aba – Arbeitsgemeinschaft für
betriebliche Altersversorgung e.V.

Public consultation on long-term and sustainable investment
aba response

22nd March 2016

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?

First of all, we would like to make two general points:

- Including ESG factors in investment decisions can take different forms, which are very different in their complexity, cost and impact. Investors can for example draw up negative lists specifying what they do not want in their portfolio, e.g. companies using child labour, companies which produce (chemical) weapons, bonds issued by non-democratic countries etc. This limits their investment universe. Another way of incorporating ESG factor for investors is to engage with the companies they invest in, be active shareholders and thereby influence the behaviour of the companies in question. This does not limit the investment universe. It is the decision of the investor how much time and effort is used to pursue these or other approaches, leading to very different strategies and results.

- We would like to highlight the situation of German IORPs: in contrast to personal pension provision, occupational pensions in Germany are always linked to a sponsoring employer and sometimes in addition to social partners of a special industry. These relationships also matter for the inclusion of ESG factors in the investment decision of the IORP. The sponsoring employer might already have an ESG strategy in place which will then have an impact on the investment strategy of the IORP. In addition, the field in which the sponsoring undertaking operates will influence ESG decisions: e.g. the IORP of a company running a nuclear plant will not put nuclear energy on a negative list.

We think that the role ESG factors play in investment decisions varies across investors in Germany. While there certainly is room for further improvement, the current low interest rate environment and the pressure it puts on IORPs mean that ESG issues have taken the back seat. The security of the investment which achieves the necessary return is more important for investors than ESG factors. Therefore some investors do not include ESG factors in their investment decisions. Their primary responsibility of strategic investment decisions is to maximize the returns to fulfil the pension commitments for the members. Other priorities are a reasonable mix and diversifications of the assets, while maintaining an adequate level of liquidity. Investors often fear the higher costs of ESG research.

The role ESG factors play in investment decisions also depends on the asset class. ESG factors play a larger role in equities, fixed-income corporate bonds and real assets.

Turning to those investors who do take ESG factors into account, they mainly perceive governance risks as material (shareholder treatments, remuneration…) and they also increasingly incorporate ESG research to get a more comprehensive view on an investment; e.g. by asking managers if they are PRI signatories and, other things being equal, choosing them over non-signatories; ESG issues can be discussed at the annual meeting and managers can be asked for actions in that field (without defining the type of actions).

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: managing asset value risk in the medium- to long-term, mitigation of exposure to long-term and systemic risks

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, (might lead to greenwashing)

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: reputation (unfortunately sometimes leading to greenwashing)

2. Information on ESG risks and opportunities

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

Governance; Bonus- systems; whether there is a plan for dealing with / addressing climate change in place (in particular for energy companies); how companies comply with labour law and treat their employees (reputation risk); corruption (states and companies); access to commodities (e.g. water) and general environmental issues.

Events such as the 2015 Climate Change Conference in Paris for example push environmental issues up the agenda for investors.

As an example from the independent multi-employer pension fund that serves Germany's construction industry: Concerning direct real estate investments they expect from their contractors (real estate developers, architects, construction companies, handicraft enterprises) to comply with collective agreements about wage and labour, health and security conditions.

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?

Asset managers in the case of indirect investments; ESG research; company reports (although the room given to ESG factors varies from company to company); NGOs;

Most investors agree that it can be difficult or even impossible to compare the information.

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

Sometimes yes, because it is expensive; not all companies publish this type of information, and if so, it might not be complete. Different actors analyse the issues and publish the information in different ways, making it difficult to compare. In addition, most research is equities focused.

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

Yes, (quality) information is expensive, additional costs often depend on the type of information needed.

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

No systems in place; no demand; expensive; do not believe in the importance and materiality of the information; data protection; often it is unclear about what and how to inform.

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

e) pressure from stakeholders

f) other

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

In some areas yes, in others not. While some hard information such as data on water use or CO_2 emissions can be measured, activities to improve e.g. governance or labour conditions are less tangible. In areas where it is difficult to measure improvement, greenwashing might occur.

