Public consultation on long-term and sustainable investment

Fields marked with * are mandatory.

Introduction

Fostering growth and investment is one of **European Commission's top priorities.**

To maintain and extend its competitiveness, Europe needs significant new long-term and sustainable investment.

These can also help achieve the EU's policy objectives linked to the transition to low carbon and climate resilient economy and promote environmentally and socially sustainable wealth creation, including respect for fundamental rights.

The Communication on Long-Term Financing of the European Economy [COM/2014/168 final] emphasized that one of the key features of long-term financing is that investors take longer-term aspects such as environmental, social, governance issues into account in their investment strategies. It further underlined the importance of ESG issues for the longer-term sustainable performance of companies and investors and announced further reflection on incentives for more sustainable investment. The Action Plan on building a Capital Markets Union [COM/2015/468 final] also reiterates the importance of ESG investments.

This consultation seeks to gather information on how **institutional investors, asset managers and other service providers in the investment chain factor in sustainability (ESG) information and performance of companies or assets into investment decisions.** The consultation will also gather information about possible obstacles to long-term, sustainable investment.

The results of this consultation will be used by the Commission to assess the state of play in this field. A feedback document outlining the overall results of the consultation will be made public.

Definitions

For the purpose of this consultation, the following definitions are used:

Sustainable or responsible investment is a comprehensive approach to investment that explicitly takes account of environmental, social and governance (ESG or sustainability) issues and the long-term health and stability of the market as a whole. The evaluation of ESG issues is a fundamental part of assessing the value and performance of an investment over the medium and longer term. It also implies that an investor should be an *active asset owner* engaging with companies (for example through dialogue on strategy, risk, corporate governance) to improve their performance. [See Principles for responsible investment, What is responsible investment?]

Material *environmental* factors include, among others, carbon emissions, climate change risks, energy usage, raw material sourcing and supply risks, waste and water management. *Social* factors include, in particular, customer and employee relations, health and safety, human capital management, fundamental rights. *Governance* matters include, in particular, board accountability, structure and size, management ability to deliver a strategy, executive compensation schemes, bribery and corruption.

Specific Privacy Statement:

SpecificPrivacyStatement.pdf

About the respondent

*1. Please provide your full name (authority, association, organisation, enterprise, ..., as applicable)

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Standard Life Investments
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*2. Please provide contact details (e-mail, phone number, postal address)

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Mike Everett
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*3. Are you replying as:

- ○ a. Public authority
- ○ b. Institutional investor
- ● c. Asset manager
- ○ d. Other service provider or advisor
- ○ e. Company
- ○ f. Association
- ○ g. Retail investor
- ○ h. Private person
- ○ i. Other

Please indicate the total amount of investments in EUR millions as of 31 December 2014

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€343bn
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Please estimate the proportion of your total investments as of 31 December 2014 that can be considered as sustainable investment on the basis on the definition proposed in this consultation paper.

€343bn

Please indicate whether you plan to increase or decrease the proportion of sustainable investments over the next 5 years on the basis of your existing investment policy and business strategy. If possible, please provide an estimation.

*4. Is your organisation registered in the EU Transparency Register? (If not, you may register here, although you do not have to be registered to reply to this consultation.)

- (x) Yes
- ( ) No

*If registered, please indicate your ID number:

28229947613-19

*5. Please indicate your country of residence or establishment:

- ( ) Austria
- ( ) Belgium
- ( ) Bulgaria
- ( ) Croatia
- ( ) Cyprus
- ( ) Czech Republic
- ( ) Denmark
- ( ) Estonia
- ( ) Finland
- ( ) France
- ( ) Germany
- ( ) Greece
- ( ) Hungary
- ( ) Ireland
- ( ) Italy
- ( ) Latvia
- ( ) Lithuania
- ( ) Luxembourg
- ( ) Malta
- ( ) Netherlands
- ( ) Poland
- ( ) Portugal

- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- (x) United Kingdom
- Other

*6. Please indicate whether you consent to publication:

- (x) Under the name indicated – I consent to the publication of all information in my contribution, and I declare that none of it is under copyright restrictions that prevent publication.
- Anonymously – I consent to the publication of all information in my contribution, except my name/the name of my organisation, and I declare that none of it is under copyright restrictions that prevent publication.
- No, I do not consent to the publication of my contribution. I understand that my anonymised responses may be included in published statistical data, for example, to show general trends in the response to this consultation.

Please note that before completing the survey you will have the opportunity to upload documents to further support or illustrate your views.

