

Going mainstream

The future of ESG investing



The Forum for Sustainable and Responsible Investment



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About the research

Going mainstream: The Future of ESG Investing was researched and written by sustainable investment experts Harry Hummels and Rob Bauer from the University of Maastricht's Department of Finance. It is based on an online survey of 281 asset owners and managers across the world, conducted in March and April 2018, as well as a dozen in-depth interviews with leading investors and practitioners in the field of sustainable and responsible investing. We are particularly grateful to the following individuals for offering their valuable time and insights:

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Executive summary

Over the past decade, a quiet revolution has been taking place in the world of investment; now, Environmental, Social and Governance (ESG) investing is going mainstream. At the end of 2016 around a quarter of all professionally managed assets were under ESG investment strategies and our research suggests that figure is only going to grow.

Though responsible investing has been gathering momentum since the financial crisis in 2008, two landmark accords marked **a turning point for the movement**: the signing by world leaders of the UN Sustainable Development Goals (SDGs) in September 2015, followed by the Paris Climate Agreement later that year. These ambitious charters that aim to tackle humanity's most pressing concerns – among them climate change, acute hunger and poverty -- require investments of upwards of USD 7 trn per year (or twice the US Federal Budget) – mostly in developing countries.

Increasingly, and encouragingly, **private finance is stepping up**. In the period following the adoption of these agreements the volume of assets covered by the Principles of Responsible Investment (PRI) expanded by 40%. Institutional investors – among them the world's leading sovereign wealth funds, pension funds and insurance companies – are boosting their ESG-focused investments. Philanthropic foundations are now linking their investments to the SDGs, and in the US, while the current administration has pulled out of the Paris Agreement, close to 2,000 investors and companies have said 'We're still in'.

Where financiers are not being compelled into action, **they are being pushed**. Those same institutional investors are mandating greater disclosure on ESG issues or getting active via shareholder resolutions; some are starting to divest from controversial sectors such as tobacco, weaponry and coal. Regulators in France (and soon across the EU) require corporations and financial institutions to report on their ESG performance; in the US, companies are increasingly reckoning with climate-related litigation.

There is also much upside. Data on investments and index performance show that taking account of ESG information can actually boost returns and reduce volatility; our survey respondents and investors we spoke with agree that integrating ESG information can improve the risk-return profile of investments, providing a “new set of eyes” for investors.

Yet our research – based on a survey of 281 asset managers and owners and a dozen interviews with leading sustainable investors and experts – identifies **a gap between intent and action**. While the vast majority of professional asset managers now apply at least one form of ESG strategy, only a small number do so consistently across portfolios. Lack of transparency means it is hard to judge what metrics are being used, and if they capture all the future risks and returns, such as those related to climate change. Meanwhile, the broad and complex scope of the SDGs (there are 17 in total, comprising 169 individual targets) risks turning ESG into a box-ticking exercise; at worst, a re-packaging of what has or would have been done.

Looking towards 2030

While there is much to critique, our research suggests those leading the ESG pack are raising the stakes, driven not only by a conviction that ESG investing makes business sense, but that it is increasingly becoming a business imperative. There are at least four emerging trends that investors expect to see developing in the years ahead:

1. **Greater integration.** Investors are moving to adopt ESG across the entire portfolio, from ESG-focused funds to products such as green bonds and impact investing
2. **Greater engagement.** Asset managers plan on working more closely with shareholders, such as in filing/co-filing resolutions, and with corporate leaders, to accelerate action
3. **More reporting.** The drive for greater transparency and accountability means investors expect greater demand not just to report on their actions, but also on impact and outcomes
4. **More divestments.** Especially on nuclear weapons, tobacco and coal

In addition, **the Paris Agreement and SDGs will continue to drive the agenda.** 65% of surveyed investors singled out topics related to global warming as their first priority: as well ramping up investments in renewables, over half of investors expect to have divested from fossil fuels by 2030.

Over 60% also have an explicit policy on the SDGs, with health and diversity among the key themes, yet many express concern about how to achieve them. Aside from their obvious complexity, a challenge is their focus on developing markets – still outside of the comfort zone of many institutional investors.

A movement at a crossroads

Clearly, much needs to be done to ensure ESG delivers on its goals of aligning finance's needs with those of humanity and the planet. Our research indicates five developments that could help 'move the needle':

Better information. Despite a recent explosion in ESG information, investors point out that most is not material to investments. Asset managers need to do a better job of searching for information, and corporations need to provide it. The Task Force on Climate-Related Disclosures – a voluntary initiative now backed by one fifth of companies – is viewed as a step in the right direction.

1.

The right kind of regulations. Experts agree on the need to find ways to encourage transparency and disclosure, and more consistency in reporting – including, if necessary – more regulations. Several pointed to France's Article 173 as a good starting point, since it mandates disclosure without being too prescriptive.

2.

Products for every asset class. Products suited to different investors are badly needed, especially more liquid instruments for institutional investors. There are now several examples in developing markets that combine financing from governments and development banks to help de-risk investments.

3.

4. **A new curriculum.** For money managers to integrate ESG into the investment process, they need to know what they're talking about. Right now there is a dearth of knowledge, but education offerings are increasing. Some investors pair ESG experts with industry specialists, and a number are starting to train analysts across the board.

5. **Greater awareness.** Practitioners agree on the imperative to make the public more aware of the impact they can have in managing their Finance's. Experience in the Netherlands demonstrates the power of raising public awareness, where a television show a decade ago led to new legislation for pension funds. Various studies indicate that Millennials are more aware of and concerned about sustainability, and in our survey, younger investors expressed more knowledge of the SDGs – also expecting them to become more relevant to their jobs – compared to their older counterparts. As tomorrow's leaders, they are a reason to hope that ESG can succeed.



Investment's quiet revolution

10 years on from the collapse of Lehman Brothers that triggered the global financial crisis, and what started as a fringe movement is moving increasingly towards the center stage.

More than ever, asset managers and owners are considering Environmental, Social and Governance factors (ESG) in the investment process.

Various referred to as 'Sustainable,' 'Responsible' or 'ESG Investing'¹, the volume of assets under management (AUM) that involve ESG strategies almost doubled between 2012 and 2016, rising from USD 13 trn to USD 23 trn, accounting for a third of the entire professional asset management market.^{2,3}

The trend has been mirrored by a similar rise in the number of signatories to the Principles of Responsible Investment (PRI), a global network of investors that commit to incorporating ESG factors into investment decisions (see box). From around 100 at its launch in 2006, the numbers of signatories surpassed 1,000 in 2012 to reach over 1,900 today⁴.

For over a decade it's been gaining ground in the retail investment community and now it's clear sustainable investing is going mainstream in the institutional investment community as well.

**Michael Baldinger, UBS
Asset Management**

These developments reflect how ESG investing is spreading beyond smaller-scale ethical or socially responsible investing, such as 'impact investing' – the explicit financing of companies and projects aiming to make a social or environmental impact.⁵ Experts in the field note that, until recently, there has been a lack of sufficiently large and liquid instruments suited to institutional investors, like pension funds. That is now changing. "For over a decade it's been gaining ground in the retail investment community and now it's clear sustainable investing is going mainstream in the institutional investment community as well," says Michael Baldinger.

Achieving impact while extending reach

“Investors are increasingly beginning to understand and appreciate the relevance of ESG information,” says Lisa Woll, CEO of the US Forum for Sustainable and Responsible Investment (USSIF), adding that over the last 12 years she has seen substantial growth in sustainable investing, with most recently a sharp increase in ‘ESG integration’ – the use of ESG information in assessing investment viability.

Yet, more does not always equal better. As ESG investing spreads there is a risk of dilution of its original goals. As one example, despite a sharp increase in the number of PRI signatories since the signing of the Paris Climate Agreement in 2015 (see box, below), greenhouse gas emissions have continued to rise.

“People often claim that integrating ESG will lead to significant shifts in how investments are made, but even investors that have rigorously implemented ESG integration programs will admit that so far that doesn’t seem to be happening,” says Harald Walkate, Head of Responsible Investment at Aegon Asset Management.

Source: Global Sustainable Investment Review 2016, GSIA (2017)

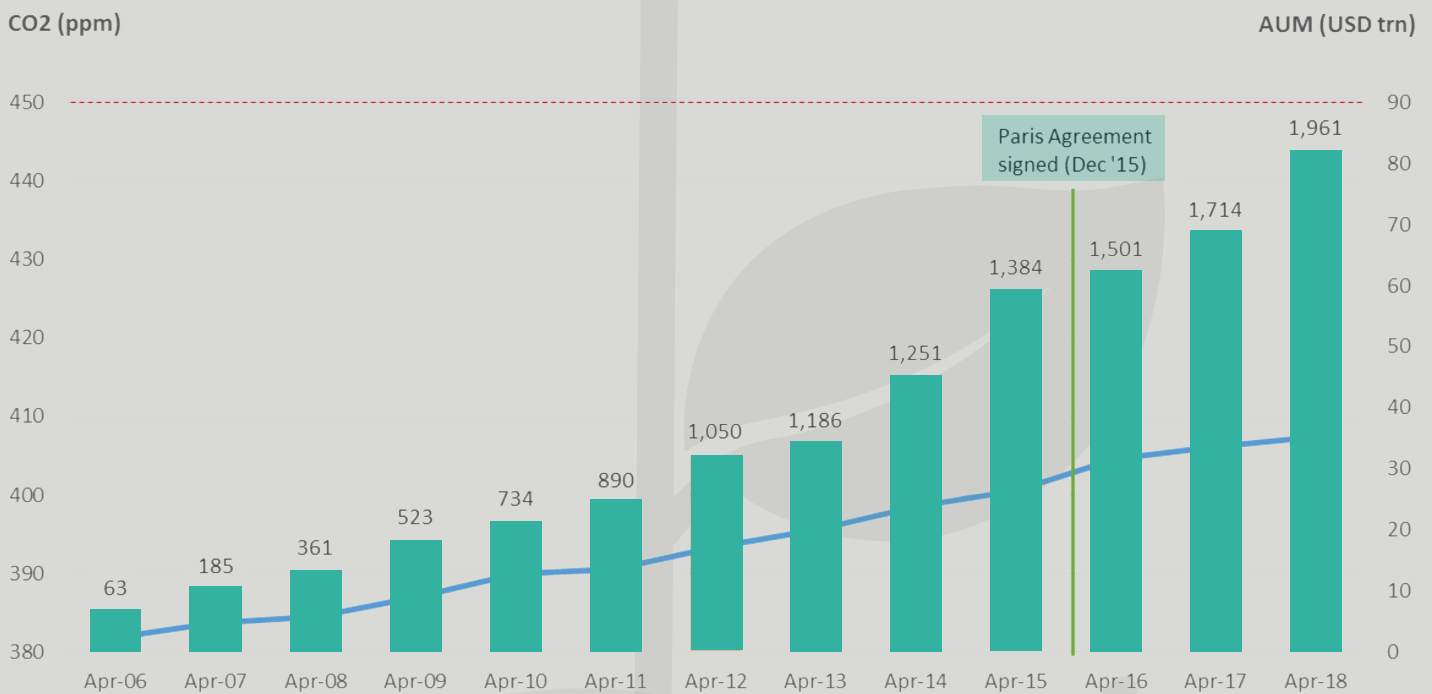
Table 1: Global Sustainable Investment Market



<i>Region</i>	<i>Growth 2014-16</i>	<i>Share of local AUM (USD, 2016)</i>	<i>Share of global SI AUM (USD, 2016)</i>
Europe	12%	53%	53%
United States	33%	22%	38%
Canada	49%	38%	5%
Australia / New Zealand	248%	51%	2%
Asia (excl. Japan)	16%	1%	0%
Japan	6690%	3%	2%
Global	30%	26%	

Sources: National Oceanic and Atmospheric Administration (NOAA) monthly direct measurements dataset; UNPRI.org

Good Intentions

Trend in atmospheric carbon dioxide emissions (in parts per million, left-hand side) and trend in PRI signatories and AUM (right-hand side)



-  PRI signatories' AUM (USD trn) and number of signatories [box]
-  Average direct CO2 measurement in ppm (seasonally adjusted, base year = 2006, max ppm of 450 = 2 degrees of warming)

Greater reach, greater demands

Yet with greater focus will eventually come greater scrutiny – both from within and outside the investment community. “In terms of ESG there are signs that the state of information is improving quickly,” says Matt Christensen, Global Head of Responsible Investment at AXA Investment Managers (AXA IM). He points to an increasing number of ESG specialists in the field, new regulations (such as in France, see below), as well as changing client demands, adding, “[Clients] no longer ask ‘did you sign the PRI?’, but instead, ‘what do you do?’”

Clients no longer ask, ‘Did you sign the PRI?’, but, ‘What do you do?’

Matt Christensen, AXA IM

As ESG veers towards the center ground of investing, it will increasingly have to prove its worth in a world where evidence of climate change and calls for action on a range of environmental and social issues continues to grow. This research investigates the main factors that will drive and shape this trend, how ESG is changing investment strategies, and what actions may be needed to ensure ESG can succeed in aligning finance’s needs with those of the future of our planet.