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

The European Federation of Financial Analyst Societies (EFFAS) and the Deutsche Vereinigung für Finanzanalyse und Asset (DVFA, Society of Investment Professionals in Germany) published in 2010 A Guideline for the Incorporation of ESG into Financial Analysis and Corporate Valuation. The Guideline includes Key Performance Indicators for ESG, building on the requirements of investors. The Guideline was published after a three year discussion process with a network of investment professionals and experts around the world.

In September 2013 the Deutsche Börse Group published "Communicating Sustainability. Seven Recommendations for Issuers (Summary)". The Recommendations were developed by market participants for market participants and are supported by a number of German associations.[1]

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

For investors it is diversification and yield enhancement. If companies want to use them to refinance this will force them to disclose ESG issues.

On the other hand, it might be too early to say. The size of the market makes it niche for now.

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.

While being far from a concrete risk assessment methodology, the UN Principles on Responsible Investment (UN PRI) are a good starting point for many investors. They are also a fall-back option for those companies or IORPs who have not developed their own catalogue of principles, they are kept simple and general and can therefore be fully or partly integrated into the investment process.

[1] According to the Deutsche Börse Groupe website, „The seven recommendations were compiled in cooperation with representatives of renowned issuers and investors from the Issuer Markets Advisory Committe (IMAC), an advisory committee of Deutsche Börse AG in capital markets issues. They are also supported by Deutscher Fondsverband (the German Investment Funds Association, BVI), Deutsches Aktieninstitut (a German issuer organisation), Deutscher Investor Relations Verband (the German Investor Relations Association, DIRK) and Deutsche Vereinigung für Finanzanalyse und Asset Management (the German Association for Financial Analyses and Asset Management, DVFA). During the consultation phase, the Guide was tested and sharpened with regard to its contents in a number of bilateral conversations with market participants.“

The most important Directive for IORPs is the IORP Directive and should be kept in mind. The discussion of the revision (IORP II) is going on (Trilogue start: 29 February 2016). The EP wants to include ESG criteria in some requirements (i.a. Articles 29 and 55). Importantly, duplication and inconsistence in the requirements for IORPs have to be avoided.

The good practices depend on the asset class.

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.

From our perspective, there are five factors which have an impact on investor behavior in this area: fear of a lower return; reduced investment universe; higher costs; many ESG factors are not specific; lack of human resources. In addition, day-to-day investment decisions are often outsourced to external asset managers, with the investors not providing additional indicators relating to ESG factors.

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?

If an investors wants ESG factors to be taken into account by external managers, this will be specified in the requirements for the asset manager. It is not taken into account in isolation, but must be based on overall performance.

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?

No, because ESG performance is difficult to extract (in many cases there is no distinction between ESG-mandates and non-ESG mandates).

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.

Even initial activities may prove complex and expensive (e.g. to take the decision to not invest e.g. in arms: apart from investing in arms companies what about their suppliers, sub-contractors, creditors like banks etc). But the more ambitious the ESG goals are, the more complex and expensive they become. The different approaches different IORPs choose are often closely related to their sponsors (and, where applicable, their ESG strategy).

Turning to the advanced and complex incorporation of ESG factors, many investors fear the costs and cannot increase their staff appropriately; and a lot of managers don´t know the newest results of the research concerning ESG;

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.

Without doubt, the UN PRI have advanced the awareness and understanding of ESG factors in investment. With the growing demand, service providers (e.g. consultants) now specialize in ESG factors, and special indices have been developed.

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.

As stated in our answer to Question 1, German IORPs have a specific governance structure: in contrast to personal pension provision, occupational pensions in Germany are always linked to a sponsoring employer and sometimes in addition to social partners of a special industry. These relationships also matter for the inclusion of ESG factors in the investment decision of the IORP. The sponsoring employer might already have an ESG strategy in place which will then have an impact on the investment strategy of the IORP. In addition, the field in which the sponsoring undertaking operates will influence ESG decisions: e.g. the IORP of a company running a nuclear plant will not put nuclear energy on a negative list.

