Position Paper

Reponse to European Commission consultation on long-term and sustainable investments

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Key messages on long-term and sustainable investments

Insurance Europe would like to share the following key messages on the EC consultation on long-term and sustainable investments:

- Insurers have a long-term business model which entails the matching of long-term liabilities to policyholders with long-term investments. Against this background, insurers have a natural interest in the long-term performance of their investments and have played an important role in the developments of standards in the area of suitability and environmental, social and governance (ESG) factors.
- Insurance Europe believes that the long-term character of the insurance business model needs to be better reflected throughout all areas of legislation that affect it. This includes the Solvency II prudential framework, which creates impediments to insurers' long-term investments.
- The Commission should take care not to make any premature attempts to foster the consideration of ESG criteria in decision-making. Sustainability criteria are, by definition, targeted at long-term performance and the building-up and verification of knowledge and expertise take time.
- Enhanced expertise in and awareness of ESG performance on the side of companies seeking long-term finance are expected to further develop once the requirements of the Directive 2014/95/EU fully apply.
- DG JUST should take care to avoid duplications of and/or inconsistencies with the work in development by DG FISMA in the area of non-financial reporting.
- Before taking any action, the Commission should take into consideration market-led or legal systems and schemes already in place (eg environmental or energy laws in some jurisdictions, well-established initiatives of voluntary investment guidelines or principles). The identification and sharing of best practices should be first considered prior to developing further initiatives.

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Responses to the consultation questions

1. Rationale for ESG inclusion into investment decisions

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

ESG factors have the potential to impact investment decision-making and portfolios across companies, sectors, regions and asset classes over time. ESG factors can affect risks and returns and are therefore considered and monitored by many insurers in various ways. This approach is based on a significant number of studies analysing the relationship between ESG criteria adherence and financial performance. Responsible investment (RI) can create value when undertaken adequately, as it improves understanding of risk drivers that can impact a portfolio's overall performance in the long term. The latter is especially true for large institutional investors whose investment performance is often representative of the performance of capital markets as a whole, as well as the growth of the broader economy (so-called "universal ownership"). The approach is therefore broader than a mere asset allocation to socially responsible investment (SRI) funds, which so far remains a niche strategy.

The relevance of ESG factors for investment decisions varies from investor to investor. The commitment to ESG integration is already reflected in numerous internal investment policies of insurers. Many insurers are also signatories to the Montreal Carbon Pledge as well as the UN Principles for Responsible Investment (UN PRI) and UN Principles for Sustainable Insurance (UN PSI), which commit them to implement the principles and report on progress in this area every year.

Insurers' commitments in the area of ESG comprise but are not limited to:

- soft and individual factors
- sustainability reports
- ESG strategies with exclusion criteria, best-in-class or other types of approaches
- engagement and voting
- preference for asset managers that follow UN PRI
- reputational risk committees to discuss potential sustainability issues
- integration of ESG performance metrics

Ultimately, internal policies and public commitments affect investment management processes, including investment decisions, voting and engagement.

1.b. What is the main rationale for institutional investors and asset managers to take ESG risks and opportunities into account in their investment decisions? Please indicate all the relevant issues (multiple choice) ☒a) risk management: ☐i) managing asset value risk in the short-term, including preservation of investment value, better investment performance, ☒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, ☒b) alignment of investment policies with the long-term interests of beneficiaries of the institutional investor, ☒c) pressure from clients on whose behalf the institutional investor invests funds, ☒d) seeking a positive social or environmental impact of investments, ☒e) ethical considerations, ☒f) legal or regulatory constraints, please specify,

Examples:

- in some jurisdictions ESG reporting obligations are in place
- investments in cluster ammunition are prohibited in some jurisdictions
- insurers have to comply with sanctions or embargoes

☒g) other, please specify.

Many insurers seek to improve the long-term financial performance of the portfolio with sustainable business models. Consumers are more likely to recycle, to switch to green energy providers and to buy goods from companies that focus on reducing packaging. This may have an impact on the long-term financial performance of companies that insurers invest in.