The Principles for Responsible Investment (PRI)

The PRI is a global network of more than 1,900 asset owners, investment managers and service providers that aims to, “better align investors with the broader objectives of society”. Signatories collectively own or manage some USD 82 trillion and commit to six principles:⁶

- 1 **Incorporate ESG issues into investment analysis and decision-making processes**
- 2 **Be active owners, and incorporate ESG issues into our ownership policies and practices**
- 3 **Seek appropriate disclosure on ESG issues by the entities in which we invest**
- 4 **Promote acceptance and implementation of the Principles within the investment industry**
- 5 **Work together to enhance effectiveness in implementing the Principles**
- 6 **Report on activities and progress towards implementing the Principles**

Putting Paris into practice

Talk to anyone in the sustainable investment community and you need not wait long until someone mentions either the Paris Agreement or the Sustainable Development Goals (SDGs).

These two sets of global commitments aiming to halt climate change and deliver on a bold plan of action for 'people, planet and prosperity' (see below), will require investments upwards of USD 7 trillion⁷ per year to 2030 – or twice the annual US Federal Budget⁸. This means governments and civil society are looking to the private sector to take a very active role.

Different approaches

How this is happening varies by region and stakeholder group. Some regions – like the **European Union** – are putting **regulations and standards** in place to bring financial targets more into line with sustainable development ones. France was the first country to do this with Article 173 of its Energy Transition Law. Enacted in 2015, the law requires asset managers to disclose information on their climate change and ESG policies taking a 'comply or explain' approach.⁹ Now, the EU is following suit with its Action Plan on Sustainable Finance (see box, below).

Across various OECD markets – and some emerging ones – **institutional investors**, especially pension funds, insurance companies, and sovereign wealth funds (SWFs) – are adopting ESG policies to actively target more sustainable investments, often engaging more directly with corporate boards and shareholders. Last year Japan's SWF announced it would be allocating a substantial 10% to ESG investments; the funds of Norway, South Korea and Canada already integrate ESG-information in their decision-making, while a number of the world's largest pension funds also engage with investees on ESG issues.¹⁰

The **United States** has a long history in sustainable investing (which has its roots in the Quaker and Methodist religious

Many investors are now trying to work out what governments will actually do, and when. And more importantly, what that will mean for their investments.

Harald Walkate, Aegon
Asset Management, on the
Paris Climate Agreement

movements¹¹) yet it has been behind the curve of ESG's recent expansion (see Table 1). Practitioners point to American investors' historically narrower understanding of 'fiduciary duty' – their responsibilities to the owners of the assets they manage.¹² Although the Obama Administration sought to allow for greater consideration of ESG factors¹³, recent guidance under the Trump Administration looks like a step back (see also box on Fiduciary Duty, p. 29).

Nonetheless, a sharp rise in ESG investing in the US – which grew by 33% in just two years – indicates it could be on the verge of catching up. One push-factor has been the rise in litigations linked to ESG factors – especially climate change.¹⁴ Another is the explosion of related shareholder resolutions.¹⁵ On the pull-side, the US's large base of philanthropic foundations are becoming increasingly active in their efforts to support the SDGs.¹⁶ And while the US is no longer a signatory to the Paris Climate Agreement (see below), initiatives like the We're Still In movement – with over 1,900 corporate and investor signatories¹⁷ – underscore the intention of many asset managers and owners to stay the course. As Lisa Woll, USSIF, notes, "With the lack of commitment by the current President and Congress to moving environmental and social issues forward, some investors are seeking out firms that can help them address these issues through their assets."

The Sustainable Development Goals and the Paris Climate Agreement

The **UN's Sustainable Development Goals** (SDGs), ratified in September 2015, are an ambitious set of 17 broad global targets – ranging from eradicating poverty, hunger and gender inequality to reversing biodiversity loss, protecting oceans and halting climate change – that UN signatories have agreed to reach by 2030 (see Table 2 p.56 for a full list). With annual financial requirements estimated at USD 5 to 7 trn per year¹⁸, they call for a concerted response from public as well as private sector financial sources. “The SDGs are the most audacious goals ever drafted in the history of mankind. They catalyze change in business in a way that we have never seen before,” says Vineet Rai, Founder and CEO of India-based Aavishkaar, one of the country's leading impact investors. He adds that the SDGs, which also focus on economic targets like decent work and sustainable industrial development, are not just about development or aid. “They allow us to build business and a better life for the bottom three billion of our planet – not just to make them less poor.”

The **Paris Agreement under the United Nations Framework Convention on Climate Change** (UNFCCC), signed by 198 countries in December 2015 (though the US later pulled out)¹⁹, aims to limit global warming to below 2 degrees Celsius above pre-industrial levels over the course of this century. This will require cuts to global greenhouse gas emissions of up to 70% between now and 2050. With each country adopting specific targets depending on needs and means, Harald Walkate of Aegon Asset Management notes that, “Many investors are now trying to work out what governments will actually do, and when, and what outcomes that may result in. And more importantly, what that will mean for their investments.”

The EU's Action Plan on Sustainable Finance

Announced in March of this year, the Action Plan aims to help member states meet targeted cuts to greenhouse gas emissions of 40% to 2030, which require an estimated investment of EUR 180 billion (USD 216 m) per year, much of which the European Commission hopes will come from the private sector.¹ Proposed measures include a unified classification system of sustainable economic activities, including new ‘green labels’ for low-carbon products; disclosure requirements for investors and asset managers to integrate ESG factors in the investment processes; and new transparency guidelines that will align corporate reporting with the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD, see p.21).

Emerging strategies

In our Survey,²¹ more than nine out of ten asset managers and owners listed at least one way in which they are now employing ESG information in the investment process.

The main strategies, adapted from GSIA definitions,²² are:

- 1. Corporate engagement: *Using shareholder power to influence corporate behavior, either by directly communicating with senior management or corporate boards, or by filing/co-filing shareholder proposals and proxy voting.*** This is the most common strategy – more than eight out of 10 respondents said they use ESG information in the investment process to engage with stakeholders, where appropriate
- 2. ESG integration: *Integrating ESG factors in the financial analysis of investments.*** More than three out of every four respondents said they integrate ESG information in their investment process, coordinating the efforts of their investment and ESG research teams
- 3. Negative/normative screening: *Excluding companies or indices for investment based on specific ESG criteria.*** Around three out of four investors said they screen and exclude some companies based on ESG information
- 4. Positive screening/impact investing: *Actively investing in companies or indices that aim to make a positive social or environmental impact.*** As with negative screening, three out of four also screen and select based on positive impact

We emphasize that the above figures should be taken as a guide only. As our survey included both asset owners and managers – making up around one third and two-third of respondents, respectively – there may be some double-counting. Moreover, respondents did not indicate the extent to which their ESG policies cover all industries or assets, or whether – such as in the case of exclusion – they focus on just a particular sector or instrument.

Measuring ESG investing's reach

Indeed, insights from practitioners suggests that most asset managers are using ESG information only selectively. Even leading asset managers with lengthy sustainable investing records, such as UBS Asset Management and AXA IM (see cases studies p.45 and p.28) have only recently started applying ESG strategies across all of their portfolios.

Another challenge in measuring the depth of ESG investing is lack of transparency, especially among newer entrants. "Some of the newer and larger money managers are not disclosing the specific ESG criteria that they use," says Lisa Woll of USSIF, "This leaves the impression that they practice it across a wide range of assets when it is actually not being applied systematically or consistently."

Then there is the question of what information is being used. "Most industry ESG ratings are historical, backward-looking and too broad," says Michael Baldinger, who argues that taking backward-looking ESG data on its own is not enough. "It has to be combined with forward-looking insights into material ESG factors," he explains. "Telling our clients what their portfolio's carbon footprint is and what the related performance risk is, that really changes the discussion we have with them."

Fiona Reynolds points out that this is starting to change with initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD), a voluntary financial risk disclosures

tool being developed for companies and backed by the G20's Financial Stability Board. With the number of companies using the tool having tripled since the start of this year, by improving the corporate information available to ESG investors, it is the kind of initiative that could enhance ESG's impact, and reach, in the coming years.²³

Mainstreaming impact investment

Although three out of four respondents to our survey say they actively screen and select investments for positive impact, the vast majority are likely to be doing so only at an instrument or index level (a number of experts point to the rise in ESG-focused indices, for example). Just 1% of assets under professional management that follow ESG principles are estimated to be involved in impact investing – direct investing into specific projects or companies with the aim of making a positive social or environmental impact.²⁴

Marilou van Golstein Brouwers of Triodos Investment Management sees this as a result of the transaction-oriented, generally short-term perspective of many financial institutions, mentioning that at Triodos IM, which specializes in impact investing, they, “aim at building long-term relationships with the investee.”

Asset managers from other types of institutions agree on the need for more effective collaboration with investees, although for certain types of investor – particularly large institutional investors – such deep involvement in projects may be unrealistic. “Although institutional investors might say they want their investment strategies to have a positive social and environmental impact,” says Michael Baldinger, “in reality that's been difficult because impact investing has been concentrated in illiquid asset classes such as private equity and private debt.”

Tine Fisker, Senior Manager for Impact Investing at the UCT GSB Bertha Centre in South Africa, says this is something they

If we are aiming for the financing of activities that are today under-financed, we should think about how investments are designed, and how we can make them more appealing to institutional investors, to attract their capital.

Harald Walkate, Head of Responsible Investment, Aegon Asset Management

are also grappling with in their work with institutional investors: how to make impact products that fit the criteria of mainstream investors, in terms of liquidity, size, risk-return, etc.

One way to have an impact is through deeper engagement. Though much of Triodos IM's business is in impact investing, the company also invests responsibly in companies with strong ESG ratings (see box, below) through a strategy of 'active engagement'. Michael Baldinger also stresses the importance of UBS Asset Management's corporate engagement efforts, which he says aim to focus on, "materially relevant sustainable investment topics," such as climate risk and gender diversity.

Another route is through more focused investment products. "If we are aiming for the financing of activities that are today under-financed, we should think about how investments are designed, and how we can make them more appealing to institutional investors, to attract their capital," says Harald Walkate. He mentions there are already some good examples of projects and investment vehicles that have clear social and environmental outcomes, and yet have been structured in such a way that they may be attractive to institutional investors.

Triodos IM: Catalyzing impact through partnerships

Triodos Investment Management (Triodos IM), has been active in the field of impact investing for over 25 years. As a full subsidiary of Triodos Bank, Triodos IM's investment philosophy is aligned with the Bank's mission to 'Change the world with money'.²⁵

"The whole reason for our existence is that we want to make a positive change in society," says Managing Director Marilou van Golstein Brouwers, "That is why all our investments are sustainable investments."

Marilou emphasizes that at Triodos, they have always recognized the importance of finance and the essential role it plays in the changes we need in society. "We need to make sure that capital is increasingly allocated into projects that address the global challenges we are all faced with,"

she notes, “Luckily this is happening more and more, but it does require a long-term investment horizon.”

At the end of 2017 Triodos IM managed EUR 3.5 bn (USD 4.2 bn) in assets, of which EUR 2.1 bn went to impact investments, focused on areas such as energy and climate, sustainable food and agriculture, and inclusive finance. The remaining EUR 1.4 bn were managed through Triodos IM’s Socially Responsible Investing (SRI) funds, which invests in listed companies with above-average ESG performance. According to Marilou, a cornerstone of the company’s SRI strategy is ‘active engagement’ – engaging with companies with the aim of discussing ESG performance, creating long-term value, and having a lasting impact.

As an example, Marilou mentions Triodos IM’s prolonged engagement activities with Belgium retailer Carrefour about their animal welfare policy and practices within the context of a wider engagement project on farm animal welfare. Since starting the engagement efforts in 2014, the company has developed several programs and initiatives to improve animal welfare and has increased its range of products that meet higher animal welfare standards. In addition, the company now tracks animal welfare information in their supply chain. “Such achievements can only be realized through active engagement based on long-term relationships with the companies we invest in”, adds Marilou.

The Business Case for ESG investing

More than simply being compelled to do for reasons of social responsibility, ESG investing increasingly makes business sense. Over three-quarters (77%) of asset managers and owners surveyed said they believe ESG-integration reduces financial risk, with one third (33%) strongly agreeing with this statement and almost no respondent disagreeing. Only slightly fewer (75% overall and 29% in strong agreement) also believe it leads to increased financial returns. In both cases responses were almost identical across regions, indicating that this is a global trend.

“Being a responsible investor is not about giving up returns,” says Fiona Reynolds, “It is about being a better investor because you are taking a more holistic approach, and you are looking at a greater range of information and risk and opportunity to make your decisions. This can only make you a better investor in the longer period.”

This is a sentiment shared by many of the asset managers we spoke with, across asset classes. Marilou van Golstein Brouwers points to the performance of the Global Alliance for Banking and Values (GABV), a global network of close to 50 banks (including Triodos) set up in the aftermath of 2008’s financial crisis. “Members’ studies show that in the post-crisis period the GABV-banks perform better and with less volatility than the market as a whole.”²⁷

“We still see investors who believe ESG integration is a trade-off with performance. Quite the contrary,” says Michael Baldinger. He cites sustainable investment indices, such as the MSCI SRI index, which between 2007 and 2017 performed in line with -- and more recently, slightly better than -- its parent index. “Nobody has ever been able to explain to me how adding additional insights that are materially relevant for the future success of the companies would hurt the performance of our investments.”