Questions

1. Rationale for ESG inclusion into investment decisions

1.a. Do ESG factors pay a role in the investment decisions of investors? If not, why?
If yes, please specify which considerations are reflecting in your investment policy and mandates? In what form is this commitment expressed?

At Standard Life Investments, we consider company policies and practices on ESG matters to be an integral part of the investment process. We believe that dynamic economies are built upon stable social, political and environmental systems, and that companies demonstrating a commitment to sustainable business practices and high standards of stewardship will likely enjoy a competitive advantage in the long run. The way in which ESG aspects are reflected in investment decision making can have a significant impact on financial performance.

Our approach centres on protecting and enhancing the investments held on behalf of our clients and includes the following:

• Company policies and practices on ESG matters are considered throughout the investment process.
• Shareholder value is improved through constructive engagement with companies on ESG issues.
• We seek to contribute to the development of principles and standards of corporate responsibility, governance and stewardship.

•   Transparency and communication is key - for customers, intermediaries and the companies in which we invest.

Our Responsible Investment Policy and Governance and Stewardship Principles and Policy Guidelines can be viewed on our website at: http://www.standardlifeinvestments.com/CG_SRI_Principles_and_Policies/getLatest.pdf and http://www.standardlifeinvestments.com/governance_and_stewardship/what_is_corporate_governance/principles_and_policies.html

1.b. What is the main rationale for institutional investors and asset managers to take ESG risks and opportunities into account in their investment decisions? Please indicate all the relevant issues (multiple choice)

- [x] a) risk management:
- [x] b) alignment of investment policies with the long-term interests of beneficiaries of the institutional investor,
- [x] c) pressure from clients on whose behalf the institutional investor invests funds,
- [x] d) seeking a positive social or environmental impact of investments,
- [ ] e) ethical considerations,
- [ ] f) legal or regulatory constraints, please specify,
- [x] g) other, please specify.

a) risk management:

- [x] i) managing asset value risk in the short-term, including preservation of investment value, better investment performance,
- [x] ii) managing asset value risk in the medium-to long-term, mitigation of exposure to long-term and systemic risks,
- [ ] iii) management of liability risks,

*g) other, please specify:

Impact on financial performance

Please provide an explanation :

The integration of ESG factors into investment decision making improves the analysis of risks that particular companies may introduce to the portfolios we manage. We believe that this improves our ability to identify companies that are more likely to deliver the long term sustainable value that many of our clients are seeking in their investments. Increasingly clients are recognising the benefit of considering ESG factors in mainstream investments and in addition demand is increasing for funds and products that may use ethical or SRI exclusion screens and also portfolios designed to focus on the delivery of positive impacts to the environment or society.

As well as being beneficial to our investment process we also believe that holding companies and boards to account for their management of ESG risks is the right thing for investors to do.

2. Information on ESG risks and opportunities

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

Any ESG risk with a financial bearing would be considered material. In our ESG analysis, we focus on the metrics that are most relevant for individual companies, based on their sector and geographical footprint. Our analysts assess the extent to which of a company may be impacted by ESG issues by considering their exposure to the relevant issue as well as their management of this exposure. This analysis includes consideration of impacts from the company's direct operations, as well as indirect impacts both upstream and downstream.

2.b. What are the main sources of reliable and relevant information for investors on material medium- to long-term risks and opportunities, particularly on ESG issues?

The main sources of information include data that companies self-report, which is typically verified by an external auditor, as well as ESG research providers such as sellside brokers, shareholder services, academia and commonly used data providers. We also maintain close links with various associations and investor groups which can help us to identify specific risks relating to companies, sectors and geographies.

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

Information is becoming increasingly available as individuals become more aware of ESG implications and companies aim to provide greater transparency in this regard. To an extent, individuals within companies can be credited with heightening awareness and compelling further disclosure because, as consideration of ESG matters in everyday life increases (e.g. recycling and energy efficiency initiatives), employees are less inclined to 'leave their beliefs at the door.' This awareness is brought into their working lives and companies' consideration of ESG issues and subsequent disclosures are improving in turn. The level of disclosure still varies amongst companies and markets.

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

Company disclosures are typically available free of charge on their website. The underlying raw data is not typically expensive to obtain; however, the analysis of and insight from this data by brokers and research agencies does come at a cost.

