European Commission consultation on institutional investors’ and asset managers’ duties regarding sustainability

BlackRock is a leading provider of asset management, risk management, and investment advisory services to institutional, intermediary, and individual clients worldwide.

BlackRock has a pan-European client base serviced from 20 offices across the continent. Public and private sector pension plans, insurance companies, third-party distributors and mutual funds, endowments, foundations, charities, corporations, official institutions, banks and individuals invest with BlackRock.

BlackRock represents the interests of its clients by acting in every case as their agent. It is from this perspective that we engage on all matters of public policy. BlackRock supports policy changes and regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analysis, preserves consumer choice.

BlackRock is registered in the EU Transparency Register (ID number 51436554494-18).

Introduction

BlackRock is pleased to have the opportunity to respond to the European Commission’s questionnaire on “investor duty” with regards to sustainability.

We believe sustainability is an important concept that is a key driver of long-term value in companies and in the economy, and therefore, sustainability-related issues have increasing importance in the investment process. Towards that end, we recently announced the additions of Brian Deese, formerly President Obama’s Senior Advisor for Climate and Energy Policy, and Tariq Fancy, founder of the Rumie Initiative, as Head and Chief Investment Officer (respectively) of BlackRock’s Sustainable Investing Platform. This global group is responsible for identifying drivers of long-term return associated with environmental, social and governance issues, integrating them throughout BlackRock’s investment processes, and creating sustainable investment solutions for our clients to help them achieve their unique financial objectives.
Prior to these additions, BlackRock was already working with clients to help them understand how sustainability-related issues affect risk and long-term performance, and to incorporate sustainable products and solutions into their portfolios. We currently manage $287bn of assets on our sustainable investment platform, with roughly $24bn in specific pooled funds across a wide range of structures and strategies. Our products range from portfolios investing in green bonds and renewable infrastructure to thematic strategies that allow clients to align their capital with specific outcomes, for example those articulated by the UN Sustainable Development Goals. BlackRock is the largest provider of sustainable exchange-traded funds (ETFs), including the industry’s largest low-carbon ETF; we manage one of the largest renewable power funds globally; and in addition to managing more than $5bn in green bonds, we are the first asset manager to offer portfolio-level impact reporting for a co-mingled green bond product.

Importantly, in addition to offering products that focus specifically on sustainability, BlackRock is committed to integrating sustainability-related considerations into our investment processes firm-wide, in both our actively managed and index oriented portfolios, as appropriate to the strategy:

- On the actively managed portfolios, BlackRock has built tools that allow our portfolio managers to analyse relevant sustainability information alongside the traditional financial metrics they consider when making active investment decisions. As new data sources and sustainability-related insights are uncovered, we integrate this information into our tools and processes.

- In index-based portfolios, while we do not have the discretion to select individual securities in the portfolio outside of their inclusion and weighting in the index, we incorporate and highlight material sustainability considerations when we engage with companies on behalf of our clients, who are shareholders. For example, BlackRock’s Investment Stewardship team identified human capital management and climate risk disclosure as two engagement priorities for 2017 and 2018.

BlackRock has a dedicated investment stewardship team that engages with public companies around the world whose stock is held in both actively managed or in index oriented portfolios. We engage as part of our fiduciary duty, acting as an agent on behalf of our clients, to protect and enhance the value of the assets entrusted to us. This engagement is active and encompasses both a dialogue with companies and the voting of shares held by clients. Michelle

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1 As of September 2017.
3 To read more about BlackRock’s approach to investment stewardship, please see: https://www.blackrock.com/corporate/en-tw/about-us/investment-stewardship
Edkins who leads the Global Investment Stewardship Group has been at BlackRock since 2009, and we recently announced that, in addition to doubling the size of the stewardship team in the next three years to over 60 professionals worldwide, Barbara Novick, Vice Chairman and a co-founder of BlackRock, will oversee the firm’s efforts in this area.

Our increased focus and continued investment reflects the importance of sustainability to the investment, risk management, and stewardship processes, and of course, the increased interest in sustainability by our clients.

**Investor Duty and Fiduciary Duty**

The question of “investor duty” is a complicated one. As an asset manager, BlackRock fundamentally understands our duty as that of a fiduciary to our asset owner clients: acting as their agent, investing their capital in accordance with their wishes, and using the means at our disposal to enhance the value of their investments. It is through this lens that we see sustainability, and in particular, the use of environmental, social and governance (ESG) considerations to mitigate risk and enhance long-term returns.

While many people conflate the roles of asset owners and asset managers, the distinction is important. Asset owners, such as pension plans, insurers, sovereign wealth funds, and individual investors, are the owners and beneficiaries of stocks and bonds. Asset owners also determine the asset allocation parameters of their overall portfolio and specify the investment parameters of any individual investment mandate within the portfolio.

