesa Sanpaolo** (Eurizon Capital and Banca Fideuram together count for 18%), **UniCredit** (Pioneer Investments), **Italian Post and Allianz**. The management segment is relatively concentrated: **the first five groups represent more than 75% of assets**. The relationship between institutional and retail management is variable and reflects the composition of the reference customers: almost exclusively institutional for Generali, with a major role for retail component in many banking groups.

PENSION FUNDS

There are three different forms of retirement schemes in Italy: mandatory retirement schemes, complementary pension funds and supplementary pension funds. The pension funds under the two last forms are set up as segregated pools of assets and are managed by professional asset managers and insurance companies.

<p><i>Definition of fiduciary duty</i></p>	<p>The Italian definition of fiduciary duty is a translation of the standard concept:</p> <ul style="list-style-type: none"> ▪ I doveri fiduciari (= "fiduciary duty") ▪ La fiduciaria (= "trustee") ▪ Il fiduciante (= "trustor") ▪ Il dovere di diligenza, di lealtà, di buona fede (= "duty of care, loyalty, good faith")
<p><i>Legal framework for fiduciary duties</i></p>	<p>FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY</p> <p>The <i>Commissione Nazionale per le Società e la Borsa</i> (CONSOB) is the public authority responsible for regulating the Italian financial markets. Pensions funds, for their part, are regulated by the <i>Commissione di Vigilanza sui Fondi Pensione</i> (COVIP).</p> <p>Fiduciary duty is mainly addressed by the following regulations:</p> <ul style="list-style-type: none"> ▪ <u>The Italian Civil Code (article 1176)</u>: in performing obligations the debtor shall use the diligence of a good father of a family. In performing obligations inherent to the exercise of a professional activity the diligence shall be evaluated in consideration of the nature of the activity carried out. ▪ <u>Testo Unico della Finanza (Decree Law no. 3 of 24.1.2015)</u>: the decree modified past Legislative Decree no. 58 of 1998 and is aimed at bolstering the national economy, in particular the banking and investment sectors. ▪ <u>Ministerial Decree no.703 of 1996</u>: the regulation lays down rules on the criteria and investment limits of the pension funds resources and the rules on conflict of interest. ▪ <u>CONSOB Regulation no. 11522 (1998 – amended in 2007) on the regulation of intermediaries</u>: general provisions and rules of conduct for investment and non-core services (art. 26 to 31) and for collective asset management services (art. 48 to 55), Provisions on ethical or socially responsible financing (art. 55-bis and 55-ter). <p>More specifically in respect of insurance reserves, dedicated legislations include:</p> <ul style="list-style-type: none"> ▪ <u>Code of Private Insurance (Legislative Decree n. 209 of 7 September 2005 and article 3)</u>: The purpose of supervision is the sound and prudent management of insurance and reinsurance undertakings and transparency and fairness in the behaviour of undertakings, intermediaries and the other insurance market participants with regard to stability, efficiency, competitiveness and the smooth operation of the insurance system, to the protection of policyholders and of those entitled to insurance benefits as well as to consumer information and protection. <p>EXTRA-FINANCIAL DISCLOSURE</p> <p>Italian companies:</p> <ul style="list-style-type: none"> ▪ <u>Decree no. 32/2007, enforcing the EC Directive 2003/51</u>: regulation on the disclosure of environmental and employee matters for Italian companies, in both consolidated-annual reports and social-environmental reports. <p>The whole Italian financial sector:</p>

	<ul style="list-style-type: none"> ▪ <u>Law no. 262/2005, Provisions for savings protection and financial markets regulation (art. 14)</u>: CONSOB can give, with its own rules, the specific requirements of information and reporting that are required for insurances and qualified entities that promote products and services qualified as ethical or socially responsible. ▪ <u>CONSOB Decision no. 16190/2007 (art. 89 and 90)</u>: Asset managers and insurance companies offering products and services labelled as "ethic" or "socially responsible" are obliged to inform and account to investors in what way those qualifications have affected their investment choice. In particular, this decision focuses on SRI policy, ESG criteria and guidelines for the exercise of voting rights. <p>Pension Funds:</p> <ul style="list-style-type: none"> ▪ <u>Legislative decree no. 252/2005, "Discipline supplementary pension schemes" (art. 6 and 19)</u>: Pension Funds are obliged to include in their annual report and their communication to the investors whether and to what extent ESG criteria are adopted in the management of assets and in the exercise of voting rights. ▪ <u>COVIP Decisions, enforcing the decree no.252/2005</u>: "Adoption of statute, regulation and information schemes" (2006), "Provisions on communications to investors" (2010), "Provisions on the process of investment policy implementation" (2012). <p>Insurances :</p> <ul style="list-style-type: none"> ▪ <u>ISVAP (now IVASS since 2013) Regulation no. 35 (the "Regulation"), 2010</u>: on the disclosure duties of insurance undertakings (with particular reference to pre-contractual information to proposed insured) and the advertisement of insurance products. The main purpose of the Regulation is to strengthen the transparency and clarity the documents used in the offer of insurance products. It includes dispositions on the information to be disclosed on insurance products, labelled as "ethic" or "socially responsible".
<p><i>Overview of duties</i></p>	<p>Although there is no specific legislation or case law in Italy to prevent the integration of ESG issues into investment decision-making, the principle of maximising return for the beneficiaries prevails as the guiding principle for fund managers. On the other hand, if the objectives of the fund concerned explicitly state that ESG is to form part of the investment criteria, fund managers must take such issues into consideration.</p> <p>MUTUAL FUND MANAGERS:</p> <p>Under article 48 of Consob Regulation 11522 of 1998, as amended, asset management companies and SICAVs must:</p> <ul style="list-style-type: none"> ▪ Operate independently and according to the principles and general rules set forth under applicable laws; ▪ Comply with the investment objectives set out in the prospectus of the collective investment scheme they manage – <u>such objectives could include, for example, investment in environmentally sound companies only or exclude investment in tobacco or weapon producers</u>; ▪ Refrain from any conduct that might benefit one set of managed assets, including those managed in connection with the supply of

	<p>portfolio management services on an individual basis, at the expense of another;</p> <ul style="list-style-type: none"> ▪ Acquire adequate knowledge of the financial instruments, goods and other valuables in which the assets under management may be invested – although this means they must weigh up all the relevant considerations before committing themselves to an investment, there is no guidance on the extent to which ESG considerations can form part of the decision-making process; ▪ Operate so as to minimise the costs borne by the collective investment scheme they manage and obtain the best possible results from the services performed, on the basis of the investment objectives of the collective investment scheme. <p>PENSION FUND MANAGERS</p> <p>From Legislative Decree no. 58 of 1998:</p> <ul style="list-style-type: none"> ▪ act honestly, fairly and professionally in accordance with the best interests of their customers and the integrity of the market ('fair dealing'); ▪ disclose material interests; ▪ avoid conflicts of interest; ▪ meet 'know your customer' requirements (i.e. conduct of business rules) (Prior to providing any investment services to a customer for the first time and throughout the business relationship, the investment firm must seek to obtain from the customer information enabling it to determine whether the investment services envisaged are appropriate for the customer in light of his/her knowledge and experience in the investment field, investment objectives, risk profile, financial situation/capacity and any trading restrictions applicable to the customer). <p>The concept of fair dealing, importantly, includes acting in the best interest of customers, which, in turn, is interpreted as a duty to maximise profits deriving from investment activities.</p> <p>INSURERS:</p> <p>The applicable laws (Legislative Decree 174 of 1995 (life insurance law) and Legislative Decree 175 of 1995 (non-life insurance law)) governing the investment of insurance company reserves do not set forth specific principles constraining the discretion of the manager but only specify the types of eligible assets. The management of reserves must, however, be carried out in compliance with sound and prudent management criteria. In particular, in selecting investments, account must be taken of the need for safe investments, profitability, liquidity and diversification and spreading of investments.</p>
Controls and sanctions	<p>The Commissione Nazionale per le Società e la Borsa (CONSOB) is the public authority responsible for regulating the Italian financial markets. The CONSOB is ensuring:</p>