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

Instances where information is under judicial consideration and therefore prohibited from public discussion would prevent companies from disclosing ESG data. In addition, the potential for misinterpretation may be discouraging and companies do on occasion decline to disclose information due to impacts on competitive advantage. However, a lack of disclosure tends to lead to the conclusion that the company has something to hide, whether this is truly the case or not. The risk and implications of non-disclosure must therefore also be considered, by both companies and stakeholders.

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

- [x] a) relevance of ESG issues to company performance
- [x] b) attracting financing for specific projects, for example green bonds
- [x] c) legal or regulatory constraints
- [x] d) demand from investors
- [x] e) pressure from stakeholders
- [x] f) other

*f) other - please specify:

Companies may also publish information in order to enhance their reputation or brand.

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

The level of accountability varies; there is still work to be done in this area. Uptake of voluntary standards is increasing, which is a positive indicator. In addition, shareholders and stakeholders are increasingly holding companies to account in order to ensure that risks are considered holistically and to avoid, as much as possible, surprises that have the potential to negatively impact the fundamental standing of the company.

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

Best practice in relation to processes to ensure proper reliability entails integrating this information into the corporate reporting processes and should include assurance by an independent third-party auditor.

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

ESG investment instruments can offer an excellent investment opportunity and to provide funding to address specific issues, such as global climate change, and allow sustainable companies to access and be more attractive to the market. However, there are a number of issues that continue to raise concerns among investors. For example, considering green bonds in particular, some of these issues include a lack of consistent mechanisms to credentiailise the market, as well as questions raised regarding the core operations of some of the businesses issuing green bonds.

These concerns can be addressed in some part by taking a true holistic view of the companies issuing ESG investment instruments and conducting a thorough review of the all its potential impacts. At Standard Life Investments, we take this approach to any company into which we invest and we have purchased bonds labelled 'green'. However, these decisions were subject to a complete assessment of the company and bond being issued, including a fundamental credit assessment and review of ESG criteria.

Our further analysis of green bonds in particular can be found on our website at:
http://uk.standardlifeinvestments.com/institutional/market_views/global_spotlight/green_bonds_all_that_glitters_is_not_green.html

3. Integrating ESG information into risk assessment models of institutional investors and asset managers

3.a. What should an appropriate long-term risk assessment methodology look like? Please indicate some examples of good practice.

The ESG risks and opportunities for individual companies vary based on the market, sector and geography of a given company. Understanding the context in which companies operate is key to developing a long-term risk assessment methodology. The majority of this research is qualitative, with a small quantitative element, and moves through an ESG assessment of the macroeconomic environment, to a sector perspective, through to the implications and impact on an individual stock.

An example of this approach is our Responsible Investment Team’s thorough review of the stranded assets debate. Our Team has developed a framework to assess the relative exposure of companies to fossil fuel stranding, which identifies companies exposed to stranded assets. Based on this assessment, we then target those companies with the highest exposure for one-on-one engagement, so that our teams may fully assess the individual company’s management of their exposure, including their approach to mitigating the associated risks and planning for a future operational strategy under a low carbon economy. Further information on this work can be found on our website at:
http://www.standardlifeinvestments.com/WP_Stranded_Assets_White_Paper/getLatest.pdf

3.b. Are there specific barriers, other than those of a regulatory nature (see question 9) for investors to integrate medium-to long-term risk indicators, including ESG matters in their risk assessment? If so, please indicate what you consider to be the main barriers.

We do not believe that there are any barriers to integrating ESG matters into risk assessments. Certain limitations may exist, such as varying levels of company disclosure discussed in section 2, the efficiency of sustainability indices and the short-term nature of broker research discussed in section 7, but there are no outright barriers to considering ESG matters in financial analysis. ESG matters have the potential to materially impact businesses across sectors and geographies; therefore, investors seeking to make full use of their risk-return options should aim to include all relevant ESG considerations in their analysis as a matter of course.

4. Integration of ESG aspects in financial incentives

4.a. When selecting and remunerating asset managers, how do institutional investors take into account asset managers' integration of ESG issues into investment strategies? What are the best practices in this area?

From our experience the majority of institutional investors do request information on the ESG practices of asset managers as part of their selection process, for mainstream mandates this information is normally provided through the 'Request for Proposal'(RFP) process and doesn't often lead to in depth discussions relating to ESG practices. Where institutional investors are seeking specific ethical, SRI or impact mandates they will take more time to understand our processes in detail.

ESG activities are generally incorporated into fees charged for the asset management service, rather than overtly referenced or separated out within the remuneration package. Given that ESG risks and opportunities make up one element among many in investment decision making, this strikes us as an appropriate approach.