Please provide an explanation:

Remark: The level of relevance varies from company to company. Generally, all objectives selected above can be considered as relevant. ESG performance usually evolves gradually and ESG factors consequently tend to have more importance in decision-making where an investment has a medium- to long-term duration.

Regarding b) Insurers have long-term liabilities with significant societal impacts. Consideration of ESG criteria in the investment decision is one way of aligning their investment strategy with their broader social agenda. Furthermore, universal ownership plays a role. Broader social, environmental and macroeconomic factors are key to the financial performance of investors that own a diversified and large portfolio. As a result, ESG can be a way to align investment practices with the interests of the insurer (eg regarding long-term societal challenges).

Regarding c) European institutional investors often explicitly request ESG/RI expertise when selecting asset managers. However, the situation for retail investors is different. While direct pressure from retail investors to consider ESG criteria remains low in most markets, some customers request information from investors on their ESG integration and engagement.

Regarding d) Seeking a positive social or environmental impact is an objective that, for instance, "impact investment" strategies are targeting.

Regarding e) Ethical considerations can lead to exclusions from the investment universe. A simple example is controversial weapons.

2. Information on ESG risks and opportunities

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

Perception of materiality of ESG risk factors differs between regions and industries, as well as within specific industries. Each investor conducts its materiality assessment according to its skills and investment profile. For example, environmental risks are likely to be more material in carbon-intensive industries, while governance risk factors are often relevant across sectors. European insurers operate globally and are potentially exposed to all types of ESG risks.

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?

Insurers use, depending on their individual situation, a large variety of data sources for their assessment of ESG risks. ESG information can be categorised according to the following criteria:

- individual vs aggregated (company disclosure vs index)
- primary vs secondary information (disclosure from companies vs ratings for these companies)
- micro vs macro information (company-specific vs market-specific information)

Examples of available data sources:

- companies' sustainability, PRI, CDP and CSR reports
- SRI rating agencies
- data vendors with ESG capacity or ESG screening agencies (companies that conduct screening against norm-based criteria, sector criteria)
- NGOs and media provide extra information that can challenge or confirm corporate disclosures
- specialist data vendors provide focused databases and analyses on topics such as corporate governance or climate change
- bilateral engagement with companies
- brokers or investment recommendations
- sometimes public statistic institutes

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

Some ESG information, especially certain indices, is already widespread and available. However, data challenges for investors include:

- cost of ESG research (eg fees for SRI agencies or in-house expertise)
- coverage of available data (eg lack of coverage for emerging markets, small caps, unlisted equity)
- lack of standardisation of ESG data
- diverging views of analyst experts (eg in complex industries)
- interpretation of heterogeneous data can pose challenges (eg information from different sources, information overload, materiality unclear, different quality)
- involvement of third parties that do not provide ESG information (eg brokers, investment advisers, asset managers)

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

The cost of access to information from ESG research and/or rating providers can be prohibitive for smaller investors. Databases, which are more easily accessible for asset managers often at lower cost, also require in-house expertise for ESG analysis. Access to raw data is not expensive but there is a lack of expertise.

However, it has to be noted that some insurers (or their asset managers) are of the view that the costs associated with accessing such data are sometimes over-estimated, since information is not only used for ESG analyses. While high-quality data and its analysis trigger additional expenses, they can create value in the decision-making processes.

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

Insurance Europe would like to highlight the following main impediments:

- Reporting obligations, depending on their depth and scope, can be significantly burdensome and costly, while not all companies have the resources for ESG-type reporting. Disclosure should therefore aim to focus on material information.
- Some ESG disclosures may contain complex, forward-looking or unusual messages, which may mislead investors without ESG expertise.
- Potential prejudices to the commercial position of a company might also prevent enhanced disclosures (see Directive 2013/34/EU Article 19a (1)).
- Further disclosures increase the exposure to reputational risk due to easier access for critics of the company.

Insurance Europe notes that DG FISMA is conducting a consultation with regard to "non-binding guidelines for reporting of non-financial information by companies", based on the requirement of the Directive on disclosure of non-financial and diversity information by large companies and groups (Directive 2014/95/EU). The guidelines will bring greater clarity, consistency and comparability regarding non-financial reporting.