	<ul style="list-style-type: none"> ▪ transparency and correct behaviour by financial market participants; ▪ disclosure of complete and accurate information to the investing public by listed companies; ▪ accuracy of the facts represented in the prospectuses related to offerings of transferable securities to the investing public; ▪ compliance with regulations by auditors entered in the Special Register <p>It conducts investigations with respect to potential infringements of insider dealing and market manipulation law. However, the controls do not tackle specific issues on responsible investments.</p>
<p><i>ESG integration in investment decision making</i></p>	<p>In Italy, RI market growth is driven by that of institutional investors, for whom investment strategies are aligned with long-term considerations. On the other hand, Italian asset managers continue to underestimate the potential demand on RI products and services in the retail market, despite Italian households recovering their investment after the negative trends registered in 2011-2012.</p> <p>A survey carried out in 2013 by Forum per la Finanza Sostenibile, in collaboration with Doxametrics, on a sample group of the Italian population reveals that 45% of private investors are interested in RI and would consider RI products in their investment choices. A key role is obviously attributed to financial advisors and, indirectly, to asset managers. Transparency is considered by retail investors as important as ESG themes.</p> <p>Exclusions and Norms-based screening are the most popular RI strategies in Italy with respectively EUR 496 billion and EUR 352 billion AuM at the end of 2013.</p> <p>Nevertheless, all RI strategies registered growth in Italy between 2011 and 2013. This growth is aligned with the global growth of assets since the market is globally expanding in the country. For RI, much of that growth has been concentrated around Integration and Engagement and voting.</p> <p>Institutional investors such as Eurizon and Generali continue to lead the Italian RI market. Some asset managers like Banca Ethica Group are even developing advanced RI strategies. Pension funds and foundations each cover 44% of the RI institutional market. While the foundations segment continues to be dominated by one main actor, the pension funds segment is more diversified. The signals of interest registered in the past among pension funds have been translated into real RI practices; the approach typically followed is a prudent one, with the initial implementation of 'soft' disclosure practices and the progressive introduction of other SRI strategies such as Exclusions, Norms-based screening and Engagement.</p> <p>Of notice, pension fund Fondo Cometa (the Italian largest private pension investor) has made known that it will make extensive use of its voting rights and seek to have a stronger influence at shareholders' meetings: the board of Cometa's directors chooses which invested companies it should dialogue with on specific ESG controversies and defines how to approach them (for instance, setting up a collective initiative of investors or moving alone with an individual letter). However, there is no input from beneficiaries to adopt a SRI policy.</p>

	RI in Italy benefits from the overall development of the asset management industry but is still considered a moral consideration.
<i>International, national, sectorial and individual initiatives</i>	<p>CODES</p> <ul style="list-style-type: none"> ▪ <u>Assogestioni's Code for the Governance of Conflict of Interest</u>: this protocol is applied to the Italian asset management companies on a voluntary basis by a "comply or explain" mechanism. It provides recommendations regarding the identification of the conflicts of interest and procedures for the efficient management of those conflicts. <p>PROMOTION & AWARENESS</p> <ul style="list-style-type: none"> ▪ <u>Assogestioni</u>: the association of Italian asset managers has been active since 1994 in the promotion of adequate corporate governance practices both within the asset management industry and in the investee companies. ▪ <u>Forum for Sustainable Finance (FFS)</u>: companies and organizations, including Assogestioni, gather in the Forum for Sustainable Finance (FFS) part of the Eurosif network to promote and support the adoption of RI criteria in finance. FFS has organized training programmes and developed guidelines on how to make information to stakeholders about RI clear, accessible and effective. A position paper was released in September 2014 that contains a general RI definition and a check-list of the essential requirements to be classified as a specific RI strategy. The check-list is focused on the quality and transparency of ESG analysis, a common prerequisite for every approach, whether Exclusions or Impact investing. ▪ <u>The Charter of Sustainable and Responsible Investment of the Italian Finance</u>: in June 2011, the Italian representatives of the banking, insurance and financial sectors (ABI, ANIA and Assogestioni) and their Federation (FeBAF), co-signed the "Charter of Sustainable and Responsible Investment of the Italian Finance". The key principles which supported by the Charter are: <ul style="list-style-type: none"> ○ the key role to be played by sustainable and responsible investments practice and their integration within the more traditional financial analysis; ○ the importance of disclosure and transparency in the financial activity and in the implementation of RI principles; ○ the adoption of medium-long term view as a mean to alleviate market distortion caused by short-termism.
<i>Recent / future developments</i>	<p>A proposal to ban the financing of controversial weapons still has to be discussed by the competent bodies in the Italian Parliament. The draft law has been blocked since 2013 and despite a petition in 2015 to resume debate, the project remains deadlocked. In 2013-2014, other initiatives arose from political representatives, with the aim to provide fiscal benefits to SRI products. The latter regards government support toward financial instruments incorporating ESG criteria, as stated in the Guidelines for the Third Sector's Reform (put in consultation on May the 13th, 2014).</p>

<i>People interviewed</i>	<ul style="list-style-type: none">▪ Davide Dal Maso, Director at Forum per la Finanza Sostenibile whose mission is to enhance the awareness of Italian financial community on sustainability.▪ Maurizio Agazzi, Director of Cometa pension fund, the Italian national pension fund for workers in the metalworking & plant installation industry and related sectors, and the Italian largest private pension investor.▪ Manuela Mazzoleni, Head of Operations & Markets at Assogestioni, the representative association of the Italian investment management industry.
<i>References</i>	<p>Publications</p> <ul style="list-style-type: none">▪ Forum per la Finanza Sostenibile (2014), La normative italiana in tema di investimento sostenibile e responsabile▪ Forum per la Finanza Sostenibile (2012), La Carta dell'Investimento Sostenibile e Responsabile della finanza italiana▪ Assogestioni (2014), Factbook 2013 <p>Websites</p> <ul style="list-style-type: none">▪ www.consob.it▪ www.assogestioni.it▪ www.ifh.assogestioni.it▪ www.finanzasostenibile.it▪ www.bancaetica.it▪ www.cometafondo.it

The Netherlands



Summary

In the Netherlands, the asset management industry relies mostly on pension funds and almost 80% of AuM are managed under discretionary mandates. The market is mature and three companies have a leading role: APG, Robeco and Aegon.