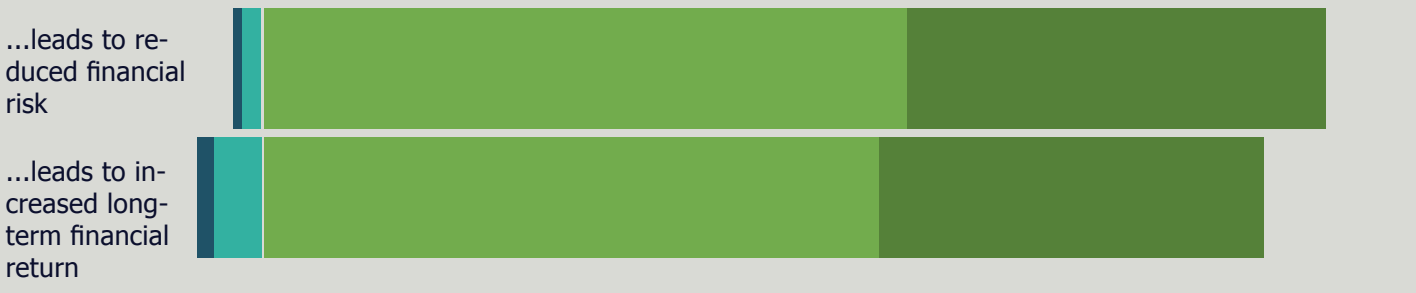
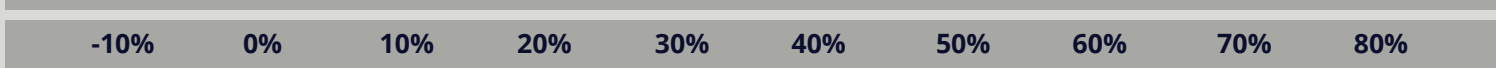
Nobody has ever been able to explain to me how adding additional insights that are materially relevant for the future success of the companies would hurt the performance of our investments.

Michael Baldinger, UBS

Source: Newsweek Vantage *Future of ESG Investing Survey*

It just makes sense

ESG integration into the investment process... (by % of repondents)



Short-term focus, short-term returns

If there's one thing that everyone seems to agree on it is that financial markets are too near-sighted. "Fund management houses still struggle to really develop a long term perspective," says Matt Christensen. "It is not easy to do. There are lots of pressures on fund managers to be more short term."

Our interviewees and survey respondents are almost unequivocal that finance needs to get over its myopia – not just so that it can better mitigate risks, but also to help deliver stronger long-term results.

Everybody is more comfortable in making a loss together than taking a risk and going ahead of the crowd

Marilou van Golstein Brouwers, Triodos Investment Management

"It is strange that it seems easier for pension funds to invest their money in instruments with negative results because everyone else is doing it, rather than taking a certain risk where you have the upside of the impact and the upside of the financial return. Some investors appear to be more comfortable in making a loss together than taking a risk and going ahead of the crowd," says Marilou van Golstein Brouwers.

More than three-quarters (78%) of survey respondents – with similar trends across regions – agreed that their organization should be making investments that aim to create positive value for society if they reduce long-term financial risks. A slightly smaller majority (71%) agreed that they should make such investments if they increase long-term – but not necessarily short-term – returns.

Making the future count

Experts point out that finance will come to value the future more as ESG's reach deepens and especially as the quality of information and its application improves.

Michael Baldinger says that at UBS Asset Management, they view longer term sustainability considerations as 'financially material' -- having the potential to impact risks and returns

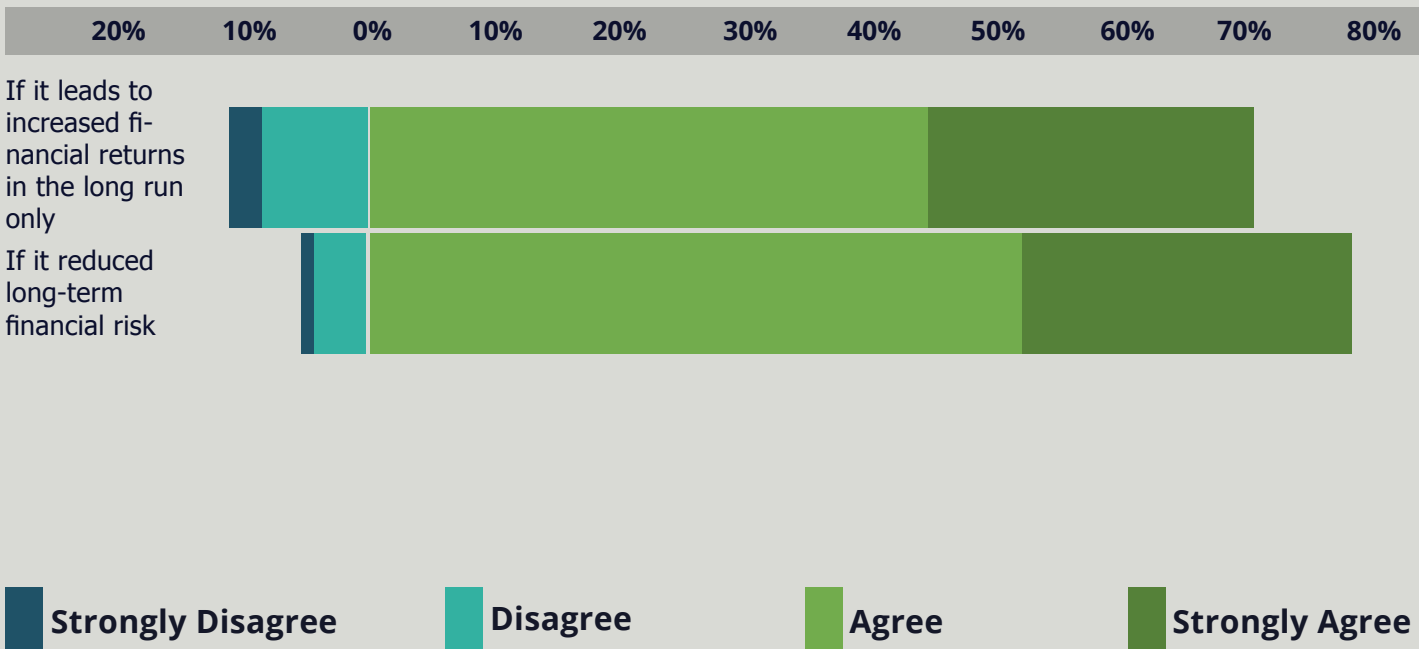
– but that they, “tend to be overlooked by investors’ frequent focus on short term results.” However, he is optimistic of the role that ESG investing could play in nudging investors to take a longer-term perspective. “If the market comes to integrate sustainability considerations into valuations, we believe that it would cause asset prices to more accurately reflect their long-term value.”

Matt Christensen of AXA IM also views ESG’s increasing materiality as a potential trigger in expanding its reach: “Investors are always seeking an edge, an ability to see something material that others have missed. Materiality is starting to become a part of the normal way ESG is being integrated into finance. The fact that ESG topics are in the business media on a daily basis shows the materiality. If I think about now compared to 10 years ago, ESG has gone mainstream.”

Source: Newsweek Vantage *Future of ESG Investing Survey*

Good things come...

My organisation should make investments that create positive value for society...



AXA IM: The business of taking a long-term view

AXA Investment Management (IM) has been in the responsible investing business for 19 years. It is part of AXA Group, the France-based insurance and wealth management company.

For Matt Christensen, Global Head of Responsible Investment, being owned by an insurance company means they naturally have a long-term view – something that has helped them on their path to becoming a leading ESG asset manager. “We are owned by an entity that has a long-term purpose,” he notes. “If the Group, CEO and board did not have the same vision, it wouldn’t work.”

Recent examples of this vision include AXA Group’s 2015 decision to cease any new investments in coal, and a decision in 2017 to gradually divest its coal and tar sands assets. For AXA this is as much a moral argument as a business one, or as CEO Thomas Buberl puts it, “A +4 degree world is not insurable”.²⁹ The Group recently pledged to quadruple a previous target for green investments, to reach EUR 12 bn (USD 14.4 bn) by 2020, and to tighten its policy on coal, committing to divest from any company that derives more than 30% of its revenues from coal.

“AXA IM believes that widely diversified portfolios with long term-horizons can reduce unwanted risk exposure, enhance financial performance and generate sustainable value,” says Matt. AXA IM’s aim is to provide product offerings that create positive social and environmental impacts across asset classes and combine various ESG approaches, from impact investing to active stewardship through to green bonds.

Like many investment houses, 2017 was a busy year for its ESG activities, with AXA IM accelerating the process of ESG-integration across its investment platforms. Just over 80% of its AUM (EUR 607 bn from a total of EUR 745 bn – USD 895 bn — at the end of March 2018) is now ‘ESG embedded’ meaning they benefit from active stewardship, ESG scoring across asset classes, and specific exclusion policies that cover controversial weapons, coal, non-RSPO palm oil and derivatives contracts on food commodities.

According to Matt, the company is also increasingly linking its work to the SDGs. As a start, it is leading by example: it has signed the Women in Finance charter, has earned EDGE gender diversity certification and has a company-specific target to have 40% of senior executive positions filled by women by 2020.

*We are developing
towards a society where
fiduciary responsibility
should include
commitment and care
for other stakeholders –
but we are not there yet*

**Marilou van Golstein
Brouwers, Triodos
Investment Management**

How ESG's rise is changing the meaning of fiduciary duty

Discussions around the materiality of ESG information point to a more fundamental shift in how asset managers are coming to view the 'fiduciary duty' or 'fiduciary responsibility' that they have to their beneficiaries – or, translated from *financialese*, the understanding that managers should take the same due care with other people's assets as they would their own.

In the context of ESG, this raises two broad questions. Who are the ultimate beneficiaries of investments – pension funds participants, the clients of insurance companies, society at large? And to what extent do asset managers also need to account for future risks and returns?

"In my opinion," says Fiona Reynolds, "fiduciary responsibility is taking responsibility for managing money in the long term seriously and managing risk and opportunity effectively. You cannot manage money properly and effectively for the long term if you don't think about the environment, social issues and governance issues as well."

Yet several experts point out that current US guidance actively discourages investors from taking a long-term view. In May 2018 the US Department of Labor (DoL) released a Field Assistance Bulletin³⁰ that stated, "[f]iduciaries must not too readily treat ESG factors as economically relevant". It goes on to note that ESG factors should only be considered relevant if they enhance the risk-return profile compared to comparable investments with the same target date.

Jane Ambachtsheer, Adjunct Professor at the University of Toronto and former Chair of Mercer Responsible Investment, says this is in contrast to previous DoL statements, which were more supportive of integrating ESG. "It leads fiduciaries to think only about historical experience and not about their future experience – and how the world may be changing, given all the social and environmental pressures."

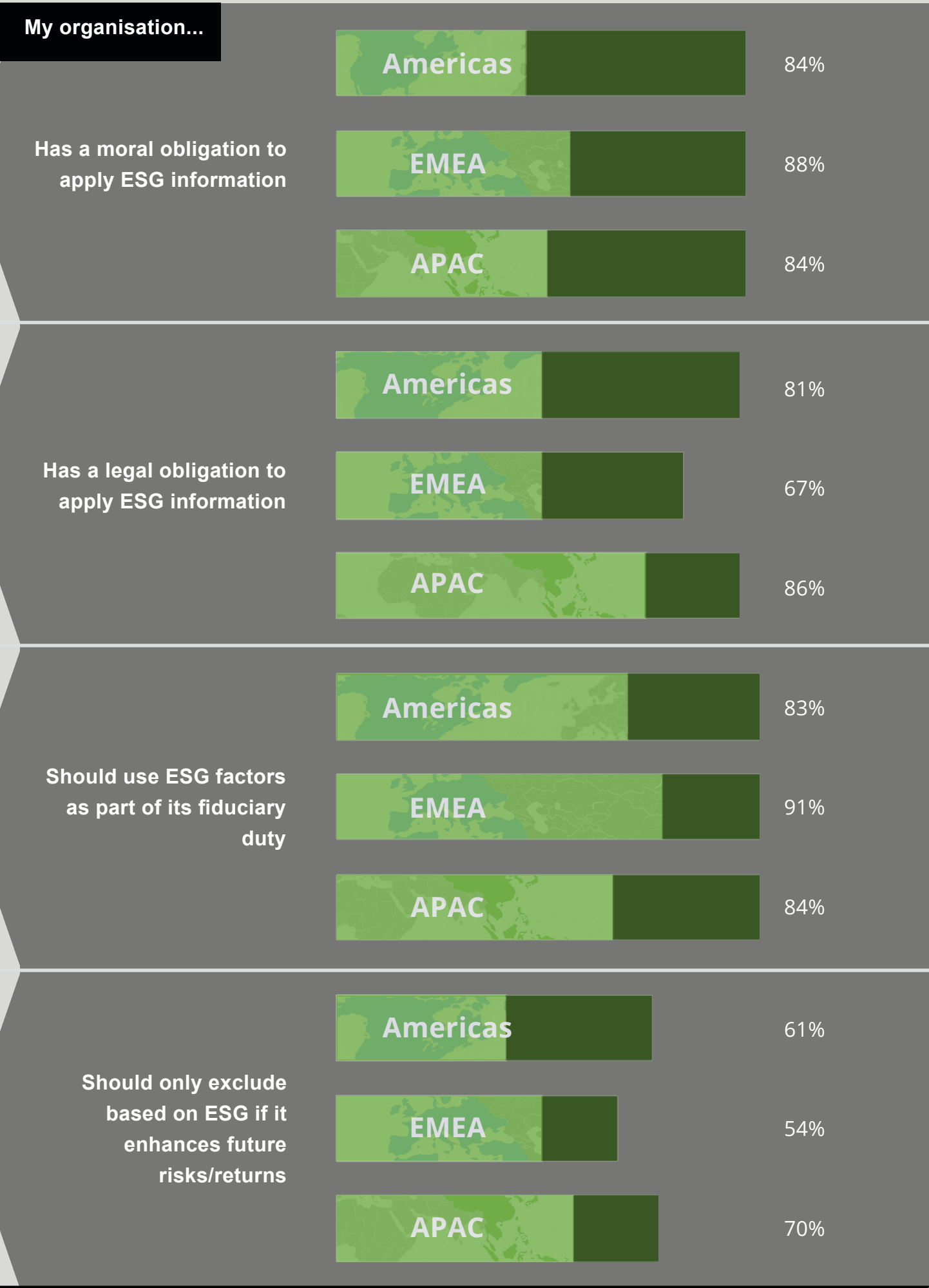
Regional differences

Our survey was conducted in April 2018, prior to the new DOL guidance, and so we cannot measure its impact. It is worth pointing out that globally and in the Americas, a strong majority (some 85%) of investors do see it as their fiduciary duty to apply ESG information. However, the figure is slightly less in Americas (83%) compared to EMEA (91%).