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

☒a) relevance of ESG issues to company performance

☒b) attracting financing for specific projects, for example green bonds

☒c) legal or regulatory constraints

☒d) demand from investors

☒e) pressure from stakeholders

☒f) other – please specify:

Remark: The rationale for publishing such information is company-specific and therefore any of the issues a)-f) is possible.

Regarding a) Often the ESG performance factors are closely linked to companies' core business risks and opportunities and ESG data disclosure is part of the business model.

Regarding b) The disclosure of ESG data for attracting investors is relevant in the case of green bonds but much less so for other investments.

Regarding c) Environmental and/or energy laws in some jurisdictions[1] require, among other things, analysis of the environmental and social impact of the investment policy and reporting to policyholders.

Regarding d) RI-focused investors require detailed ESG reporting.

Regarding e) Relevant stakeholders (apart from a-d): clients, NGOs, employees, jobseekers.

Regarding f) Leaders in the market may make an initial step in disclosing ESG-type information and this will often trigger similar initiatives by other market players. ESG factors are also taken into consideration as selection criteria in Directives 2014/23/EU, 2014/24/EU and 2014/25/EU on concessions and public procurement.

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

Regarding company-specific data, some jurisdictions require ESG information to be audited by the company's external auditors, which strengthens the reliability and trust in the data, but also comes at a cost. Most ESG disclosures, however, remain at the discretion of the reporting entities, with varying levels of rigour and limited standardisation.

Insurance Europe supports market-led disclosure initiatives, particularly given the material costs associated with the disclosure of such information and different approaches followed by companies. In addition, Insurance Europe notes that DG FISMA is conducting a consultation with regard to "non-binding guidelines for reporting of non-financial information by companies", based on the requirement of the Directive on disclosure of non-financial and diversity information by large companies and groups (Directive 2014/95/EU). Insurance Europe recommends not to make any decisions or recommendations with regard to disclosure / audit of non-financial information without taking into account the outcome of this consultation.

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

Within companies, clear internal policies are best suited to ensure reliability of the disclosed information.

[1] An example is the recent Energy Transition for Green Growth Act (especially Article 173) adopted in France last year, which includes specific reporting requirements for institutional investors. As a consequence, insurers have to provide to their policyholders information on how they consider social and environmental objectives in their investment policy.

Elements of internal ESG policies can include:

- reference to material ESG information in the company's main reporting documents
- regular (eg annual) and formalised oversight of ESG/RI strategies by executive management and supervisory boards
- reporting according to already developed sustainability reporting standards
- putting in place sustainability committees in companies

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

The role of ESG investment instruments varies from market to market (in terms of availability) and from company to company (in terms of suitability and attractiveness). Often, these instruments only play a minor role since there is still a lack of or limited supply of ESG-specific investment instruments.

Green bonds have the potential to be a powerful instrument to channel a proportion of fixed income assets into projects that directly tackle environmental challenges such as climate change. The ambitious label 'green bonds', however, bears a reputational risk of being subject to accusations of greenwashing (which can be reduced by consulting external advice on the projects supported or adherence to certain green bond market standards). Furthermore, it is not obvious that the existing green bonds have led to an increase in environmental investments. For example, in 2014 EIB invested €19.6bn in environmental projects while it raised €4.3bn in green bonds. It is therefore possible that the EIB would have invested with a similar volume even without funding via green bonds.

Alternatives to direct purchase of green bonds are, for example, thematic funds, which in some cases have built a good track record.

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 analysis of risks should not be limited to purely financial information and to backward-looking approaches and outcomes. A risk analysis should be linked to parallel long-term risk assessments (ie forward-looking approach), eg involving climate change models and reflecting other emerging risks to the extent possible.

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.

Costs associated with gathering and processing of ESG information can represent a barrier, especially for medium-sized and small insurers. However, the availability of data is expected to improve once the requirements of Directive 2014/95/EU apply.

Furthermore, an important parameter in investment decision-making is represented by the historic performance of specific assets, based on track records of 5-10 years. While some investments have such a track record, many sustainable investments lack this sort of history and would be difficult to assess on this basis.