Dutch regulators refer indirectly to “fiduciary duties” by requiring the asset management industry to promote “the interests of its clients in an honest, fair and professional manner”.

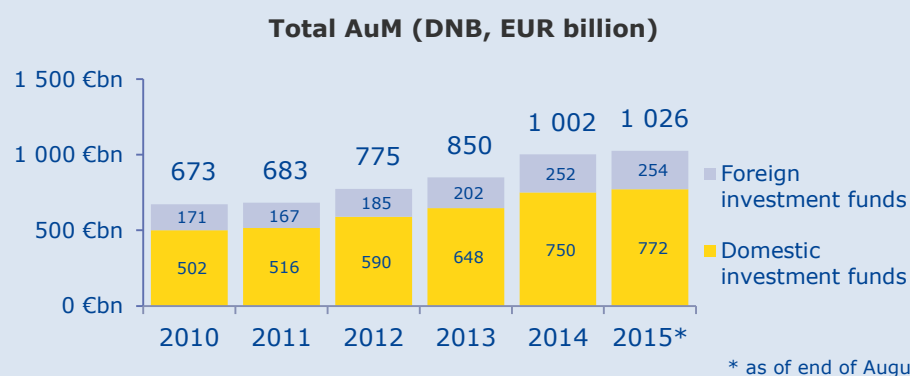
The Dutch legal framework does not particularly address the inclusion of ESG criteria in decision-making process but there is no ban either. Asset management must follow the prudent person rule. However, the law forbids the financing of cluster munitions producers to all financial institutions. To be noticed, the country did not yet implemented the European Directive as regards disclosure of non-financial and diversity information.

Nevertheless, APG, Aegon or PGGM have strong commitments in ESG integration and are boosting the RI market. But it must be mentioned that RI strategies may vary from one player to another, from dedicated RI funds and research to broad ESG integration in all assets. Almost all asset managers have signed the PRI and responsible investment assets reached EUR 2.7 trillion in the country in 2013, mostly based on exclusion strategy. For the moment, the pillar the most emphasised in ESG-related debates is governance, with various Codes and organisations addressing this topic. But the discussions are diversifying. The Code of the Dutch Pension Funds for instance asks for a full transparency regarding ESG policies and would require pension funds to make sure stakeholders support the investment strategy at hand. Also, the industry association Eumedion was first a platform on governance and is now dealing with broader ESG issues.

There is no new development ahead in terms of law, either hard or soft. Responsible investment in the Netherlands remains largely supported by asset managers and pension funds themselves.

Financial market attributes

Total AuM in the Netherlands reaches approximately **EUR 1 trillion** in 2014. The country has a singular place in the EU since over 80% of the AuM are discretionary mandates. It reflects the important role played by occupational pension schemes in asset management in the country.



	<p>Breakdown by ownership (2014)</p> <table border="1"> <thead> <tr> <th colspan="2">Top asset managers</th> </tr> <tr> <th>Top 4 in 2014</th> <th>EUR bn</th> </tr> </thead> <tbody> <tr> <td>APG</td> <td>401</td> </tr> <tr> <td>Robeco</td> <td>246</td> </tr> <tr> <td>Aegon</td> <td>240</td> </tr> <tr> <td>PGGM</td> <td>182</td> </tr> <tr> <td>ING</td> <td>180</td> </tr> </tbody> </table> <p>About 200 asset management companies intervene in the Dutch market but the largest players are APG, Robeco Group and Aegon Asset Management.</p> <p>The Dutch asset management industry is facing a period of consolidation, with managers having to invest heavily in new technology, seek out niche markets or move abroad to survive.</p> <p>Insurers for their part are experiencing difficulties on their core markets, and this had led several insurers to actively position themselves as broader providers of financial services, including collective or group pensions.</p> <p>The Dutch pension system may be characterised in terms of three pillars, namely:</p> <ul style="list-style-type: none"> ▪ Basic state old age pension under a statutory insurance scheme (first pillar – mandatory and public); ▪ Supplementary pension schemes by virtue of the employer (second pillar – mandatory and private); ▪ Private savings for retirement (third pillar – voluntary and private). <p>The legal framework of occupational pensions consists of the Pensions Act (PW), the 2000 Mandatory Participation in an Industry-Wide Fund Act (Bpf 2000), the Mandatory Pension Act for Professional Groups (WVB) and the Equalisation of Pension Rights in the Event of the Divorce Act (WVPS).</p>	Top asset managers		Top 4 in 2014	EUR bn	APG	401	Robeco	246	Aegon	240	PGGM	182	ING	180
Top asset managers															
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APG	401														
Robeco	246														
Aegon	240														
PGGM	182														
ING	180														
<p><i>Definition of fiduciary duty</i></p>	<p>In Dutch, the appropriate term for fiduciary duty is:</p> <ul style="list-style-type: none"> ▪ Fiduciair verplichtingen / Fiduciair plichten (= "fiduciary duties") ▪ PGGM is the only leader in the Dutch asset management industry which is referring namely to fiduciary. According to its website, the key question is: "what is the most suitable implementation form given your investment policy and your investment beliefs?" This suggests that fiduciary duties come from investors themselves and not the asset managers on behalf of them. 														
<p><i>Legal framework for fiduciary duties</i></p>	<p>FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY</p> <p>There are two regulators in the Netherlands: the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM).</p> <p>Act on Financial Supervision (Wet op het financieel toezicht):</p> <ul style="list-style-type: none"> ▪ <u>Section 4:90</u>: an investment firm shall promote the interests of its clients in an honest, fair and professional manner. <p>Financial Supervision Act (Wet financieel toezicht)</p>														

	<ul style="list-style-type: none"> ▪ <u>Article 21a</u>: the act forbids the financing of cluster munitions producers to all financial institutions, including banks, asset managers, insurance companies, pension funds, etc. <p>In the Pensions Act and the Pensions Act for Professional Groups, a number of mandatory provisions on communication exist but none refer to ESG issues.</p> <p>Pension Fund Act</p> <ul style="list-style-type: none"> ▪ <u>Article 135</u>: a pension fund will conduct an investment policy in accordance with the prudent person rule. ▪ <u>"Wet Versterking Pensioenfondsbestuur" bill</u>: increases transparency, security and knowledge regarding pensions in the Netherlands. It requires sufficient expertise of the board as internal supervision. <p>EXTRA-FINANCIAL DISCLOSURE</p> <p>While Directive 2014/95/EU is not yet implemented, there is no general legal obligation for companies and investors to report on the ESG impacts of their business.</p> <p>As for now, the Dutch Civil Code states that "non-financial performance indicators, including environmental and employee matters" can be disclosed in annual reports "if necessary for a good understanding" (article 2:391).</p>
<i>Overview of duties</i>	<p>Section 4:90 of the Act on Financial Supervision stipulates that an investment firm shall act in an honest, fair and professional manner when performing investment activities and shall refrain from actions that are detrimental to the integrity of the market.</p> <p>Pursuant Article 135 of the Pension Act, a pension fund must have an investment policy which is compliant with the prudent person rule:</p> <ul style="list-style-type: none"> ▪ The assets are invested in the interest of pension beneficiaries; ▪ Investments in the contributing company are limited to a maximum of 5% of the portfolio as a whole, and if the contributing company belongs to a group, investments in the companies belonging to the same group as the contributing company are limited to a maximum of 10% of the portfolio. If a group of companies pays premiums to the pension fund, investments in these contributing companies will be made prudently, taking into account the need for appropriate diversification; ▪ The investments are valued at market price.
<i>Controls and sanctions</i>	<p>The DNB examines the financial position of the pension funds. The Financial Assessment Framework (FTK), which is part of the Pensions Act, sets out the requirements for the financial position of a pension fund. The FTK is relied upon for pension fund oversight for:</p> <ul style="list-style-type: none"> ▪ Evaluating funding requirements; ▪ Mandating funding recovery plans; ▪ Determining permissible changes to benefit levels (benefit reductions and indexation). <p>The AFM is responsible for supervising the operation of the financial markets. The AFM supervises the conduct of the entire financial</p>