When asked whether they would exclude companies or financial instruments from their portfolios, the results overall were less encouraging – particularly in the Americas and APAC, where 61% and 70% of investors, respectively, said their organizations should not exclude companies or instruments that may have potentially harmful impacts on other stakeholders or the environment, without financial justification. In EMEA just over half (54%) agreed. As Marilou van Golstein Brouwers asserts, “We are developing towards a society where fiduciary responsibility should include also the commitment and care for other stakeholders, but we are not there yet at all.”

See you in court

Even if the current US administration is taking a back seat on ESG, the court system is not. Americas-based investors view ESG-application as much more of a legal obligation (almost as much as moral one), compared to their counterparts in EMEA. This could reflect the recent surge in climate-related litigations: research by the UN Environment Program found that the number trebled between 2014, with cases filed in the US making up three-quarters of the global total (cases in APAC, another region that tends to view ESG as a legal obligation, are also on the rise).³¹ As Steve Lydenberg of New York-based Domini Impact Investment, points out, “ultimately, fiduciary duty is what lawyers say it will be.”



Strongly agree

Agree



Maintaining the momentum

What makes climate change so powerful is that is only going to get stronger and stronger every year -- and it is not going to go away, so that's going to be very helpful.

**Steve Lydenberg, Domini
Impact Investment**

Climate change, the SDGs, regulations, fiduciary duty, litigation, shareholder activism ... take your pick – any and all of these drivers point to the growing relevance that ESG is going to have in shaping the investment world.

Investors agree. In our survey, some 97%³² of asset owners and managers said they expect that ESG information is going to become more relevant to the investment process in the years to 2030.

One of the most powerful, cross-cutting themes is the push for greater transparency, and accountability – evidenced not least by the growing number of signatories to the PRI in recent years. Some 83% of surveyed investors expect their organizations to increasingly report on ESG performance to 2030.

“We believe greater transparency will drive the issue of fiduciary responsibility over the coming years as demand for ever greater amounts of disclosure grow,” says Harald Walkate of Aegon Asset Management. “This in turn will lead to a greater demand for asset owners to incorporate ESG factors in their investing models.”

Broader, deeper strategies

The drive for greater transparency as well as more measurable evidence of the private sectors' contribution to solving humanity's problems means investors expect ESG strategies to both grow and mature in the coming decade.

In balance across different strategies, there are four broad emerging trends:

Greater integration - moving towards adopting a total portfolio approach

Greater engagement - with shareholders as well as asset owners, beneficiaries, and investees

More reporting - on actions as well as impact

More divestments - as ESG factors become increasingly material

Harald Walkate believes we are coming to the end of the experimentation phase. "I think we are at a turning point – we are increasingly seeing investors taking a more technical approach towards sustainable investing, for example in how they are approaching climate investment risk."

Lisa Woll says she expects investors to increasingly, "seek out strategies that more aggressively seek to make impact." These include integrating ESG across product offerings and increasing their shareholder engagement activities. In particular, she expects more engagement in, "filing or co-filing shareholder resolutions, and participating in dialogues with company management on ESG issues."

AXA IM's Matt Christensen predicts that in future, asset owners will be more visible, as institutional investors come under pressure to exercise their ownership duties. "The asset owners

have to a certain degree been like absentee landowners,” he says, “A diverse investor base means that companies haven’t had to worry about large-scale, concentrated asset owners challenging them and exercising their voting and engagement rights. I think this is now changing.”

The rise of E and S factors

Perhaps not surprisingly – and given the growing importance of both the Paris Agreement and the SDGs to society at large (as well as governments’ need for private finance to help deliver them) – investors expect the ‘E’ and ‘S’ of ESG to become increasingly relevant: 87% of respondents said environmental and social factors would grow in importance, compared to 81% who listed governance. Trends were almost identical across regions and between asset managers and owners.

Around two-thirds of investors rank themes related to climate change as the foremost issue they are focusing on

Our survey also asked investors to tell us specifically up to three themes that are on their radar, which we then summarized under around 40 headings, and then grouped these again by broad theme. The results reveal that ‘E’ factors are front-of-mind – from the themes investors ranked in first place, the leading five are all linked to environmental goals with ‘environmental’ or ‘ecological protection’ ranked first. The others referenced climate change specifically, as well as renewable energy, energy efficiency programs, and fossil fuel divestment (see also box, below). Overall, 65% of first-ranked themes related to environmental issues, most with links to climate change.

Combining themes one, two and three together and the balance is more evenly split across environmental (48%) and social (43%) goals. Among the social themes, ‘health’ or ‘well-being’ ranked top (and fifth overall) followed by ‘social responsibility’, as well as topics related to ‘safety, peace and security’.

This is interesting not least because the themes map closely to the SDGs – especially SDG 16 on peaceful and inclusive societies and SDG 3 on promoting health and well-being (see

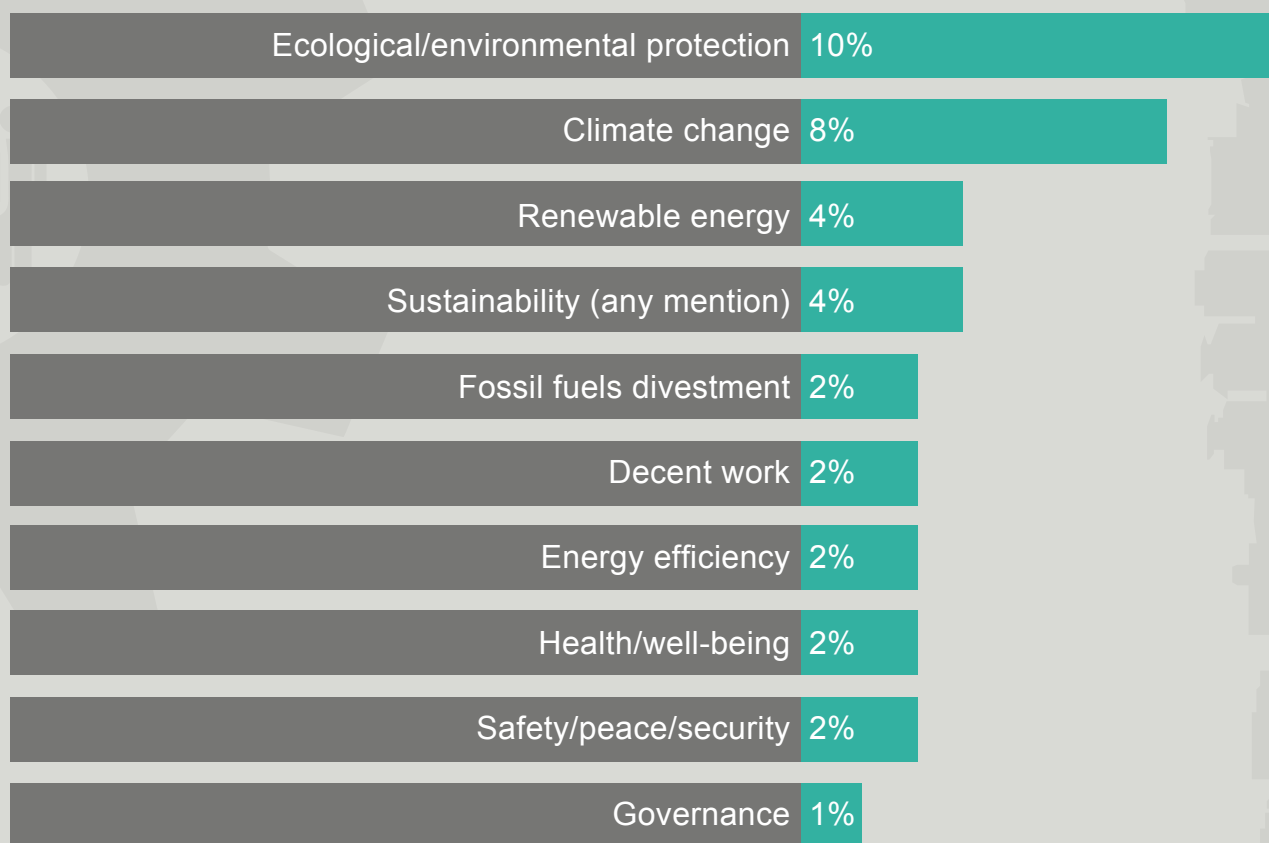
Table 2, p.56, for full list). This confirms anecdotal reports from investors that the SDGs are growing in relevance even if the private sector does not yet know how to fully implement them (see next section).

“I think that there is going to be ... a redefinition of the role of finance in society and therefore a reassessment of the societal role of asset management, pension funds and other financial actors,” says AXA’s Matt Christensen, “They will be expected to ensure returns and the sustainability of portfolios as measured against the SDGs.”