In some cases, despite evidence to the contrary, social and environmental performance and risks may not be recognised or valued by investors due to the lack of a 'business case' that links social and environmental issues with financial performance and risks. This is often because social and environmental impacts are viewed as externalities and policy risks are assumed to be not significant — for instance, when related environmental policies or their enforcement are either weak or lacking. Sometimes lacking expertise is also the reason. ESG risks are not a subject widely taught by finance/business degrees across Europe. As a result, many fund

managers who are involved in day-to-day investments may not see or understand the value of incorporating ESG risks into their investments.

Other barriers can include difficulties in comparing available ESG data (especially in the case of qualitative instead of quantitative ESG data).

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?

In general, it is not common practice that fees are linked to ESG factors. ESG issues can, however, be addressed in the mandate to the asset manager itself. This could include:

- reflecting ESG factors in the due diligence process
- asset manager has an ESG policy in place that requires, for example, signature of UN PRI
- compliance with company-specific ESG strategy
- some investors put in place rolling multi-year incentive programs for asset managers

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?

It is very rare that ESG performance is taken into account in the executive remuneration. However, it depends on the market and specific situation of a company. Company-specific information can be found in annual reports or corporate social responsibility (CSR) reports.

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.

Considering ESG factors, for example by signing and complying with the UN PRI or via complete ESG integration, is cost-intensive and therefore, to a certain degree, it can become a matter of resources and consequently scale. However, specific ESG factors as part of the overall risk analysis can be considered by smaller companies as well.

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.

Examples of measures/practices that facilitate the integration of ESG factors:

Enhanced access to data

- ESG research services
- ESG ratings
- CSR reporting
- UN PRI
- integration of ESG data in commercial investment databases

Enhanced expertise

- increasing track record of ESG investments (also where the company itself has not yet integrated ESG factors, but can observe the performance of competitors)
- increased expertise on the side of asset managers in the analysis of ESG factors

Other

- local sustainable investment fora (SIF)

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.

Internal governance certainly influences the ability and willingness of investors to integrate ESG factors in investment decision-making and engagement on these issues. For instance, the involvement of the management board is key to promoting the integration of ESG factors and raising company awareness.

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.

The extent to which information on ESG elements is available to policyholders largely depends on the extent to which adherence to ESG criteria is done on a voluntary basis (in which case the insurer often has public disclosure on how ESG elements are incorporated in investment decision-making) or on a legal requirement basis (in which case there may be/or not a requirement for disclosure/choice given to the policyholder).

The insurer does have due diligence requirements in investment decisions and Solvency II incorporates a broad prudent person principle, as a consequence of which investment decision-making is done for the benefit of policyholders.

In terms of practical examples, interested policyholders often have the option to select products that consider sustainability aspects. In such a case, the policyholders will also receive respective information from their insurance company. In some member states, the legal framework for certain retirement products requires disclosure of the integration of ESG factors to policyholders.

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

Policyholders have not shown great interest in ESG matters related to their insurance policies. Companies only receive few such requests. Many insurers, however, consider raising ESG awareness is part of an insurer's role in society.

7. The role of other service providers

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

While the supply of external ESG research has improved, the market remains small. Providers of such services predominantly provide information in retrospect. Asset managers that have an explicit commitment to sustainability elements can also represent a relevant source of external ESG information. Most external investment research looks at risks over 10 years and is backward-looking.

Insurance Europe sees a potential conflict of interest where ESG agencies offer both research and advisory services. This could make insurance companies face reputational risks as a consequence of commercially driven research from ESG service providers. Potential conflicts of interests should be addressed.

Regarding indices, the increasing history and more wide spread use of the main indices has brought enhanced quality and accountability.

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?

The information varies with regards to providers of recommendations, instruments, project and technology, but it is mostly short term focussed.

There is anecdotal evidence in some markets suggesting that investment banks, when they make recommendations to buy, sell and hold, do not always comment with respect to ESG factors. While investors already have access to a broad range of information, they would expect investment banks to consider information on ESG criteria, however, only in cases where it is material.