	<p>market sector (savings, investment, insurance and loans) and supervises the conduct of the financial markets. Under the Pensions Act, pension administrators are obliged to properly inform the people for whom they manage the pension or to whom they pay the pension benefits about their pension rights.</p>
<p><i>ESG integration in investment decision making</i></p>	<p>According to VBDO (the Dutch Sustainable Investment Forum), Dutch asset managers have three motivations for implementing ESG-integration:</p> <ul style="list-style-type: none"> ▪ Most investors use ESG-analysis because they are convinced that it leads to better quality investment decisions; ▪ There is an increasing demand from clients to take ESG-issues into account; ▪ The conviction that ESG-analysis contributes to a more sustainable society overall. <p>VBDO published two benchmarks in 2014. Main conclusions include that all Dutch pension fund boards are currently discussing responsible investment and the matter is increasingly taken seriously by them. Top insurance companies for their part have also made significant progress and are catching up with the top pension funds regarding responsible investing. The benchmark shows that exclusion and ESG integration for equities are being used on an increasing level. However, insurers are facing many business challenges (lack of trust, tighter regulations, declining demand...) and this situation may have prevented some of them from implementing strong RI strategies.</p> <p>Total RI market was about EUR 1 trillion in 2013. Exclusions is the most popular RI strategy (EUR 1,068 billion), followed by Norms-based screening (EUR 746 billion) and Engagement & voting (EUR 649 billion). Best-in-class strategy has significantly grown (+1,200 % since 2011) but remains small.</p> <p>Almost all asset managers in the Netherlands have signed the PRI and have a Responsible Investment strategy and instruments.</p> <p>The Dutch RI market is expected to grow, doubly pushed by consumers' expectations and supportive regulatory frameworks.</p>
<p><i>International, national, sectorial and individual initiatives</i></p>	<p>STANDARDS</p> <ul style="list-style-type: none"> ▪ <u>Code of the Dutch Pension Funds</u>: this Code replaces the Principles of Good Pension Fund Governance and sets standards for 'good pension fund governance'. The code requires pension funds to define a Responsible Investment strategy and make this available for stakeholders. Furthermore, the pension fund should take shareholder interests into account and make sure stakeholders support the investment strategy at hand. ▪ <u>Transparantiebenchmark</u>: since 2004, the Ministry of Economic Affairs has organised an annual Transparency Benchmark, to assess the extent to which businesses account for their activities in the area of Corporate Social Responsibility (CSR) in their annual reports. ▪ <u>Tabaksblad Code</u>: the Dutch Corporate Governance Code contains principles and best practice provisions that regulate relations between the management board, the supervisory board and the shareholders (i.e. the general meeting of shareholders).

	PROMOTION & AWARENESS <ul style="list-style-type: none"> ▪ <u>Dutch Association of Investors for Sustainable Development (VBDO)</u>: works to create a sustainable capital market, a market that considers not only financial criteria but also extra-financial, social and environmental criteria. ▪ <u>Eumedion</u>: the platform is dedicated to Dutch institutional investors and works on promoting ESG in investments, particularly for the governance side (engagement and voting). ▪ <u>Dutch Fund and Asset Management Association (DUFAS)</u>: DUFAS has the objective of promoting the collective interests of asset managers which are active in the Netherlands, by preparing for developments in the business climate of the very important financial sector. Among responsibilities, DUFAS recognises that "the Fiduciary Manager may advise the Pension Fund on a policy for socially responsible investment and assume responsibility for the implementation of such policy."
<i>Recent / future developments</i>	<p>In order to make ESG-analysis more efficient, the Dutch Investor Association for Sustainable Development (VBDO) recommends (2014) some issues to be further developed:</p> <ul style="list-style-type: none"> ▪ The evidence for the positive relation between ESG-analysis and risk adjusted return needs to be strengthened. ▪ More research is needed to answer the question if and how ESG-integration contributes to sustainable development. ▪ The education of analysts requires more attention to ESG-data and the application of these data in the investment process. ▪ ESG-data needs to be better suited for the application in other asset classes than solely in public equity, which is often the case at present. ▪ ESG-integration can also be used on a more strategic level, such as strategic sector allocation and topics such as the 'Carbon Bubble'.
<i>People interviewed</i>	<ul style="list-style-type: none"> ▪ Harald Walkate, Head of Responsible Investment at Aegon Asset Management, one of the world's leading financial services organizations for life insurance, pensions and asset management. ▪ Marcel Jeucken, Managing Director at PGGM, a large pension fund and the second biggest asset managers in the Netherlands.
<i>References</i>	Publications <ul style="list-style-type: none"> ▪ VBDO (2014), ESG-integratie - Toepassing en best-practices binnen de Nederlandse markt, Dutch Investor Association for Sustainable Development (Vereniging van Beleggers voor Duurzame Ontwikkeling). ▪ VBDO (2014), Benchmark Responsible Investment by Insurance Companies in the Netherlands ▪ VBDO (2014), Benchmark Responsible Investment by Pension Funds in the Netherlands ▪ PensioenFederatie (2010), The Dutch Pension System, an overview of the key aspects. ▪ R. Maatman (2004), Dutch Pension Funds, Fiduciary Duties and Investing

- DUFAS (2012), The DUFAS Principles of Fiduciary Management

Websites

- www.pensioenfederatie.nl Federation of the Dutch Pension Funds
- www.transparantiebenchmark.nl The Transparency Benchmark

Latvia



Summary

Asset management in Latvia is at an early stage and almost cornered by Nordic financial groups. There are a dozen of investment management companies operating in the country, managing 30 investment funds, only one of which is including specific ESG criteria. The growth of the industry is slow due to low average income of the population as well as the dominance of vanilla savings products such as term deposits. The low level of trust the population tends to have in institutions can also be mentioned as a barrier (Saksonova, 2013).