Some of these asset owners manage their assets in-house; others outsource this function. The outsourcing process may include institutional investment consultants (for example, Morningstar or Willis Towers Watson), or wealth managers (for example, the wealth management arms of many leading European or global banks), as well as asset management firms (be they asset managers like BlackRock, PIMCO or Amundi who offer a wide range of strategies and products, or specialist alternative firms like the Carlyle Group, KKR, or Bridgewater). Part of the challenge in specifying an “investor duty” is deciding where to attach this standard, and how to define a

4 These announcements were made on 15 January 2018 as part of BlackRock CEO Larry Fink’s annual letter to the CEOs of listed companies setting out BlackRock’s corporate governance and stewardship expectations for the coming year: [https://www.blackrock.com/corporate/en-tw/investor-relations/larry-fink-ceo-letter](https://www.blackrock.com/corporate/en-tw/investor-relations/larry-fink-ceo-letter)

standard without conflicting with well-established concepts of fiduciary duty and client best interest.

Many asset owners are subject to a set of regulations that are tailored to the different types of entities. For example, European insurers are subject to Solvency II rules that specify risk-sensitive capital requirements to ensure insurers are able to meet their long-term liabilities. When these entities outsource the management of a portfolio to an external asset manager, the assets remain on their balance sheet and are still subject to the asset owners’ regulatory rules. As a result, it is common for the investment management agreement (IMA) — which outlines the terms of the mandate that the asset owner has given the asset manager — to state that the asset manager must follow the same rules that the asset owner is required to follow. Clearly, regulators do not want to create a regulatory arbitrage opportunity that would allow asset owners to evade the rules. Likewise, the asset manager cannot legally override the contractual instructions of its clients or manage the assets using a different set of rules.

All asset owners have their own unique investment constraints and objectives, driven by their assets and liabilities, their investment beliefs, their tax and accounting considerations, and their regulatory framework. Some of their investment aims are purely financial — in which case to the degree that ESG issues are considered it would be solely through the lens of improving risk adjusted returns — and some may be more rooted in ethical or stakeholder priorities — where considerations such as how their investment portfolios measure up to particular ESG criteria or particular outcome metrics are prioritised.

As asset managers, it is important that we, first and foremost, remain a fiduciary to our clients. As regards sustainability, this means that we can help our clients understand the relationship between ESG issues and long-term financial performance; it means we can integrate the consideration of material sustainability-related data and insights into our investment processes (as appropriate to the mandate and strategy); it means we can help deliver solutions that meet our clients’ sustainable investment objectives, and; it means we can engage companies as a shareholder on sustainability-related concerns. But as regards "investor duty", the decision as to whether a particular investment portfolio should have specific ESG objectives (for example, excluding particular companies or sectors) must rest with the asset owner.

**Conclusion**

BlackRock remains strongly supportive of policy frameworks that support the goal of growing assets dedicated to sustainable investing, and we would like to suggest ways in which the
European Commission can increase the allocations in this area and encourage best practices. Our recommendations fall into four categories:

1. Create incentives for asset owners to increase allocations to sustainable investments
2. Encourage disclosure by issuers of material information on sustainability and recognise a set of standards that can apply broadly
3. Increase the number of sustainable offerings in the marketplace
4. Recognise investment stewardship standards

**Asset owner incentives**

BlackRock would be supportive of a holistic review of the regulatory (and where appropriate, tax) framework for various types of asset owners – looking at whether or not there are impediments within the regulatory and tax frameworks for each type of asset owner to various types of long-term investment (for example, we are entirely supportive of recent efforts to build a specific asset class within Solvency II to enable greater investment in infrastructure), or barriers to greater consideration of sustainability objectives within each asset owners’ investment strategies and objectives. This process was started with the Commission’s call for evidence review in 2016, and we remain supportive of the aims of revisiting, and where appropriate recalibrating, regulatory frameworks to ensure they appropriately balance financial stability, growth, and sustainability objectives.

We recognise that the debate on reviewing capital requirements for certain types of sustainable investments (for example, the ‘green’ supporting factor proposed by the European Parliament in their review of the CRD V package) is in its early stages. Capital frameworks have been primarily designed to meet prudential and broader financial stability aims, but at the same time, they can be powerful influences in dictating the investment policy of different types of asset owners. Whether or not capital frameworks are appropriately calibrated to the specific risks and features of a particular asset class can impact how asset owners deploy their capital in such investments. We are supportive of greater exploration as to whether there are regulatory changes that would be appropriate for certain types of sustainable investments. However, we would caution that any potential changes to capital rules should be measured and appropriate and not encourage undue risk taking (we consider the example of Solvency II and infrastructure to be an excellent example of a well-considered and appropriate change to capital weightings to remove investment barriers and set the right incentives for investment) and ensure that capital frameworks can still achieve their prudential aims. Because each regulatory framework is unique to different types of asset owners, we equally believe that any reconsideration of rules would need to be tailored accordingly.
Disclosure of material data

One area where both asset managers and asset owners can grow their integration of sustainability is in regard to the use of material ESG considerations within investment and risk management processes and decision-making. We believe that sustainability-related issues have real impacts on long-term financial performance. But the take-up of these issues as inputs to investment or risk management processes is hampered by the lack of clear, consistent standards for the reporting of material ESG data by companies.