Source: Newsweek Vantage *Future of ESG Investing Survey*

Top 10 ESG themes

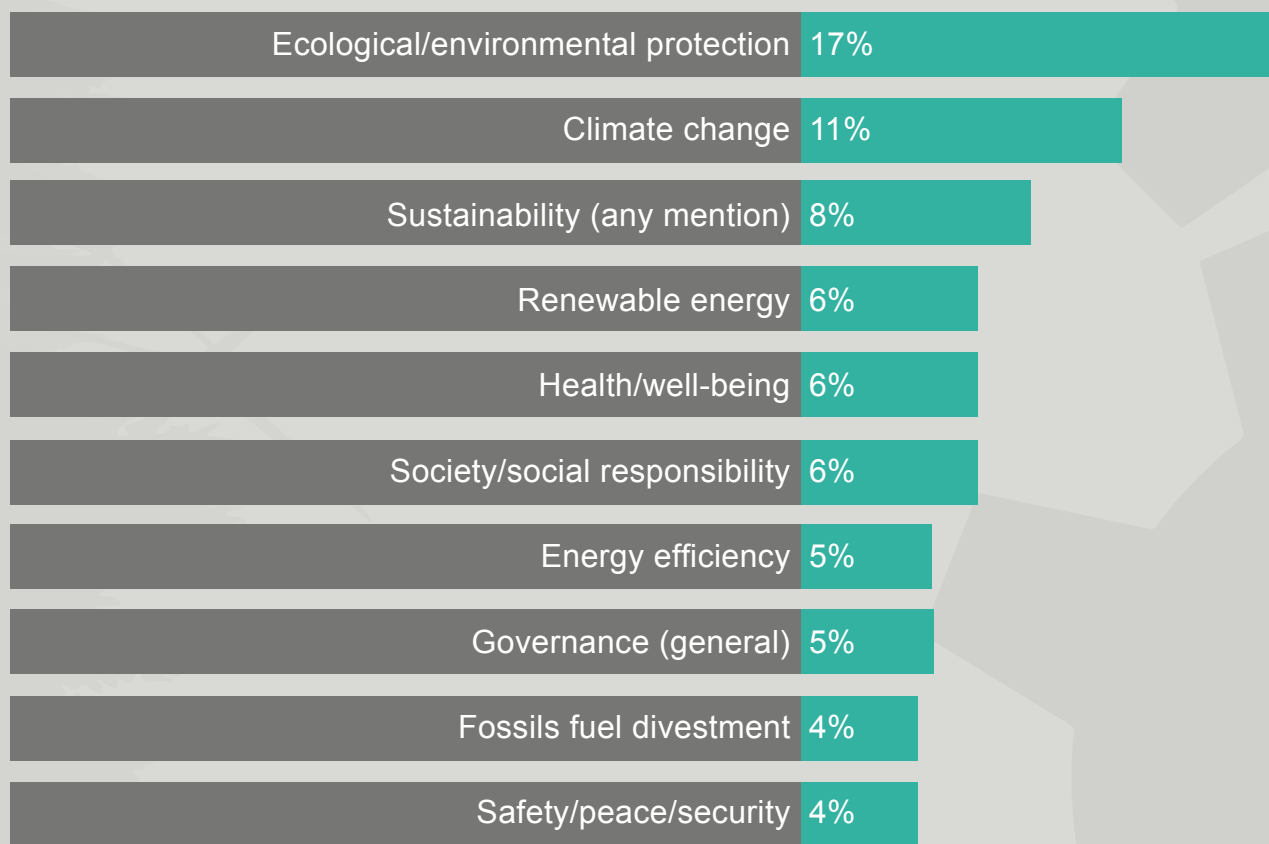
Investors’ top themes

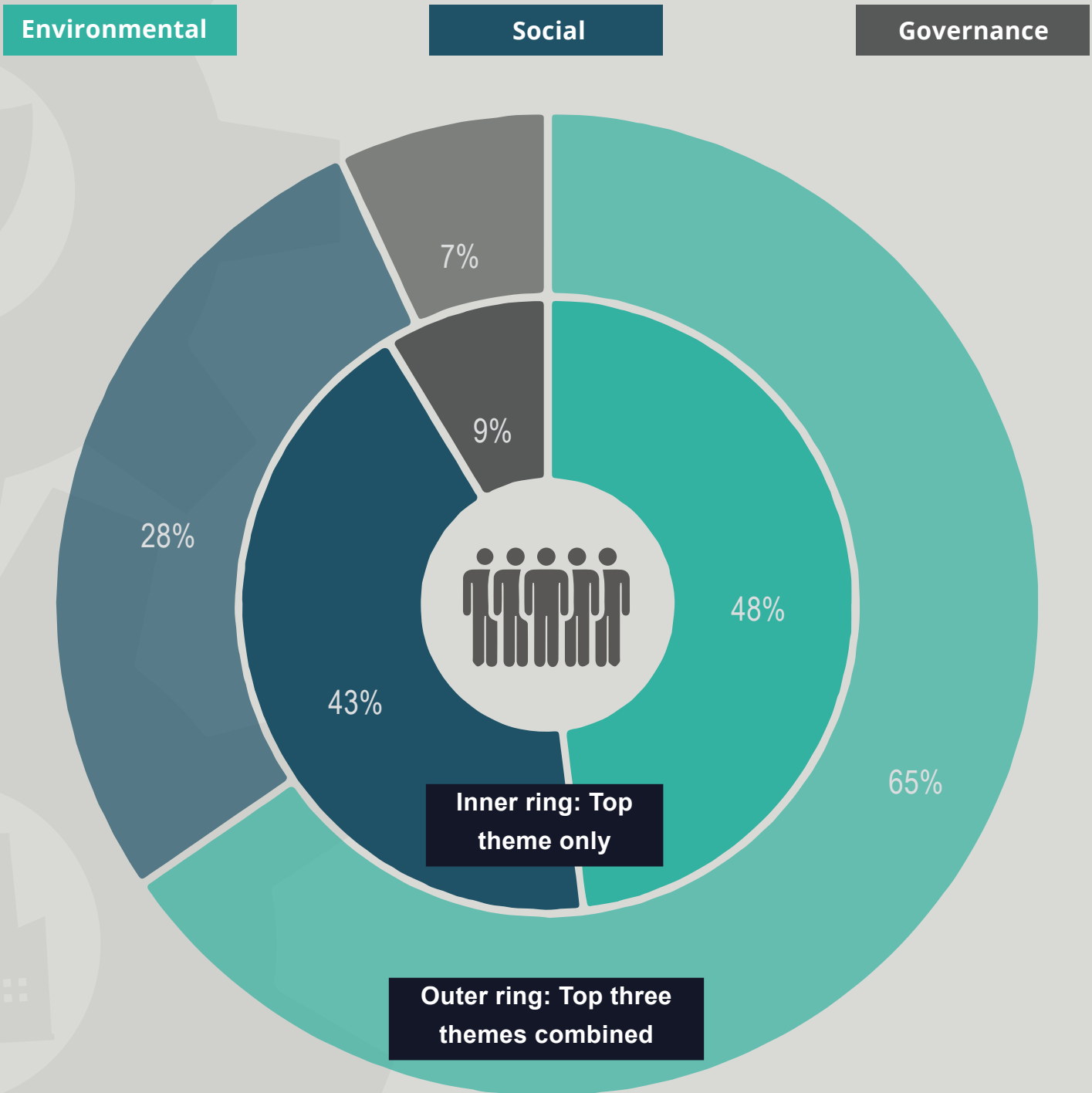


Source: Newsweek Vantage *Future of ESG Investing Survey*

Top 10 ESG themes

Combined rank of top three themes





Key themes grouped by Environmental, Social and Governance category

Source: Newsweek Vantage *Future of ESG Investing Survey*

Divestments rising

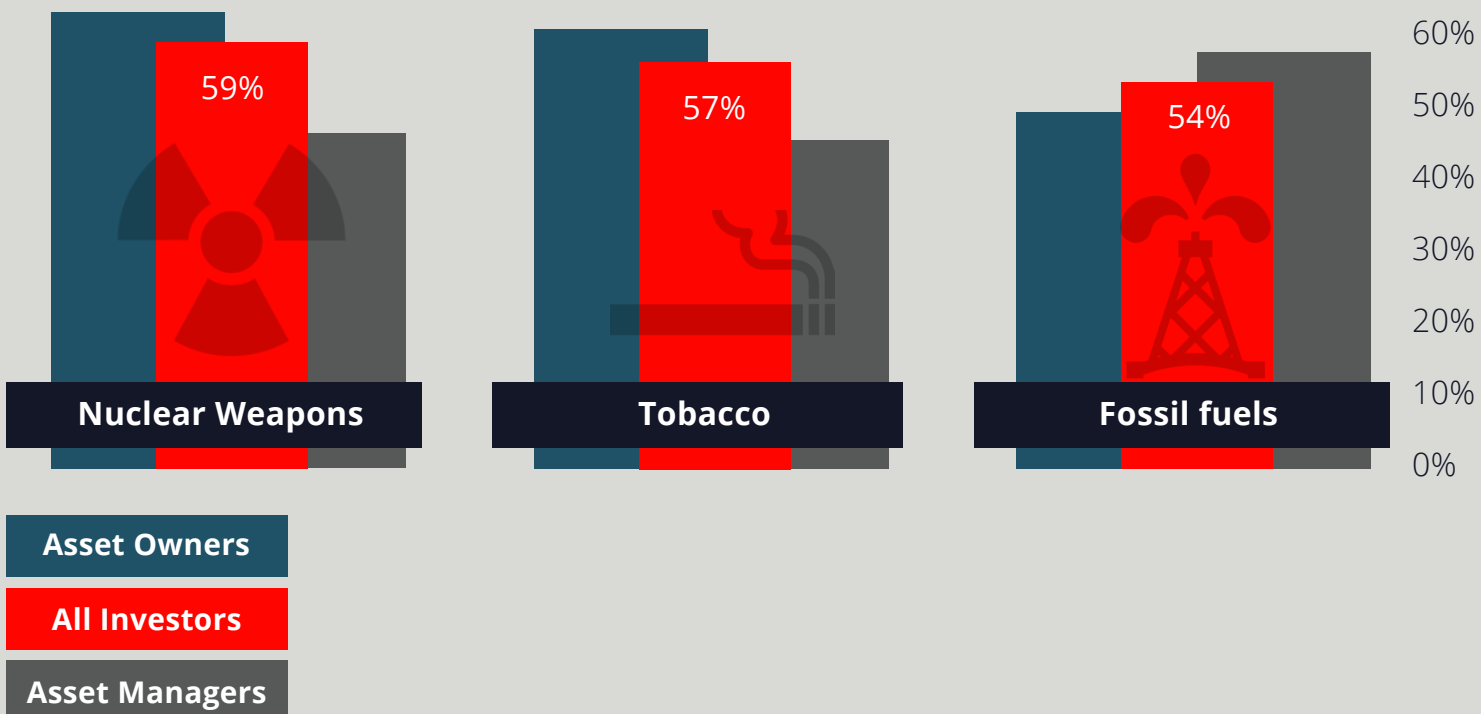
Our research indicates an overwhelming intention among investors to 'do no harm', but until now, most have been reluctant to let go of investments unless there is a clear case based on their risk-return profile (see box on Fiduciary Duty, p.29). As ESG information becomes more material, divestments look set to rise, and investors expect to increasingly extract themselves from sectors that cause harm to human health, social cohesion, or the ecological systems on which life depends.

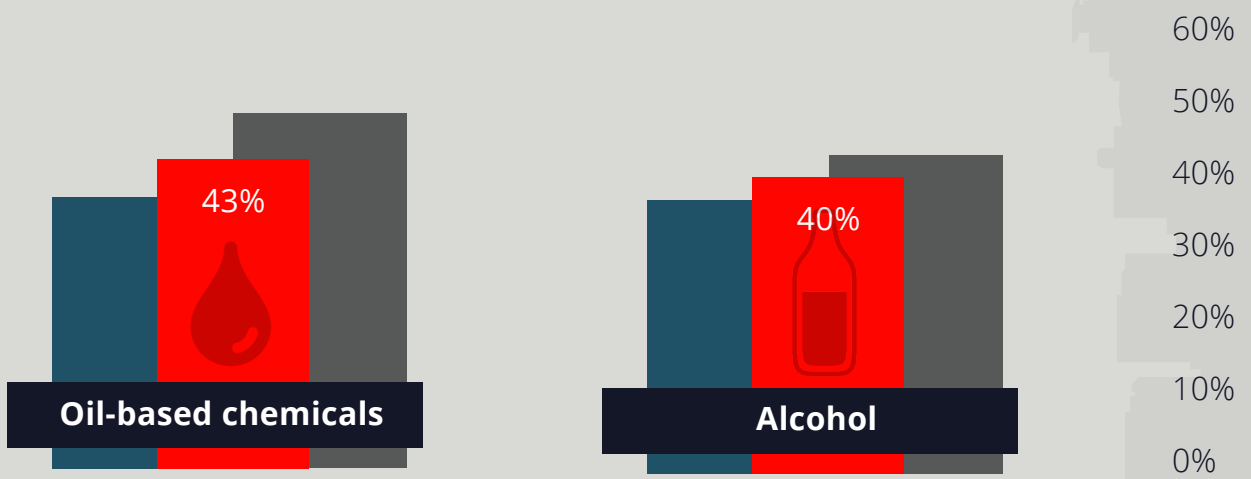
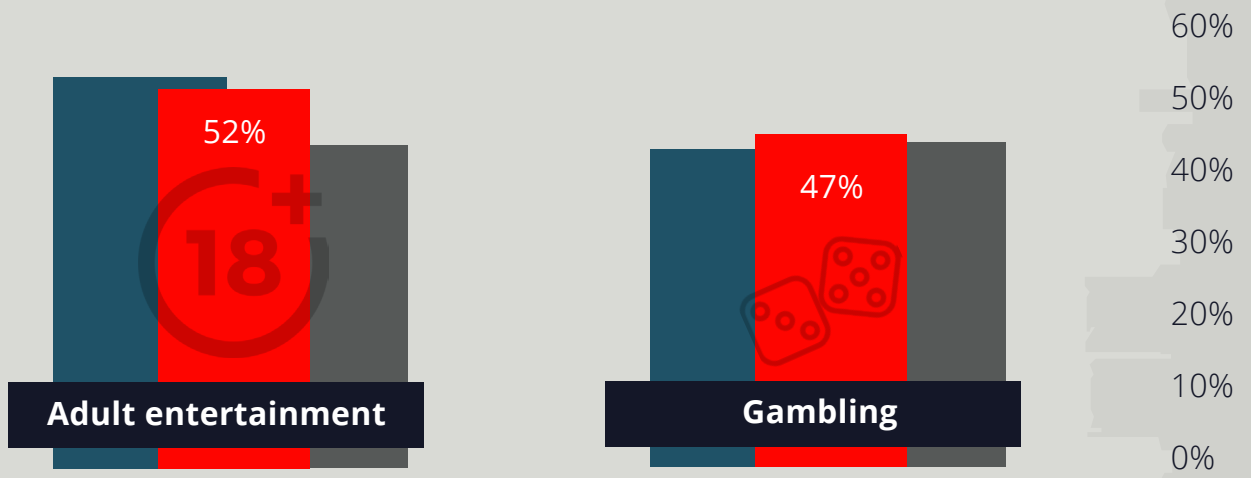
In our survey we asked investors which of up to seven products they expect to have divested from by 2030, choosing from fossil fuels and oil-based chemicals, alcohol and tobacco, nuclear weapons, and adult entertainment and gambling. 99% of investors selected at least one of the above. At the top were nuclear weapons: almost 60% said they would not, or no longer, invest in nuclear weapons by 2030. Tobacco, listed by 57% of investors, came next while over half (54%) said they planned to drop, or have dropped, fossil fuel investments (and a further 43% related oil-based chemicals). Just around half also singled out adult entertainment and gambling. A not-insignificant 40% said they would divest from alcohol.