ESG integration will be challenging since companies are barely reporting ESG information, a key precondition for evaluation and for building RI portfolios. However, the legal framework does not prevent investors to take ESG issues into account when investing.

Financial market attributes

The relative size of Latvia's financial system is still small compared to the euro area average. Financial markets are dominated by commercial banks, in particular Nordic financial groups such as the Swedish Swedbank AB and SEB AB. Together with the Latvian ABLV Bank, the three banks are concentrating most of assets in the Latvian banking industry. For its part, the non-banking part of the Latvian financial sector remains small.

At the end of 2014 there were 12 investment management companies operating in Latvia, managing EUR 2.6 billion among 30 investment funds (28 open-end and two closed-end funds).

Concerning private pension funds, at the end of 2014, there were five open-end pension funds and one closed-end pension fund operating in Latvia for 240,000 pension plan members. There is a slow dynamic of long-term savings in Latvia. The main explanation for this trend is the low average income in the country and consequently the limited saving possibilities for the population. Other possible explanations include an insufficient financial literacy of a large proportion of the population, a slow demographic growth and a low level of trust of the population in institutions in general (Saksonova, 2013).

Legal framework for fiduciary duties

FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY

Regulation and supervision of all financial institutions is carried out by the **Financial and Capital Market Commission** (FKTK). The Commission ensures enhancing stability, competitiveness and development of the financial and capital markets as well as protection of the interests of investors, depositors and insured persons.

Asset managers are regulated by the **Law on Investment Management Companies**. Article 61 introduces their fiduciary duty: "When making investments at the fund expense, the company shall have a duty to invest only in the investment objects set out in the fund prospectus, observe the investment limitations set out therein, obtain sufficiently comprehensive information regarding the potential or acquired investment objects, as well as constantly monitor and

	<p>analyse the financial standing of those persons into whose financial instruments the fund assets are or will be invested.”</p> <p>NON-FINANCIAL DISCLOSURE</p> <p>Both the Annual Accounts Law (Section 55) and the Consolidated Annual Accounts Law (Section 29) state that the consolidated report should include an analysis of the main non-financial indicators characterising the company. It mentions explicitly “the influence of regulatory requirements regarding the environment and information regarding the employees”.</p>
<i>ESG integration in investment decision making</i>	<p>Responsible investment is still almost non-existent in Latvia. Among investment management companies operating in the country, only foreign asset management companies are distributing SRI funds. For instance, “Global Emerging Markets SRI” from the Norwegian asset manager DNV is an equity fund, focusing on emerging countries. The fund is distributed in a dozen of countries, including in Latvia, by JSC DNB banka for instance.</p>
<i>International, national, sectorial and individual initiatives</i>	<p><u>It must be mentioned that despite a low market for RI, some initiatives are innovative.</u> For instance, national power supply company Latvenergo AS issued a green bond in May 2015 to support its green investments. The bond amounting EUR 75 million is listed on the Nasdaq OMX Baltic Bond List. Nasdaq noted that “due to investors’ high interest in the issue, the total size of the bond issue was increased from EUR 50 million to EUR 75 million in the placement process”.</p>
<i>People interviewed</i>	<ul style="list-style-type: none"> ▪ Uldis Upenieks, CEO at “CBL Asset Management” IPAS, one of the leading expert in investment and wealth management service provider in the Baltics, based in Latvia.
<i>References</i>	<p>Publications</p> <ul style="list-style-type: none"> ▪ Lulewicz-Sas, A. & Kiloin, J. (2014), The effectiveness of SRI funds in Poland ▪ FKTK (2015), Annual Report and Activity Report 2014 ▪ European Commission (2013), Convergence Report 2013 on Latvia ▪ Saksonova, S. & Orlova, S. (2013), Development of Long-Term Savings System in Latvia ▪ Nasdaq (2015), Nasdaq Welcomes Latvenergo's First Green Bonds to Nasdaq Baltic Market <p>Websites</p> <ul style="list-style-type: none"> ▪ www.fktk.lv/en Financial and Capital Market Commission (FKTK)

Poland



Summary

Poland is one of the most dynamic markets in Central and Eastern Europe and is expected to grow by 7% annually. AuM are driven in a balanced way by investment funds, pension funds and insurers.

For mutual funds, the Polish law refers to the interests of the participants but for pension funds, the law is simply asking investors to manage the assets in accordance with the fund's Article of Association. Therefore, if a pension fund introduces on day ESG consideration in its Articles, it will become its fiduciary duty to include them by managing the assets.

Responsible investment is in the initial phase: very few companies are reporting ESG information and there are no specific requirements in the regulatory framework. However, the RI market is emerging and reached EUR 2.4 billion in 2013. About 60% of Polish investors are aware of the concept of RI.

Financial market attributes

Poland's economy is among the largest in Central and Eastern Europe (CEE) and is one of the most dynamic investment fund markets in this area: early 2014, the total value of assets under management (AuM) in Poland was EUR 124 billion (PLN 522 billion). In line with the constant increasing wealth of individuals for more than 10 years, this amount is expected to grow by 7% every year until 2016.

Investment funds, pension and insurance are representing 39%, 32% and 29% respectively of total AuM. Even if smaller asset managers are gaining market shares, almost 40% of total AuM are managed by three major companies: PZU, Aviva and ING.

At the end of 2014, 12 open pension funds for a total of 16.6 million members and 4 occupational pension funds (44,700 members) conducted activities in Poland.

Legal framework for fiduciary duties

FINANCIAL MARKETS AND OVERALL FIDUCIARY DUTY

Financial services industry in Poland is supervised by the **Polish Financial Supervision Authority** (PFSA). Its aim is to ensure regular operation of this market, its stability, security and transparency, confidence in the financial market, as well as to ensure that the interests of market actors are protected.

Capital market in Poland are regulated by three main acts: the Act of 29 July 2005 on public offering, conditions governing the introduction of financial instruments to organised trading and public companies, the Act of 29 July 2005 on trading in financial instruments and the Act of 29 July 2005 on capital market supervision. More specifically, investment funds are regulated by the **Act of 27 May 2004 on Investment Funds** of which article 3.3 states that "an investment fund shall conduct its operations with due regard to the interests of the participants of such fund, and in keeping with the investment risk mitigation rules defined in this Act".