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 extent of advice depends very much on client preferences and asset classes. The advice is still mainly based on traditional financial criteria, although a growing number of investment consultants have developed advanced RI/ESG expertise. Investment consultants are decisive players who provide advice for a large volume of investments but their understanding of ESG factors is sometimes inadequate. Shortfalls attributed to investment consultants' analysis of ESG risks include:

- Overlooking how fund managers analyse corporate governance, corporate sustainability, cultural and ethical issues when investing.
- Failing to consider how effective fund managers are as owners, or stewards, of companies in promoting better performance in non-financial areas.

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

Proxy voting agencies have significant potential to sway how ownership influence is exercised via the voting process, as they advise a substantial portion of the market at shareholder meetings. The voting recommendations depend on the investment, technology and location. Although the relevance of ESG performance is increasing in some markets, it is still sometimes observed that proxy advisors do not embed ESG factors in their advice.

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?

Credit rating agencies consider ESG criteria as soft factors in their ratings, mainly with regard to governance. Generally the impact on the rating is perceived as very limited, if there is an impact at all.

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?

-/-

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.

-/-

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.

With regard to investors' capacity to adopt a long-term stance in their strategies and align their behaviour with the sustainable development goal, it must first be recalled that such an alignment must also occur with regard to the regulatory framework. Indeed, while insurers are natural long-term investors (as they try to match their long-term liabilities with cash flows from assets), their role can only be maintained if regulatory impediments are removed. For instance Solvency II capital treatment and definitions relating to infrastructure (including the ongoing work on corporate infrastructure) and securitisation have to reflect the actual risks for insurers and give appropriate consideration to their long-term business model.

Insurers are prevented from investing in energy projects along the whole value chain due to the restrictive application of the current unbundling regime in the Electricity Directive (2009/72/EC) and the Gas Directive (2009/73/EC). Unlike traditional energy companies, institutional investors have no incentive to exercise market power or abuse shareholder rights because energy projects are not part of their core business. Since such investments cannot be seen as strategic but only as financial investments, there is consequently no risk of negative implications for the competition in the energy sector from these investments. The respective directives should be changed accordingly. In the meantime, a simplified "impact test" should be introduced for institutional investors, since the current impact test is very complex, time consuming and comes with legal uncertainties.

Sometimes ESG is opposed by some investors on the grounds that integrating "extra-financial" considerations into investment processes violates their fiduciary duty. While priority must typically be given to the highest possible financial return on investment, Insurance Europe is not aware of legal limitations in the EU or any of its member states regarding institutional investors taking into account ESG factors in their investment decisions (compare with EY 2015 report to EC DG Environment). This is also supported by the fact that most leading institutional investors in the EU have sustainable and responsible investment policies and are signatories to the UN PRI, which commits them to incorporating ESG issues into investment analysis and decision-making processes.

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.

From a regulatory perspective, insurers' investments have to meet the investment principles of security, profitability, liquidity and quality. Investment decisions are made on a risk/return basis. If the risk is not obvious or quantifiable, as is sometimes the case for long-term investments, it is difficult to steer the asset manager accordingly.

Fiduciary duty is one of the areas in which uncertainty around stewardship is one of the greatest barriers to overcome. This has been recognised both by the OECD and in particular the Commission's DG Environment in a report on 'Resource efficiency and fiduciary duties of investors'. Insurance Europe would encourage the Commission to be active in the discussions at OECD level to ensure consistency.

10. Others

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

ESG investments are often illiquid (eg infrastructure and private equity). This is not a problem per se for insurers, who are not as vulnerable to liquidity risk as other sectors in financial services. However, it might become a problem if regulators require insurers to invest mainly in liquid assets or create a regulatory framework that impedes investments in illiquid asset classes.

Awareness of the relevance of ESG factors is still very low in some areas. Some investors do not aim to enhance their expertise in longer-term risk and return drivers such as climate change, income disparity, resource scarcity and changing demographics although they aim to establish a long-term contractual relationship with their clients.

Furthermore, standardisation of information and terms is still at an early stage. This is, for example, the case for green bonds.

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.

Lower capital requirements or higher profitability of sustainable investments would result in a further increase of insurers' sustainable investments. This is true in particular for the regulatory treatment of debt or equity investments in renewable energies such as wind farms (infrastructure).