Source: Newsweek Vantage *Future of ESG Investing Survey*

Letting go

Share of investors expecting to have ceased investments in potentially harmful sectors, by 2030



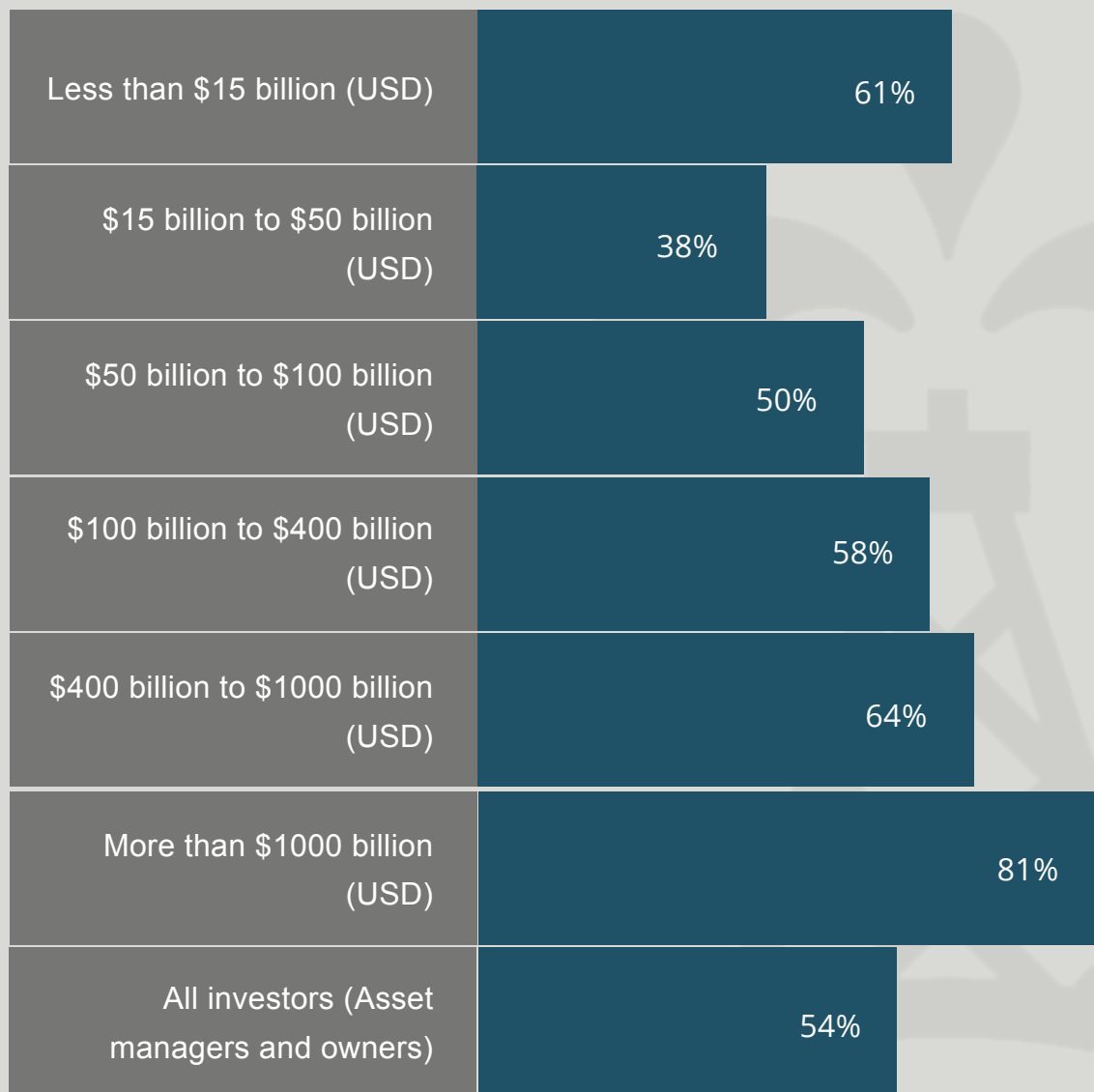


The results point to a particularly bleak future for fossil fuels. That at least half of investors plan on divesting is perhaps not surprising – the Paris Agreement requires greenhouse emissions to peak by 2030 or sooner. Asset owners also show a greater inclination to divest – 60%, compared with 50% of asset managers – chiming with other evidence of a rise in ESG-influenced shareholder activism. But our figures also suggest that, as a share of overall assets under management, a potentially greater amount of financing could be pulling out of fossil fuels. In our survey, the commitment to divest rises in line with volume of assets under management: almost two-thirds of investors with assets of between USD 400 bn and USD 1 trn and four-fifths of those with over USD 1 trn in AUM expects to have dropped oil, gas and coal investments by 2030. (It’s worth noting we observed no such trend for the other products).

Source: Newsweek Vantage *Future of ESG Investing Survey*

Rising tide

Share of investors expecting to have divested from fossil fuels by 2030, by assets under management (AUM)



The growing relevance of the SDGs

Among the most conclusive findings of this research is the impact the Sustainable Development Goals (SDGs) are having in shaping ESG strategies. Both our survey respondents and interviewees overwhelmingly agree on their importance in maintaining the momentum of ESG investing in the years ahead.

“I think it is our first chance to have a common framework that investors, citizens and companies can use to work together towards common objectives,” says Matt Christensen. He likens the SDGs to the role the PRI initiative played in the early days of ESG investing. “The SDGs bring impact and ESG together to give us a combination that in the future will be: what is your financial return or outcome? How have you integrated ESG to better manage risk? And what is your SDG outcome? I think that is what’s great about it.”

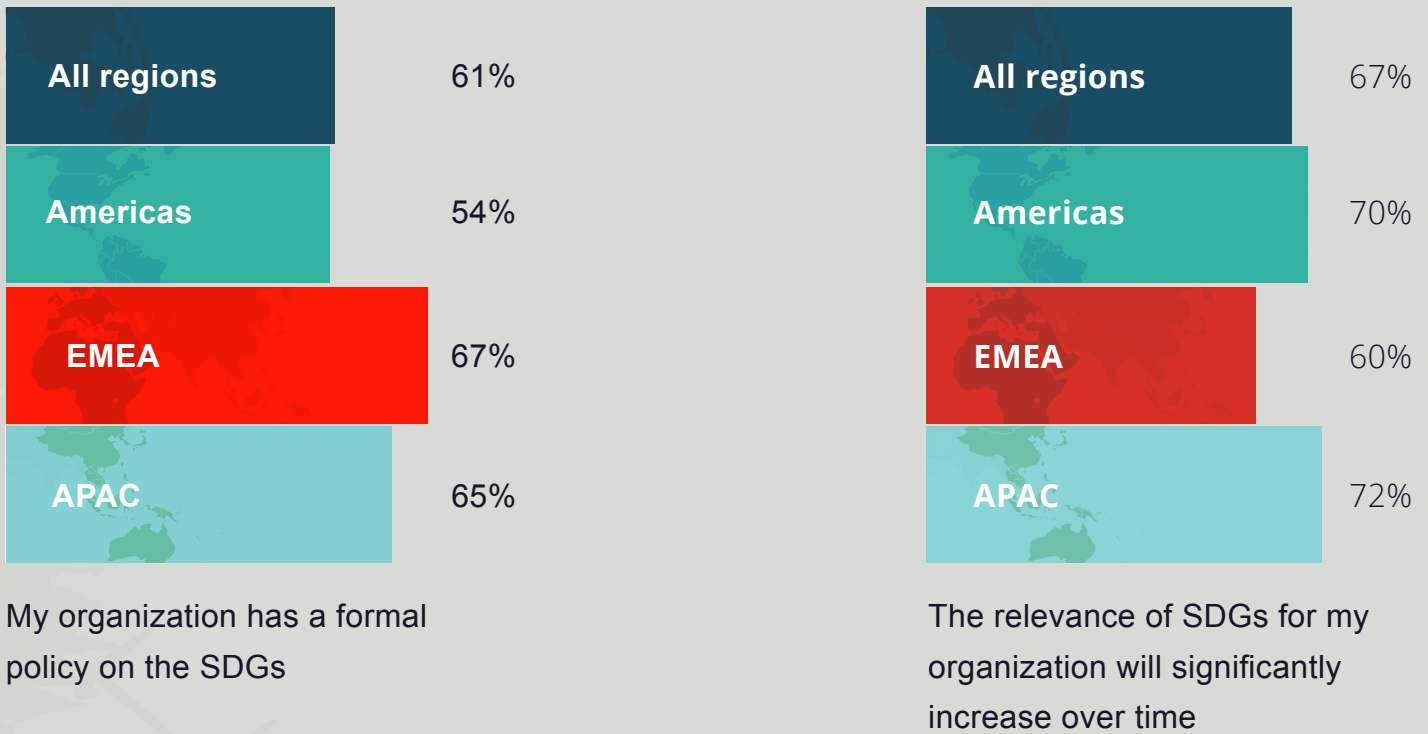
In our survey, four out of five (83%) asset managers and owners said they are aware of the SDGs and three out of five (65%) could name at least five. A majority (61%) also stated that their organization has a formal policy on the SDGs.

Until now, investors in the Americas have lagged other regions in terms of the focus given to the SDGs -- just over half (54%) of surveyed investors currently has a formal SDG policy, compared with two-thirds (67%) in EMEA. However, and in-line with other data and anecdotes on the rapid rise in ESG investing in North America in particular, fully 70% of respondents in the Americas expect the importance of the SDGs to increase significantly over time (compared with 60% in EMEA, coming from a higher starting point). But it is investors in APAC – which is home to just under half of the world’s poor³³ – that expect the SDGs to have the greatest impact on their investment strategies looking ahead.

Over 60% of investors say their organisation has a formal policy on the SDGs

Gunning for the Goals

Current and expected significance of the SDGs, by region



More than pretty little squares

A majority of 62% of survey respondents say that their organization reports on its SDG performance. This is in-line with findings from similar studies analyzing corporate SDG reporting . But experts caution that reporting alone does not imply action. “Although SDG investing appears to be on the radar of many institutional investors,” says Marilou van Golstein Brouwers, it is often, “a relabeling of what investors have already done. All of a sudden, an investment then becomes an SDG investment.” Or, as Steve Lydenberg of Domini Impact Investments puts it, “Everybody wants to put those beautiful little colored squares on their annual reports.”

Vineet Rai notes that in India, so much capital is currently entering the economy, “that it becomes very difficult not to make an impact if you are doing business in emerging countries”.

However, he cautions that we need to look carefully into the real added value to ensure it's not simply, "old wine in new bottles."

There are signs that investors are becoming more strategic about their approach to the SDGs: according to Fiona Reynolds, many PRI signatories are increasingly doing mapping against the SDGs, to identify what they are already doing and where they still have gaps. "However, I do have a slight concern that people stop at mapping," she says, "That people will start ticking boxes rather than actively contributing to the SDGs. Mapping alone will not meet the challenges of the SDGs."

Turning intent into action

Among the practitioners we spoke with, there is a clear intent to move beyond simply mapping or box-ticking the SDGs, but also a recognition that their large and complex nature makes them less obviously actionable than say, the Paris Climate Agreement.

"The majority of the money towards the SDGs is earmarked for climate change and the green economy, so it's quite skewed towards that part of the market," says Tine Fisker. "The social goals can be perceived to be more value-driven, whereas there is an established business case for investing in green projects as well as wide acceptance of the need."

"The SDG framework summarizes the world's biggest challenges, which is helpful to us, especially in impact investing because it serves as guidance on how investments can contribute to solving society's problems," says Harald Walkate. "However, the downside is that it does not give you much specificity on how to actively contribute and implement it."

UBS has identified a number of SDGs which they deem "investable", according to Michael Baldinger, including Goals 3, 5

Managers need to become more innovative in developing products that meet the SDGs

Fiona Reynolds, CEO PRI

and 6 (on poverty, gender and sanitation) and 7, 13 and 15 (on clean energy, climate and the environment – see Table 2, p.56 for full list). In addition to a climate product it has recently created one on gender (see also UBS: Innovating for the SDGs, below).

Fiona Reynolds also points to countries such as Sweden and the Netherlands, where some of the leading funds have committed allocations to Sustainable Development Investments (SDIs), which can be directly linked to the SDGs. Tine Fisker believes this is already starting to have an impact on the investment strategies of African money managers, who are now developing ESG frameworks in order to meet the requirements of foreign investors.

Such developments could be an important step in helping risk-averse institutional investors pivot towards developing markets, where most of the SDG investment is required. “Most institutional investors are still geared towards investments in OECD countries,” says Jane Ambachtsheer. “If you look at the call on the international community, it would actually require much more reallocation of capital towards developing countries.” She notes that, on average, OECD country pension funds allocate 1% to infrastructure. “To meet the needs of African infrastructure investments over the coming 20 years that would need to go up to 2.2% or 2.3%, with all of that extra money being channeled into African infrastructure. So, while it may appear to be a small addition, in terms of absolute investment figures, that’s a big ask.”

UBS Asset Management: Innovating for the SDGs

For Swiss-based UBS, ESG has become a core business driver. “We’ve been investing sustainably for 20 years,” says Michael Baldinger, Global Head of Sustainable and Impact Investing UBS Asset Management.

Yet even this stalwart of the scene is finding itself racing to keep with sustainable investing’s recent, rapid rise.

Last year UBS Asset Management doubled its SI-focused AUM – 20 years on from when it launched its first sustainability strategy. By the end of this year, it aims to have full ESG integration across its Equity and Fixed Income research platforms, meaning that all 900+ investment staff will be able to take SI factors into consideration. “For us, what matters is the broad integration of SI across all asset classes at UBS Asset Management,” says Michael, “that’s what will move the needle in terms of bringing ESG to the mainstream.”