The main legal act regulating the rules of establishment and operation

	<p>of pension funds in Poland is the Act of 28 August 1997 on the organization and operation of pension funds. Fiduciary duty relies on the Articles of Association, which define precisely fund's specifications (article 3). According to article 152, the portfolio manager shall manage the assets "in accordance with the fund's investment standards as laid down in the fund's Articles of Association". The Act also states that "A fund member may lodge a complaint with the supervision authority against the fund where, in the member's opinion, the fund conducts its activity unlawfully or in contravention of the fund's Articles of Association" (article 205.1).</p> <p>NON-FINANCIAL DISCLOSURE</p> <p>The Polish accounting Act of 29 September 1994 invites companies to include in their annual report "financial and non-financial indicators, together with the information relating to environmental and employment matters" (article 49).</p>
<i>ESG integration in investment decision making</i>	<p>Despite the Polish Accounting Act, very few companies are adding non-financial information to their financial annual reports: even if corporate governance issues are often well informed, most companies provide a low level of disclosure on their environmental and social impacts (SEG, Crido Taxand, & GES, 2013). Investors have then great difficulty in performing sound ESG analysis.</p> <p>On top of that, there is no specific RI regulation in Poland for funds, asset managers or asset owners. Investors are not required to take ESG factors into account. However, there is no ban on including ESG factors in the investment policy: such considerations can be included in the Articles of Association which precise the "fund's investment principles and standards" (Act of 28 August 1997 on the organization and operation of pension funds, article 13).</p> <p>Poland is in the initial phase of development of socially responsible investment and none of Polish investors have signed the PRI. It is estimated that socially responsible market in 2013 was at around EUR 2.4 billion, mostly invested in accordance with exclusion and norm-based screening strategies (Eurosif, 2014).</p> <p>According to the most recent survey, for which the response rate was 33%, about 60% of Polish individual investors are familiar with the concept of RI but only 33% of investors declare using SRI approach in portfolio management. Similarly, only 32% consider ESG factors when deciding how to vote at general meetings (Deloitte, 2011). The survey suggests that consideration of ESG factors in investment decisions could be improved mainly by external drivers: legislation or directly by customers.</p>
<i>International, national, sectorial and individual initiatives</i>	<p>STANDARDS</p> <ul style="list-style-type: none"> ▪ <u>RESPECT Index project</u>: the Warsaw Stock Exchange (WSE) created in 2009 the first domestic index of socially responsible companies in Central and Eastern Europe. The RESPECT Index portfolio currently includes a record-high number of 24 companies. ▪ <u>Code of Best Practice for WSE Listed Companies</u>: the WSE updated this Code in 2011 (it has been firstly published in 2006). It provides recommendations for listed companies, management boards,

	<p>supervisory boards and shareholders. The Code only focuses on best practices in terms of corporate governance.</p> <p>PROMOTION & AWARENESS</p> <ul style="list-style-type: none"> ▪ <u>Responsible Investment Working Group</u>: this initiative has been launched in 2009 by the Ministry of Economy and aims at promoting SRI. ▪ <u>ESG Analysis of Companies in Poland</u>: this report is published annually by the Polish Association of Listed Companies (SEG), an ESG rating agency (GES) and a consulting firm (Crido Taxand). It analyses how ESG issues are gradually integrated by Polish companies and investors. There have been 3 editions of the study but the last one has not been translated in English yet.
<i>People interviewed</i>	None.
<i>References</i>	<p>Publications</p> <ul style="list-style-type: none"> ▪ Lulewicz-Sas, A. & Kiloin, J. (2014), The effectiveness of SRI funds in Poland ▪ Chamber of Fund and Asset Management (2014), The 2013 report ▪ SEG, GES & Crido Business Consulting (2013), ESG transparency as competitive advantage for listed companies ▪ Deloitte (2011), Investment Decisions and Corporate Social Responsibility Survey Report <p>Websites</p> <ul style="list-style-type: none"> ▪ www.mf.gov.pl Ministry of Finance ▪ www.knf.gov.pl Polish Financial Authority ▪ www.mg.gov.pl Ministry of Economy ▪ www.gpw.pl Warsaw Stock Exchange ▪ seg.org.pl Polish Association of Listed Companies (SEG) ▪ www.izfa.pl Chamber of Fund and Assets Managers ▪ odpowiedzialnybiznes.pl Responsible Business Forum (FOB) ▪ www.odpowiedzialne-inwestowanie.pl Media on SRI ▪ www.inteliace.com Financial research in Eastern European countries

Annex 3 – Stakeholder meeting

Date: Thursday 2nd July, 2015

Place: DG Environment, BU-5, Room C, Beaulieu, Brussels

Participants

Julia Backmann.....	German Investment Funds Association BVI
Amra Balic.....	BlackRock
Hans-Ulrich Beck	Sustainalytics
Zineb Bennani	Mirova
Thierry Bogaty	EFAMA & Amundi
Mathilde Bouye	World Resource Institute
Jérôme Courcier.....	ORSE & Crédit Agricole
Camilla de Ste Croix	ShareAction
Caroline Delérable	EY
David Henry Doyle	Standard & Poor's
Elodie Feller	UNEP Finance initiative
Martin Halle	Global Footprint Network
Antoine Héluin.....	EY
Axel Hesse	SD-M
Andreas Hoepner	Henley Business School
Nicolas Huber.....	Deutsche Bank
Anne-Catherine Husson-Traore	Novethic
Carlos Joly	Cambridge University
Zsolia Kerecsen	European Commission, DG JUST
Bettina Kretschmer.....	European Commission, DG ENV
Will Martindale.....	PRI
Paige Morrow	Frank Bold
Marion O Donnell	Fidelity International
François Passant	Eurosif
Julian Poulter	Asset Owner Disclosure Project
Diane Strauss.....	2° Investing Initiative
Adrian Tan.....	EY
François Wakenhut	European Commission, DG ENV
Harald Walkate.....	Aegon Asset Management

The following minutes are provided along with the presentations given during the meeting.

Agenda

<i>Time</i>	<i>Topic</i>
10:45 – 10:55	Welcome and opening (<i>European Commission</i>)
10:55 – 11:05	Tour de table
11:05 – 11:20	<i>Presentation (EY): Introduction to the study on resource efficiency and fiduciary duties of investors</i>
11:20 – 11:40	<i>Presentation (UNEP FI / PRI): UNEP FI: Freshfields: 10 years on – A global roadmap for fiduciary duties and ESG integration</i>
11:40 – 12:15	<i>Presentation (EY): State of play of fiduciary duties and the inclusion of environmental and resource efficiency issues in investment decision-making in Europe</i>
12:15 – 12:25	<i>Presentation (Dr. A. Hoepner): An overview of the latest academic research</i>
12:25 – 12:45	<i>Plenary discussion (Chair: Dr. A. Hoepner): Are there any cases where fiduciary duties limit the integration of environmental and resource efficiency issues in investment decision-making in Europe?</i>
12:45 – 13:45	<i>Lunch break</i>
13:45 – 15:15	Group discussions: What can be done to improve the conditions for including environmental and resource efficiency concerns in institutional investments and portfolio management?
15:15 – 15:45	Summary and reflections of the day (EY)
15:45 – 16:00	Closing remarks (<i>European Commission</i>)

Welcome and introduction to the study

The European Commission (EC) welcomed all participants and introduced the context of the study. Financing investments for resource efficiency and the circular economy is a top priority for the Commission. The issue is addressed by several Directorate-Generals, including DG Environment (ENV), DG Justice (JUST), DG Climate Action (CLIMA) and DG Financial Stability, Financial Services and Capital Markets Union (FISMA). The study and this stakeholder meeting is an opportunity to discuss the preliminary findings and possible policy action together with experts and key stakeholders.

The background of this study was that several stakeholders and experts in the European Resource Efficiency Platform and the Resource Efficiency Finance Roundtable had asked for clarification on the integration of environmental and resource efficiency issues into fiduciary issues in order to leverage the funds managed by institutional investors. Moreover, the study is a continuation of the work on responsible investment (RI) that the Commission has been working on for a long time.