4.b. Is ESG performance and active asset ownership taken into account in the remuneration of the executives and/or board members of institutional investors? What are the best practices in this area?

ESG performance is not typically accounted for in remuneration of executives and/or board members, and we do not believe that this detracts from successful integration in investment strategies.

The ESG landscape is continually evolving as values shift and change and investor awareness increases. In order to keep pace, we believe that dedicated professional resource is required to monitor and analyse ESG risks, and it may be necessary in the future to consider whether current practices incentivise in a meaningful way that adds value to investment decision-making.

5. Capacity of institutional investors

5.a. Do you think that the lack of scale or the lack of skills and resources of some institutional investors may affect their ability to integrate ESG factors in investment decision-making and engage on such issues? If so, how? Please provide evidence if possible.

We do believe that a lack of scale, skills and resources effects investors' ability to integrate ESG factors and engage on such issues. As stated previously, we believe that ESG integration is a fast-moving investment discipline that requires dedicated professional resource. The ability to effectively engage with companies to discuss their management of ESG issues adds an important facet to this type of analysis. Published ESG indicators may be out-of-date and/or may not reflect the steps that a company is taking to address their exposure to an ESG issue. The ability to discuss this directly with the company, as well as to corroborate information with its suppliers, competitors and customers, therefore adds significant value to the overall assessment. Investors without focused resources and/or those that struggle to gain access to companies (due to a lack of either resources or scale) in order to obtain and verify ESG information would therefore struggle to adequately consider ESG issues in decision making.

5.b. Please indicate measures/practices that have contributed to enhance institutional investors' capacity and ability to integrate ESG factors in investment decision-making and engage on such issues.

The establishment of industry standards, such as the UN-backed Principles for Responsible Investment and Stewardship Codes in regions such as the UK and Japan, as well as newly formed indices, have aided the ability of investors to integrate ESG into decision making and engage on such issues. The creation of these standards establishes an element of consistency in setting the expectations of the market and of asset owners, and enables them to hold their investment managers to account more clearly and articulately. In addition, with increasing awareness and focus comes an increasing understanding and fluency in the wider market regarding ESG considerations, which facilitates effective dialogue with companies.

6. Internal governance and accountability of the institutional investor

6.a. To what extent can good internal governance of institutional investors, such as mechanisms aiming to align interests between beneficiaries, board and key executives, influence their ability and willingness to integrate ESG factors in investment decision-making and engage on these issues? Please provide evidence or good practices if possible.

Delivering to the expectations of the beneficiaries is and should rightly be the main focus of the boards and key executives of institutional investors. It is therefore necessary to put in place well governed mechanisms by which the expectations can be set and managed accordingly. Such processes where the interests of beneficiaries are clearly understood may allow boards and key executives to develop mandates that are more specialist and include more restricted investment universes by excluding certain investments. Where it is more difficult to obtain a clear consensus of beneficiary expectations institutional investors will find it more difficult to place specific restrictions on investments but this does not prevent the use of ESG factors in the investment process which we have indicated above have significant financial impacts on investments.

We have experience of certain institutional investors which are more able to gauge the values of their beneficiaries and do put in place more restricted mandates while our mainstream investment process does include the consideration of ESG factors in our investment process used in respect of all of our portfolios management on behalf of clients.

6.b. Do beneficiaries of pension funds and other institutional investors with long-term liabilities obtain sufficient and clear information about how the fund or investor is managing ESG risks? Can they give their opinion/be consulted on these aspects? Please provide examples of good practice.

Improvements could be made in this area. Better reporting would facilitate a deeper understanding and more meaningful dialogue on ESG implications. At Standard Life Investments, we aim to provide investors will all relevant information; in addition to clients receiving regular reporting on the funds in which they invest, we also regularly publish our voting and engagement activities on our website, as well as various research and thought leadership pieces to provide more in-depth analysis of prevalent and/or emerging ESG issues. These can be found on our website at: http://www.standardlifeinvestments.com/sustainable_and_responsible_investing/documents.html and http://www.standardlifeinvestments.com/governance_and_stewardship/documents/index.html

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

While our reports are freely available on our website, web analytics show that, despite the direct links from our homepage, the specific Responsible Investment and Governance sections of the site have received less than half the traffic of our broader Capabilities section over the last year. This may suggest that investors are unaware that the information is available to them or potentially that it is not necessarily at the front of their minds.

ESG reporting is at an early stage and will naturally increase and improve in the coming years in response to further requests for this type of information. Currently, we find that Trustees acting on behalf of beneficiaries tend to be more interested in this information than the beneficiaries themselves.