In addition, members and beneficiaries are often represented in decision-making bodies of the IORP. They are in a position to advocate the inclusion of ESG factors in the investment decisions of the IORP.

Overall, ESG factors tend to matter in the long rather than in the short run, it is therefore important to set long-term goals rather short-term performance measures or short-term incentives for asset managers.

As with any other objectives, senior beliefs and convictions are crucial.

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

In Germany, IORPs (Pensionskassen and Pensionsfonds) as well as life insurers for direct insurances (Direktversicherungen) are required by the Versicherungsaufsichtsgesetz to inform their members and beneficiaries at the beginning of the contract and then annually about how ethical, social and ecological factors have been considered when investing their contributions.[2]

Overall it seems to be the exception in Germany that individual members voice opinions or even just ask about the incorporation of ESG factors. They can give their opinion, but often ESG aspects are very complex in the context of investment decisions, so they get a general overview.

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

There are exceptions, but overall interest is perceived to be relatively low in Germany. However, driven by external events such as the UN Climate Change Conference in Paris or, on the other hand, scandals (e.g. emission scandals; labour conditions of supplies; investment in cluster bombs etc.) often trigger individuals to contact their pension scheme. One IORP reports that decarbonisation and labour rights are regularly an issue.

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?

The market for ESG research is already quite big and growing further, the quality is also improving. But the comparability of the different research is complex and this also burdens the companies, because they do not know the assumptions / requirements / standards of the researchers.

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?

Detailed information is almost never provided. However, on demand assessments and information are shared.

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 ofasset managers?

Almost never, unless it is already included in the concept.

[2] Text from the Versicherungsaufsichtsgesetz (VAG): Information as to whether, and, if so, how, it takes ethical, social and ecological interests into account in the way it invests the contributions paid. (Art. 144 for Direktversicherungen; Art. 234 for Pensionskassen and Art. 237 for Pensionsfonds).

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

Often to always (because those engaging proxy advisers will have an interest in ESG performance, otherwise they would not engage them).

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?

Increasingly, but it is not yet mainstream. All rating agencies take long-term performance into account, ESG is only sometimes included.

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 are not aware of any best practices as regards independent external assurance for disclosure in Germany.

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.

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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.

Generally not, however, there might be certain ESG strategies which are unlikely to achieve the actuarial interest on a yearly basis.

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.

No, but fiduciaries are busy people and ESG is not priority; please refer to the Freshfields Report (2006, new one in 2015).

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10. Others

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

Again, we would like to highlight the situation of German IORPs: in contrast to personal pension provision, occupational pensions in Germany are always linked to a sponsoring employer and sometimes in addition to social partners of a special industry. These relationships also matter for the inclusion of ESG factors in the investment decision of the IORP. The sponsoring employer might already have an ESG strategy in place which will then have an impact on the investment strategy of the IORP. In addition, the field in which the sponsoring undertaking operates will influence ESG decisions: e.g. the IORP of a company running a nuclear plant will not put nuclear energy on a negative list.

One further obstacle might be the vagueness of the concept of incorporating ESG factors – everyone takes ESG to mean something different, making communication and especially comparisons difficult. However, we would like to stress that pensions and particularly IORPs are facing sufficient challenges at the moment: they need to navigate the low interest rate environment, while IORPs also face the uncertainty stemming from the review of the IORP Directive. It should therefore be left to the individual IORP and where applicable to the sponsoring undertaking to decide how and to what extend they want to pursue ESG goals.

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.

ESG factors may play an ever larger role in future tenders. But for the moment the aspect of ESG remains to be one of lesser importance.

To avoid uncertainty for IORPs and sponsoring employers and to allow them to address the challenges they currently face, the Review of the IORP Directive should not lead to additional regulatory changes in this field.

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