EY then presented the overall study, including its objectives, scope, methods and main definitions. Some remarks have been raised on the Background Paper and are listed later in this document.

UNEP FI: Freshfields: 10 years on

UNEP Finance Initiative (UNEP FI) and the Principles for Responsible Investment (PRI) presented the preliminary results of their on-going global study on fiduciary duties and the integration of environmental, social and governance issues in investment decisions. Compared to the first UNEP FI Freshfields report released in 2005, where one of the main findings was that the integration of ESG issues as part of fiduciary

duty was considered permissible and arguably required, the findings from the on-going study is that it is now not only permissible but also blatantly required: *"A failure to consider long-term investment value drivers, which include environmental, social and governance issues, is a failure of fiduciary duty"*. Part of the reason why the notion of fiduciary duty was considered incompatible with taking into account ESG issues was claimed to be due to *"lazy legal advice"* (particularly in the US and Canada).

UNEP FI and PRI presented their global recommendations targeted at institutional investors, intermediaries (including stock exchanges, brokers, credit rating agencies, investment advisers, legal advisers and data providers) and policymakers.

Comments to the UNEP FI and PRI presentation

- "To take into account of ESG issues" can mean that ESG issues were considered during the investment decision making process, but then found to be not important. Previously the integration of ESG issues in relation to fiduciary duties was considered to be limited to the investment decision making process, but now one can argue that integrating ESG issues, if applicable, needs to be reflected in the result of the investment decision. The recent ruling (24th June) of the Hague District Court (a group of Dutch citizens (Urgenda) versus the Dutch Government) was provided as an example. The Hague District Court ruled that the Dutch Government must take more action than they do to reduce the greenhouse gas emissions in the Netherlands and it must do more to avert the imminent danger caused by climate change in view of its duty of care to protect and improve the living environment. Similarly, there might be an increased litigation risk when investment decisions are not based on ESG integration.
- It is not correct to say that fiduciary duty does not exist in civil law. The concept of fiduciary duty is present in the legislation of every EU Member State - even if the term is not used explicitly. However, as all countries do not share the same definition, a common understanding across the EU is needed, especially since institutional investors operate across the EU and clients are international. There is no need for a common legal definition across EU Member States regarding fiduciary duty, but perhaps a common understanding of fiduciary duty in relation to the integration of ESG issues.
- Overall, the effort should be put on ensuring and increasing transparency in investment decisions. In France, according to the Monetary and Financial Code (Code monétaire et financier) open-ended investment companies and management companies must state the ways in which their investment policies take into account ESG criteria (art. L.214-12) but it is still insufficient to get all investors to explain why and how they are integrating ESG issues in their investment policies.
- Policy action should avoid the implementation of new legal requirements for two reasons: first, it would make investors understand ESG integration as a "compliance" issue and not as a fiduciary duty (i.e. following the duty of loyalty and prudence); second, there are already too many or even conflicting regulations: investors are already struggling with the existing legal framework, which is difficult to comply with. Furthermore the point was made that legal cases are traditionally tested in court before being implemented, but ESG integration has already been implemented.

State of play of fiduciary duties

EY presented the state of play of fiduciary duties and ESG integration in the EU and presented the main areas for advancing the integration of ESG issues in the investment decisions of institutional investors (see the slides).

Regarding EU policies, it was mentioned that the last draft proposal for the IORP Directive deleted the reference to the risk assessment of "*emerging risks relating to climate change, use of resources and the environment*". The PRIIPs Regulation, which requires packaged retail and insurance-based investment products to disclose the specific environmental or social objectives targeted, also missed the opportunity to include all financial products in its scope.

Overview of the latest academic research

Dr Andreas Hoepner gave an overview of the latest academic research that show how ESG integration is financially relevant, for both financial returns (Alphas) and the competitiveness of financial institutions. He stressed that ESG integration mostly relies on materiality (environmental issues are business model specific), independent audit of ESG information and a good understanding of ESG data from asset managers. He then presented two of his papers: the first one (Hoepner, Rezec & Siegl, 2013) demonstrated that ESG integration allows asset managers to significantly reduce the downside risk; the other paper (Adamsson & Hoepner, 2015) pointed out that, contrary to what is usually thought, sin stocks (alcohol, gambling and tobacco) do not outperform other investments.

Plenary discussion regarding limitations due to fiduciary duty for the integration of environmental and resource efficiency issues in investment decision making in Europe

The discussion first focussed on legal aspects and enforcement. At present there are no enforcement mechanisms to ensure that investors are actually integrating ESG issues as they claim. It was pointed out that nobody has been sued for taking material issues into consideration when making investment decisions – only the opposite has resulted in court cases. Pension funds could be sued for not taking ESG issues into consideration, especially when it comes to climate change. Most participants agreed on the fact that beneficiaries are becoming more vocal. For example, an Australian pension fund now receives letters daily from retirees in favour or against ESG integration. ESG issues are now recognised as material and the final beneficiaries want to know the *real price* (i.e. impacts) of their investments.

The UK Law Commission has investigated the legal aspects of fiduciary duty and found that where ESG issues are financially material they have to be taken into account. The majority of participants at the stakeholder meeting agreed with the Law Commission's findings, i.e. the materiality of ESG issues. It was however noted that the Law Commission's recommendations have not been put into law and have so far not had an impact on the behaviour of institutional investors. Some pension funds are considering divesting from fossil fuels but most lawyers still view such exclusions as a moral issue and not part of fiduciary duty. A comment was made that lawyers tend to be biased against ESG issues and are in general reluctant to any form of innovation in terms of investment decision and process.

A participant confirmed that there is no jurisdiction in the EU that prevents investors from integrating ESG issues in their investment decisions. This led to the questions that if ESG issues are material, then why is there a need to create a whole new terminology related to responsible investment and legislate on the integration of ESG? The capacity of asset managers to integrate ESG in investment processes and decisions is a part of their operational excellence and a key element of their competitive advantage. The issue that the liability of asset managers is linked to the length of their contract was mentioned.

The end of the debate explored the materiality of ESG issues. All participants agreed that climate change is material (and this is why investors are calling for a carbon

price) but there was disagreement on the capacity of existing tools to capture this long-term risk. Overall, financially material ESG information is not the issue: the tricky question is the integration of ESG criteria that are not directly financially relevant. Should this be part of fiduciary duty? To what extent can trade-offs between the financial return and moral/ethical considerations be justified?

Group discussions on how to improve the conditions for including environmental and resource efficiency concerns in institutional investments and portfolio management

After the lunch, participants were split in three groups to brainstorm on three types of recommendations:

1. Legal reform and obligations;
2. Incentives and economic instruments;
3. Improving ESG information, tools and skills.

Group 1: Legal reform and obligations

There is no law in the EU that says institutional investors cannot take ESG into account. The issue is there are still some misconceptions regarding fiduciary duties.

One possible solution would be to **shift the burden of proof** in order to make investors explain why and how ESG issues are integrated into their investment decisions.