Currently, there are a number of competing standards for disclosure of ESG data by issuers. Some standards cover the broadest range of sustainability issues while others are more focused on data that is relevant to investment and stewardship decision-making. The numerous and competing standards, and the resultant lack of consistent and clear data creates a situation where for many investors the end result is not greater clarity about the ESG risks and opportunities, but noise that can obfuscate a clear picture of material sustainability considerations. In our 2016 ViewPoint “ESG: A Practitioner’s Perspective” we outlined a range of competing standards for ESG disclosure: in the period since the number of such standards has grown further. We would be very pleased to see the EU help encourage issuers to provide clear and consistent data on material sustainability issues and to contribute towards greater standardisation of reporting frameworks. We see the EU’s Non-Financial Reporting Directive as an important piece of legislation in this regard, and following the initial disclosures made during 2017, we see the scheduled review over the course of 2018 as an important opportunity to reflect on the best ways to improve this framework moving forward.

Growing the suite of dedicated sustainable investment products

We have observed an increase in interest from our clients, especially in Europe, in recent years for solutions that can help them take greater consideration of ESG issues in their portfolios. This includes an appetite for investing approaches where the integration of ESG issues is designed to enhance long term risk-adjusted return as well as approaches that ensure some or all of their portfolios align with an ESG-based ‘values’ objective that they have. As we have outlined above, we believe our responsibility to our clients is helping them realise these objectives – but we also believe that policymakers can play an important part in helping asset owners in this regard.

Building a robust landscape of sustainable investment products allows asset owners to more easily increase their incorporation of ESG and sustainability considerations. We currently see a range of different investment products marketing themselves in Europe as ‘green’, ‘sustainable’, ‘socially-responsible’ or other related labels, even if the criteria can vary widely. In many cases, national regulators or industry organisations are developing their own taxonomies. This can create confusion and make it difficult to build pan-European scale for investment products that seek to offer asset owners cost-efficient solutions to meet their sustainable investing needs. In this regard, we believe that a pan-European taxonomy could be helpful in giving a broader range of asset owners and asset managers the confidence and certainty to invest in and offer (respectively) such products.

We would be supportive of efforts to find innovative ways to offer investors easier and more cost-efficient investment solutions – as such, we would welcome a discussion with policymakers on various ways to contribute towards this aim; for example, building streamlined product approval processes and/ or structural features for investment funds intended to make sustainable investment on a pooled basis more easily scalable.

**Contribute to stewardship standards**

BlackRock sees investment stewardship as a fundamental way in which we protect and enhance the value of our clients’ investments. It is equally a way in which we encourage the companies in which we invest on behalf of clients (the true owners of the companies in which BlackRock invests capital) to manage and adapt their businesses in a way that supports sustainable, long-term financial performance. We undertake stewardship activities across all of our equity shareholdings.

We strongly believe that assets managed using an index-based approach provide a source of committed, stable capital – which in turn makes index managers long-term investors who can enable companies to focus on long-term, sustainable value creation. However, it also means that the securities in the portfolio cannot be sold if the manager is concerned about the performance track record, strategic direction or long-term growth prospects of the company. In contrast to an active management strategy, the manager of the index-based portfolio cannot express their concern by selling the security so long as it is included in the index. Hence, the critical role of stewardship for index mandates.

But stewardship is important across all investment strategies; even managers of active portfolios may not want to sell the security if they believe their concerns could be addressed by management.
We see stewardship as a key mechanism for asset managers (and asset owners who manage their assets internally and hence, retain voting power over shareholdings in companies) to encourage companies to adopt sound practices in relation to ESG and sustainability factors relevant to their businesses. In doing so, they not only enhance the value of their clients’ investments in those companies over time, but they contribute to a more sustainable economy. Promoting stewardship standards should be a key focus of the European Commission’s efforts in promoting the role of the financial sector in meeting broader sustainability goals. While the revised Shareholders Rights Directive (SRD) requires disclosure of stewardship or shareholder engagement policies and how they are executed (on a comply or explain basis), we believe adding to best practices across Europe can complement the SRD requirements and help raise the bar for stewardship practices, corporate governance standards, and shareholder promotion of long-term business value creation.

We thank the Commission for the opportunity to respond to this consultation and we stand ready to discuss any topics raised in this response further as this important agenda develops in the near future.

7 Globally, numerous initiatives encourage asset managers not to be “passive” shareholders. Stewardship initiatives include the UK Financial Reporting Council’s UK Stewardship Code, Japan’s Principles for Responsible Institutional Investors, the upcoming Eumedion Stewardship Code in the Netherlands, and the Investor Stewardship Group’s (ISG) Stewardship Framework for Institutional Investors. At launch, participants in the ISG consisted of BlackRock, CalSTRS, the Florida State Board of Administration (SBA), GIC Private Limited (Singapore’s Sovereign Wealth Fund), Legal and General Investment Management, MFS Investment Management, MN Netherlands, PGGM, Royal Bank of Canada (Asset Management), State Street Global Advisors, TIAA Investments, T. Rowe Price Associates Inc., ValueAct Capital, Vanguard, Washington State Investment Board, and Wellington Management. In addition to these initiatives, the Organisation for Economic Co-operation and Development (OECD) engages in dialogue with companies on responsible business conduct.