Creating compelling products

Michael says that, as a leading asset manager (with USD 795 billion AUM), they are convinced of the value added from sustainability and are using it to provide product offerings that are compelling both in terms of the sustainability profile and of financial returns. “[We believe] no client should have to sacrifice returns to meet their social objectives. We say that what SI will give them is the risk-return profile they would have had anyway, but with the added benefit of sustainability on top.”

So far it has developed two products that line up with some of the SDGs it has identified as “investable”. The first is its award-winning Climate Aware Fund, in line with SDG 13 on climate change, which grew out of a collaboration with the UK’s National Employee Savings Trust, which had approached UBS to help it incorporate a forward-looking assessment of climate change risk into its equity allocation.

Earlier this year, UBS also developed an ETF that gives clients exposure to companies with strong gender diversity.

In other SDG-related work, UBS has teamed up with the pension fund manager, PGGM, in developing an impact measurement methodology for four impact categories, including climate action, air pollution, access to clean water, health and food security.

Ensuring ESG's success

There is an overwhelming sense of optimism among the investors we interviewed and surveyed about the potential for ESG investing to play a key role in tackling humanity and the planet's challenges in the years ahead – as well as a cautious optimism that its goals are achievable.

“At its best, what sustainable investing offers is transparent and forward-looking answers in the form of a completely new set of investment analysis metrics. I like to call it a ‘new set of eyes’ for investors. I really believe it when I say this is a game changer for our industry,” says Michael Baldinger.

Yet – as we have alluded to throughout this report – investors agree that several things will need to come together to make sure ESG delivers on its promise. Below we highlight the key recurring themes.

Five ways to move the needle

1.

Better, more material information

There is a growing abundance of ESG-related information, but our experts and surveyed investors stress the need to make the information more relevant, material and linked to actual impact and outcomes. In our survey, six out of 10 asset managers and owners agreed that current investment analysis within their organizations does not reflect all environmental, social and governance costs. Fiona Reynolds mentions that at PRI, they are increasingly working with academics, “since they are of crucial importance to validate the materiality of responsible investing.”

Corporations also need to do their bit. “Investors need to provide better indications to corporates on what kind of data and information they need,” says Harald Walkate, “but also, cor-

porates need to improve their ESG data reporting and provide data which they think is material for the business.” To this end, initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD, see also p.21) are a step in the right direction.

Marilou van Golstein Brouwers of Triodos argues that we need not just metrics, but evidence of impact. “We need substantial evidence of the real positive effects of investments. We need to see the theory of change behind the investment.”

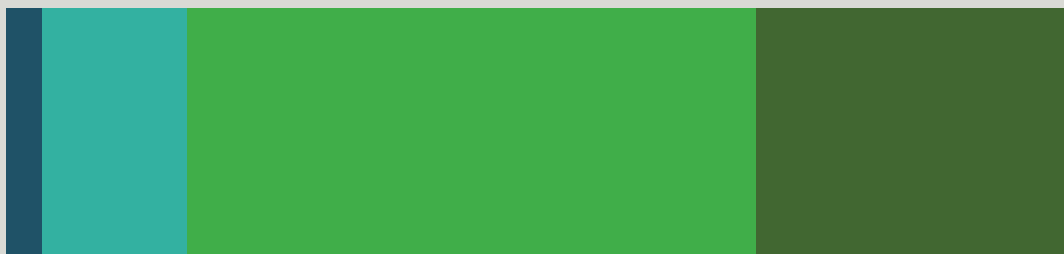
Other investors concur that metrics need to move beyond box-ticking or mapping what has already been done. Jane Ambachtsheer says she hopes to see a common framework emerging for the SDGs. “We have one set of Sustainable Development Goals, we should have one set of key metrics for how investors measure their contribution to those.”

Source: Newsweek Vantage *Future of ESG Investing Survey*

Could do better

Current investment analysis does not reflect all external social, environmental and governance costs

20% 10% 0% 10% 20% 30% 40% 50% 60% 70% 80%



Disagree Strongly disagree Agree Strongly Agree

2.

The right kind of regulations

Investors are naturally reticent about gunning for more regulations for their industry, yet there was a broad agreement among the practitioners we spoke with that the right kind of regulation could help improve the way ESG investing is practiced (and thus its impact), particularly as regards setting reporting and disclosure standards.

“By 2030, I think it will be better regulated than today,” says Matt Christensen of AXA IM. “A regulatory role would be helpful if it does not force a prescriptive idea of fiduciary duty but does make it clear that ESG is expected to be discussed.” He points to France’s Article 173 (see page 17), which requires disclosure on ESG issues without mandating which method to use, as a good example, describing it as, “a smart way to push fiduciary duty forward.”

With the recent US guidance on fiduciary duty taken as a backward step by many, Marilou van Golstein Brouwers is optimistic that growing societal pressures can also bring about change, rather than it simply being “forced” through by legislators. “I am quite hopeful that by [2030] integrating ESG information will be seen as part of the fiduciary responsibility. I hope that it will become the ‘license to operate’ for both companies and investors.”

3.

Products for every asset class

With some USD 7 trillion needed each year to finance the Paris Agreement and the SDGs, sustainable investment experts stress the importance of developing new products and tools suited to different investors and types of asset – especially as much of the investment will need to be directed at developing markets, which are unfamiliar territory for many institutional investors.

“At PRI, we aim to make the case for responsible investing

across all the different asset classes,” says Fiona Reynolds. “Because what you do in terms of responsible investing in listed equity is different to what you do in private equity or fixed income. She adds that she hopes asset managers will start to, “become more innovative in developing products that meet the SDGs.”

Harald Walkate also sees product innovation as particularly critical to investing in the SDGs. “Institutional investors are often not set up to invest in non-OECD countries - it is not the kind of risk they can take.” He emphasizes the need for more initiatives that “structure investments which bring knowledge and expertise of these markets, but also may source financing from governments, development banks and other organizations that may provide certain guarantees or risk hedging.”

A good example is Climate Investor One, a blended ‘finance and capital recycling facility’ that finances renewable energy projects in emerging markets . By combining donor funding with development financing (DFIs), it can offer different risk-return profiles for different types of investor – including commercial and institutional investors.

Yet interviewees also noted certain SDGs will be more challenging to influence directly. Lisa Woll suggests that private sector could also contribute to the SDGs in other ways, such as by, “assessing how their government lobbying might conflict with their SDG priorities,” as well as finding ways to financially support civil society organizations, which she notes often play a key role in pressuring governments to facilitate change.

Managers need to become more innovative in developing products that meet the SDGs

Fiona Reynolds, CEO PRI

New teaching and incentives

If investors are to increasingly integrate ESG into the investment process, then they had better know what they’re talking about. “There is an urgent need for more education directed at financial professionals,” says Lisa Woll. She mentions that US SIF has created online courses and has partnered with the US

4.

There is an urgent need for more education directed at financial professionals

Lisa Woll

College for Financial Planning to create the first sustainable investment designation in the United States.

Several investors noted that the number of ESG specialists is now increasing, but also stressed the need for people that have deep knowledge of the industries they are investing in, to make sure they can determine what is material to the investment. At Aegon Asset Management, ESG training is now compulsory for asset managers and the business is extending education to other functions as well (see case study, below).

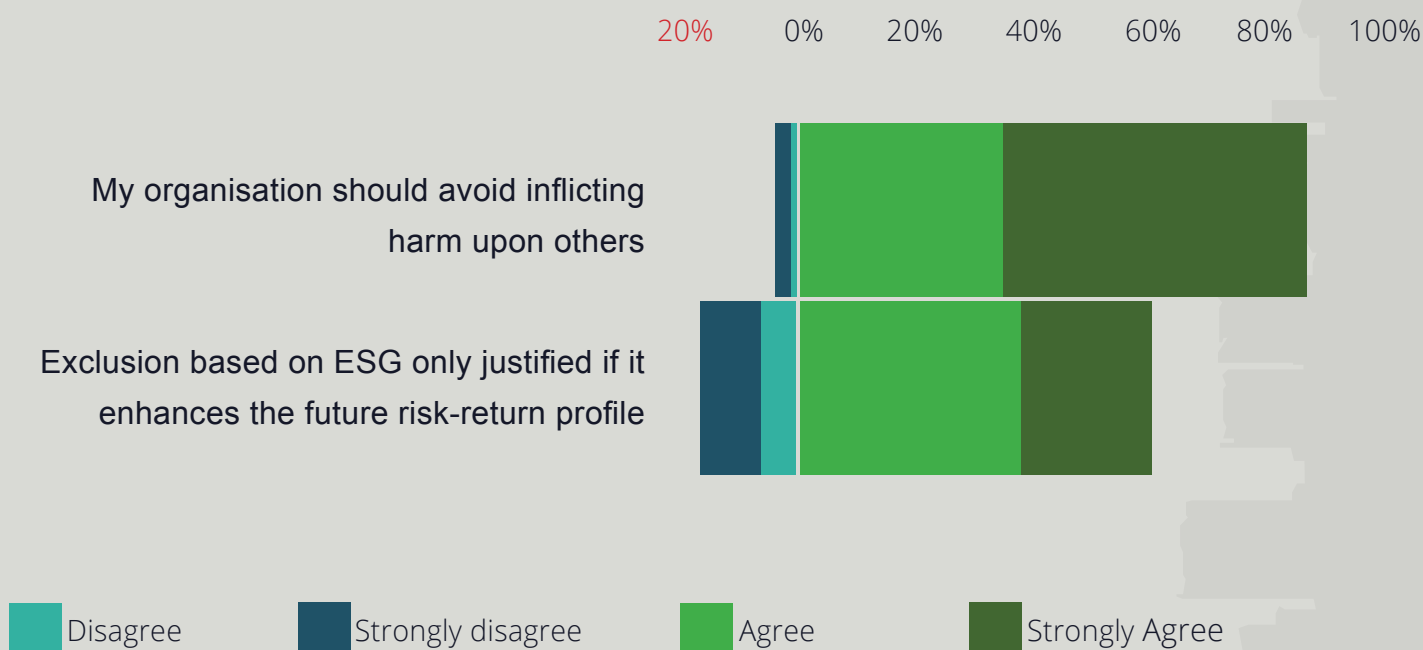
A key question is whether an increase in knowledge will start to impact the myopic mindset within the investment community, as the managers of money start to better understand the broader, longer term impact their investment decisions can have.

“I think in the financial industry in general we still see a big discrepancy between how people behave in their jobs and what their actual values and motivations are,” argues Marilou van Golstein Brouwers. “As long as you are not able to bring your own values and your professional actions together things will not change. Investors must start aligning their personal values with what they are doing in their job.”

Fiona Reynolds also argues that beyond changing finance’s mindset, corporate culture and incentives also need to come into step with ESG’s long-term goals. “The main barrier is that we are trying to be long-term investors, but we are working within a system that is set up for the short-term. We are rewarding portfolio managers for short-term performances. The way we incentivize CEOs of companies can be quite short-term. That’s why we really need to change the mindset and the time horizon of the market.”

Turning thoughts into action

Share of investors agreeing they should ‘do no harm’ versus share prepared to divest only if it impacts the risk-return profile



Engage the beneficiaries

5.

One of the greatest challenges investors cite is not awareness in the investment community – but among the beneficiaries of investments themselves. “Various studies show that the beneficiaries of pension plans put a higher value on sustainability than the management of the pension plans,” says Michael Baldinger. In our survey, respondents listed ‘engagement with beneficiaries’ as the form of engagement they are most likely to increase between now and 2030, ahead of engagement with investees (companies) and with governments and civil society (see chart, below).

Doing so effectively is not easy, though. “The true missing link is that beneficiaries and asset owners are not in regular discussions on investments and long-horizon matters,” says Matt Christensen, “It is a hard one to address – do you focus on a segment of the beneficiary base as a proxy?” He gives

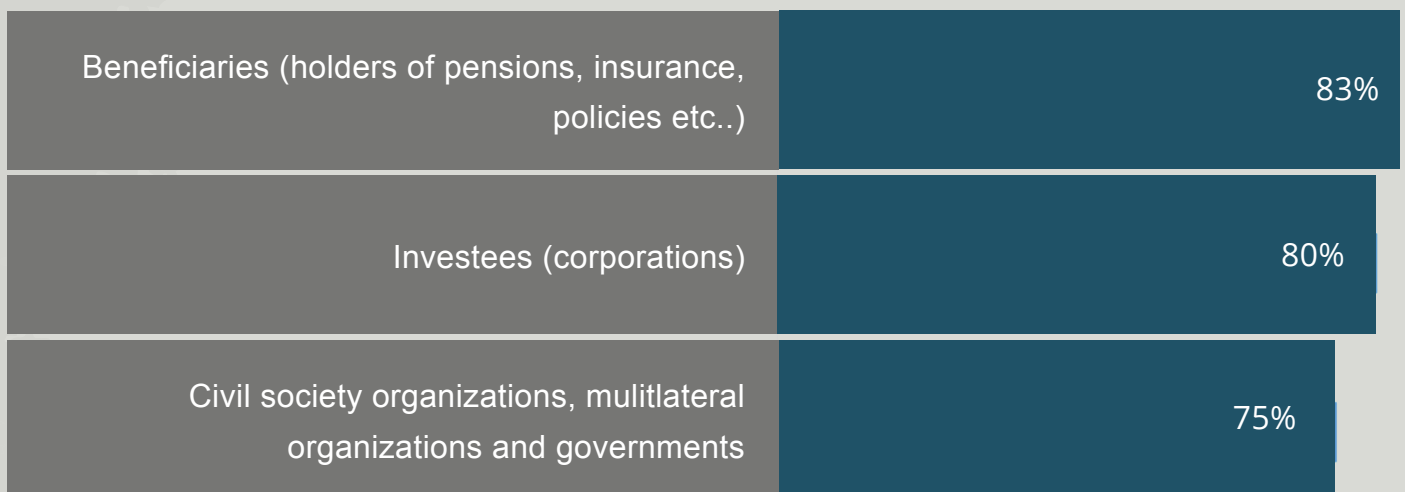
one successful example of the Netherlands, where a television program in 2007 that documented how pension funds were allocating capital to controversial activities – such as land mines and cluster bombs – led to strong public reaction, an official review and ultimately, to legislation requiring pension funds to invest responsibly.