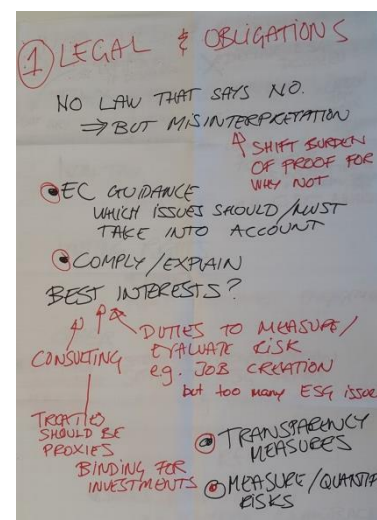
Since fiduciary duty is a flexible concept, the European Commission could issue a **guidance note** on how fiduciary duty should be understood across the EU.

The group discussed a **"comply or explain"** mechanism. Some participants highlighted the failures of such voluntary instruments in France and in the UK.

Clarifying the definition of the "best interests" of beneficiaries could be a way to include ESG factors but the great amount of different SRI specific products would make this difficult. Asset owners could benefit from **consulting services** to provide guidance on how investment policy could, for example, use international treaties signed by the EU or national governments regarding CO₂ emissions or controversial weapons as a proxy for ESG criteria that must be taken into consideration.

Transparency measures could be also a legal tool, by strengthening CSR reporting of companies in the EU.

Finally, participants discussed the problem of **measuring/quantifying risks** in a way that incorporate ESG issues. Indeed, most of the benchmarks reflect where the market is at the moment and do not consider long-term perspectives.



Group 2: Incentives and economic instruments

Tax incentives were discussed, but most participants were not in favour for several reasons. First, putting tax incentives on SRI would entail that ESG integration is a specific action or type of product. Secondly, tax is not an EU prerogative and it would be impossible to implement a common tax across Member States. Thirdly, it would require defining SRI which is quite difficult in regards to the variety of responsible investment strategies. Last but not least, tax incentives can lead to inefficient capital allocations. However, it was mentioned that the negotiations regarding a financial transaction tax could be an opportunity to promote ESG integration.

The group then discussed non-tax incentives such as an **award** or (cash) prize based on the performance of implementing sound sustainable investments.

Changing voting rights was seen as an enabler but it was thought more important to promote stakeholder engagement and **engagement strategies**.

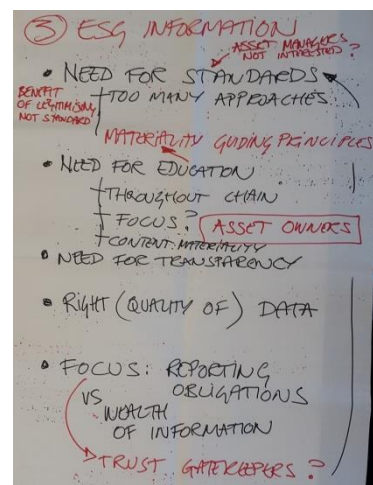
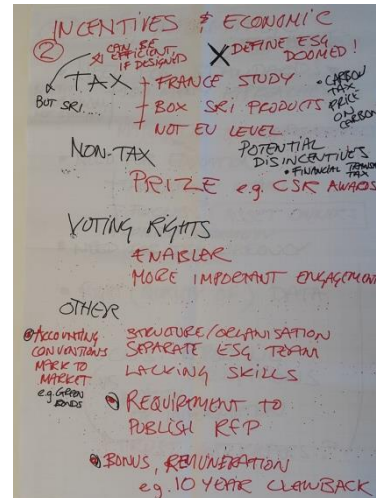
Other ideas included the need to **improve the skills and the organisation** of ESG analyst teams (research, marketing, etc.) with dedicated training. It could also be relevant to require asset owners to **publish their request for proposal regarding asset management contracts** and making it explicit what they expect on ESG integration. The importance of **remuneration and bonus** in the financial industry was also mentioned as a potential lever for greater consideration of ESG issues. The idea would be to target certain behaviours, not the players themselves.

It was pointed out that mark-to-market is calculated with a valuation methodology which only focuses on volatility instead of being connected to long-term considerations (e.g. stranded assets), at least for certain asset classes. It was noted that in this context accounting conventions represent a barrier for long-term investments.

Group 3: Improving ESG information, tools and skills

The **need for standards** was discussed intensively. A survey from Mercer identified about 5,000 different approaches in SRI and this variety is confusing the market. Consequently, materiality should be a guiding principle in order to narrow down the number of strategies.

The need of standardisation of ESG information does not only affect SRI strategies but also the **sources of ESG data** from companies: the right quantity and the right quality of data. It seemed difficult to find the right balance between the wealth of information and standardised information, with some suggested to focus on a limited number of "key performance indicators" only whereas others advocated for taking a broader approach. It was also mentioned that asset managers should trust the rating agencies in their capacity to assess the ESG performance of companies.



Another shared idea was to **develop education on ESG** along the entire value chain, starting from the companies to the beneficiaries, the trustees and the asset managers - there was some agreement that the effort should be focused on asset owners. In terms of content, the group agreed on the need to focus on materiality and draw the attention to the need to use a clear and comprehensible language when using ESG information.

The group overall stated that **transparency** was a key challenge and recognised the PRI as a valuable leading example.

Remarks on the Background Paper

During the meeting some participants asked for the possibility to provide comments to the Background Paper that was shared before the Stakeholder meeting. Remarks were of two types: the overall report and the preliminary recommendations.

The report:

- The term “non-financial” criteria or information when talking about ESG integration is counter-productive – particularly if ESG issues are material, then they are indeed financially relevant.
- Contrary to what is stated on page 3 in the Background Paper (“Some investors claim that taking ESG issues into consideration during investment analysis and decision making may offer investors potential long-term performance advantages”), it is important to mention that many investors do integrate ESG issues in their investment decisions.
- The paragraphs dedicated to resource efficiency are confusing since all SRI strategies include environmental concerns. That part should specify that it deals with environmental thematic funds.
- It was suggested to exclude the governance pillar from ESG since governance issues are already well covered by investors.

Its recommendations:

- Educating the beneficiaries has been highlighted as a main action. In this context, it would be good to clarify how to make it easier for beneficiaries to understand their pension statements.
- It was suggested that this study should provide legal guidance, but this was not thought to be within the scope of the study, but could be pursued by the Commission.
- Some ESG information is not relevant from a financial point of view and the consideration of such criteria is clearly a moral aspect (but might still be in the beneficiaries’ interest). There is an issue since the current pricing approach (based on benchmarks, volatility and risk adjusted returns) does not capture the long-term risks. It is a question of shifting from forecasting to foresight.
- The need for standards was debated. Some argued that standardization was an efficient means to push ESG integration forward while others insisted on the overall priority to build reliable data.
- Fiduciary duties should be extended to all trustees. This includes chartered accountants in the context of the second pillar of Basel II framework when defining “the risk appetite in a manner that considers long-term performance over the cycle”.

The Commission thanked all participants for their participation and good discussions. It was agreed among the participants to share emails and the presentations as well as the meeting minutes.