7. The role of other service providers

7.a. Is there sufficient long-term oriented, reliable and relevant external investment research? Are there barriers to good quality external investment research on ESG risks and opportunities? If so, please explain. What role, if any, do financial incentives or conflicts of interests of some service providers play?

Useful research on ESG risks and opportunities is available and we believe that the quality of information provided is increasing. However, care must be taken when using this information to form a long-term (3-5 years) view. While longer-term analysis may be included, by their nature, broker reports aim to encourage more immediate, short-term action based on their recommendations.

7.b. To what extent do investment banks, investments analysts and brokers provide information on medium-to long-term company performance, including corporate governance and corporate sustainability factors, when they make buy, sell and hold recommendations to investors?

As mentioned above, research available from analysts and brokers may prove more useful in driving short-term behaviour than in forming longer-term views.

7.c. To what extent do investment consultants consider the asset managers' approach to ESG issues and active asset ownership when advising institutional investors about the selection of asset managers?

The consideration that investment consultants give to ESG and active ownership when providing advice is increasing. We have seen more consultants integrate specific research on the ESG capabilities of their potential asset managers into their advisory process, as well as those aiming to develop more quantitative-based scoring tools in relation to ESG.

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

The majority of resolutions tend to be in relation to governance issues, such as board composition, remuneration and audit matters, which are strong considerations in voting recommendations. Environmental and social resolutions are also increasing, and as a result are becoming a more of a consideration; however, to date, the number of environmental resolutions has been relatively limited. When considering voting action we believe that the policies and recommendations of proxy advisers are aligned to delivering the long term success of a company.

7.e. To what extent do credit rating agencies take medium-to long term performance of companies, including ESG performance, into account in their ratings?

We believe that there is room for improvement in this area, but are encouraged by the increasing consideration of ESG issues by credit rating agencies. Many agencies already consider ESG issues in their ratings and are making this more transparent. For example, Moody's recently published a report to explain how it integrates ESG considerations into its ratings, methodology and research.

7.f. What are the best practices as regards independent external assurance (for example auditor review) for the disclosure by companies of material medium- to long-term risks and opportunities, particularly ESG issues?

We believe that best practice entails assurance by an independent third-party auditor who should review and assess the material risks disclosed by companies which could have material financial impact on the company.

8. The role of non-professional investors

8.a. Do you know of initiatives that led to more sustainable and responsible investment from non-professional investors? Please provide details about them.

We are not aware of any initiatives.

9. Legal or regulatory constraints

9.a. Are there legal or regulatory constraints likely to significantly and unduly prevent or discourage investors from taking a long-term view in their investment strategies and decisions and from investing in a sustainable way? If so, please provide details.

We firmly believe that companies demonstrating a commitment to sustainable business practices and high standards of stewardship will likely enjoy a competitive advantage in the long run, and that investors seeking to make full use of their risk-return options should aim to include all relevant ESG considerations in their analysis as a matter of course. We therefore do not see any reason why legal or regulatory constraints aimed protecting beneficiaries' interests should prevent or discourage investors from taking a long-term view or from investing in a sustainable way.

9.b. Do you believe that there are any barriers to the understanding by institutional investors and asset managers of their fiduciary duties that would not enable them to appropriately take ESG factors into account in their investment decisions? Please explain.

There has been significant discussion on whether the concept of fiduciary duty restricts institutional investors' and asset managers' consideration of ESG factors in their investment decisions. We understand that this is predicated on an interpretation that requires investment decisions to be based solely on financial considerations. As we have previously stated, we believe that ESG factors do have a financial impact on the portfolios we manage for our clients and therefore do not believe that the concept of fiduciary duty would impact on our ability to consider them in our investment decisions.

10. Others

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

No

10.b. Would you consider further increase in sustainable investments if market or regulatory conditions for sustainable investment would be more favourable? If so, please provide estimations, if possible.

At Standard Life Investments, we aim to integrate ESG considerations into all of our investment research because they have the potential to materially impact the financial performance of the portfolios we manage and of businesses across sectors and geographies in which we invest. We believe that these aspects will become increasingly important for our clients and are committed to evolving and improving our processes in line with client demand and expectations, which includes developing tailored sustainability product offerings as well as integration into mainstream products.

You can upload additional documents here:

Disclaimer:

This document is a working document of the Commission services for consultation and does not in any manner prejudge the final form of any future decision to be taken by the Commission.

Contact

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