Jane Ambachtsheer believes at least one segment of the population may need less convincing. “There is a lot of survey evidence suggesting that millennials are very interested in sustainability. There are surveys that suggest that millennials will save more if they know that their money is aligned with their social and environmental values.” (In our own survey, younger investors expressed more knowledge and interest in the SDGs, and expect them to become more relevant to their jobs in future than their older counterparts – see chart, below). Jane suggests that, as society moves towards individuals taking more responsibility for their retirement, sustainable investment products could even be the “hook” to get younger people saving.

Source: Newsweek Vantage *Future of ESG Investing Survey*

We can work it out

Which of the following stakeholders do you expect to engage more with in future?



An inevitable agenda for the future

Over the past decade a quiet revolution has been taking place within the investment community. Now ESG is entering the mainstream it will get the attention it deserves – but also more scrutiny. This can only be a good thing, given such high stakes. Just like one of its key drivers – climate change – our research suggests it is “not going away.”

“Responsible investing is an inevitable agenda that will continue to grow,” says Fiona Reynolds. “I hope that by 2030 all investments will be done in a responsible manner, in a way that considers the longer term, and contemplates future impacts. I really hope that we will be there by 2030.”

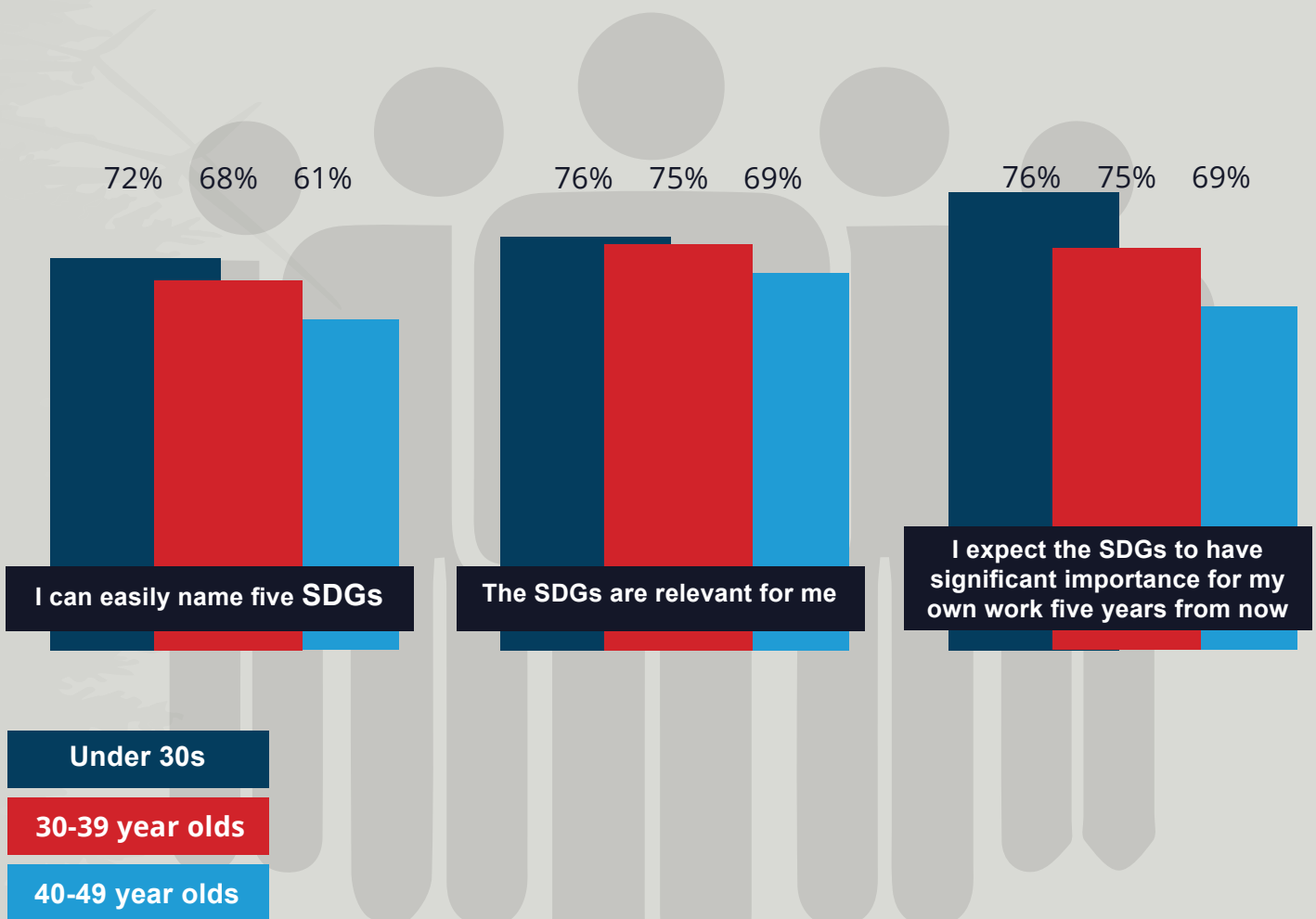
Yet despite many positive developments to date, still too little appears to be happening on the ground. The question now

must be whether the financial community – either supported or cajoled by governments, corporations, institutional investors, civil society and the public at large -- can build on current momentum, and start to have a lasting impact. There is one more reason for optimism: among the investors we surveyed, those in their 20s and 30s today showed more commitment to the SDGs, and expect them to be more relevant to their future careers, than those in their 40s. As tomorrow’s leaders, they offer hope for ESG’s success. Not just the future of finance – but humanity – may well depend on it.

Source: Newsweek Vantage *Future of ESG Investing Survey*

Talkin ‘bout a revolution...

Significance of the SDGs by investor age group



Aegon Asset Management: Building knowledge from within

Aegon Asset Management, subsidiary of the Dutch insurance group, developed its first Responsible Investment (RI) Strategy in 2010, focusing on three strategic areas: ESG integration, impact investing and active ownership (exclusion/negative screening, voting, and engagement). Since then, it has reported annually on its ESG activities and has continually expanded its portfolio of investments, including adding over USD 1 bn to its impact investment portfolio in 2017.

A key part of its strategy is to ensure analysts have access to ESG training that is relevant for their industry – a requirement Aegon Asset Management has mandated since 2013 (as of the end of last year, more than 80% of analysts had completed ESG training)³⁸. “In order to have a meaningful dialogue about how the industry can change you can’t bring a junior engagement manager to the table who has read one industry report,” says Harald Walkate, Head of Responsible Investment. “You need to build knowledge to have credibility, and that takes time and resources.”

In 2016 Aegon Group’s management board highlighted RI as a strategic priority looking to 2020. Since then Aegon Asset Management has launched several programs aimed at expanding its knowledge and reach within its organization as well as with stakeholders.

Last year it launched the ESG Next Program comprising two pilot projects in which RI specialists work intensively with investment teams to develop a deep understanding of the investment process. As Jennifer Moore, Aegon Asset Management’s Director of US Credit Research, explains, “ESG Next is really about formalizing the ESG integration process and making sure everything is happening in detail at the portfolio level. The project allowed us to focus on a specific asset class, to work through case studies and live examples together, and extend the knowledge we have to other parts of the organization.” In addition to portfolio managers and analysts, the project also involved risk management, sales and marketing, and communications teams.

TABLE 2: The 17 UN Sustainable Development Goals

Goal 1	End poverty in all its forms everywhere
Goal 2	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
Goal 3	Ensure healthy lives and promote well-being for all at all ages
Goal 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
Goal 5	Achieve gender equality and empower all women and girls
Goal 6	Ensure availability and sustainable management of water and sanitation for all
Goal 7	Ensure access to affordable, reliable, sustainable and modern energy for all
Goal 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
Goal 9	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
Goal 10	Reduce inequality within and among countries
Goal 11	Make cities and human settlements inclusive, safe, resilient and sustainable
Goal 12	Ensure sustainable consumption and production patterns
Goal 13	Take urgent action to combat climate change and its impacts
Goal 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
Goal 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
Goal 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
Goal 17	Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development

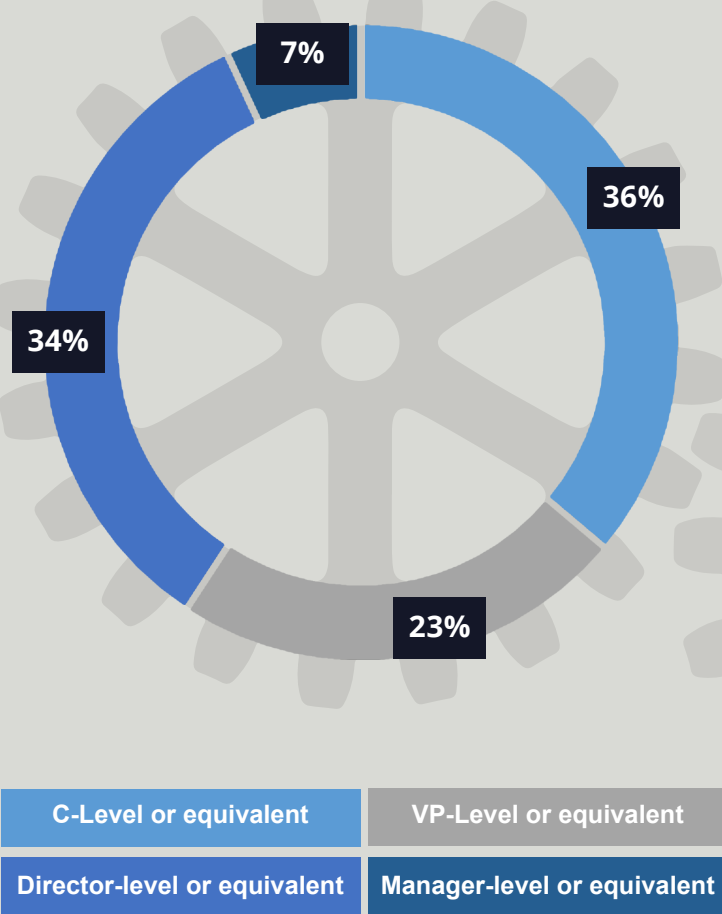
Source: sustainabledevelopment.un.org/sdgs

Appendix

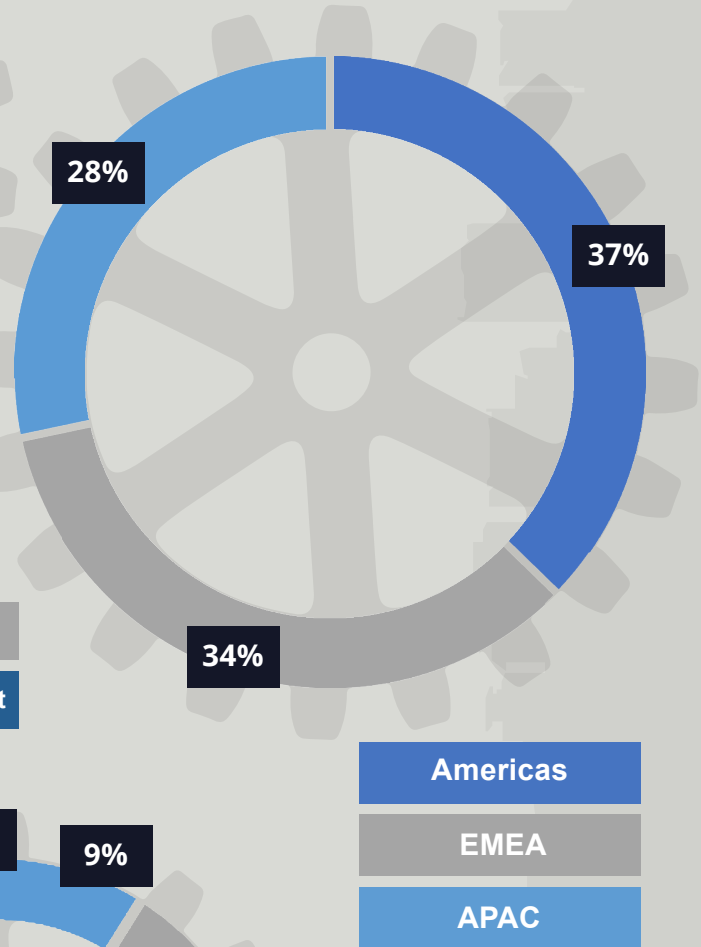
Source: Newsweek Vantage *Future of ESG Investing Survey*

Survey demographics

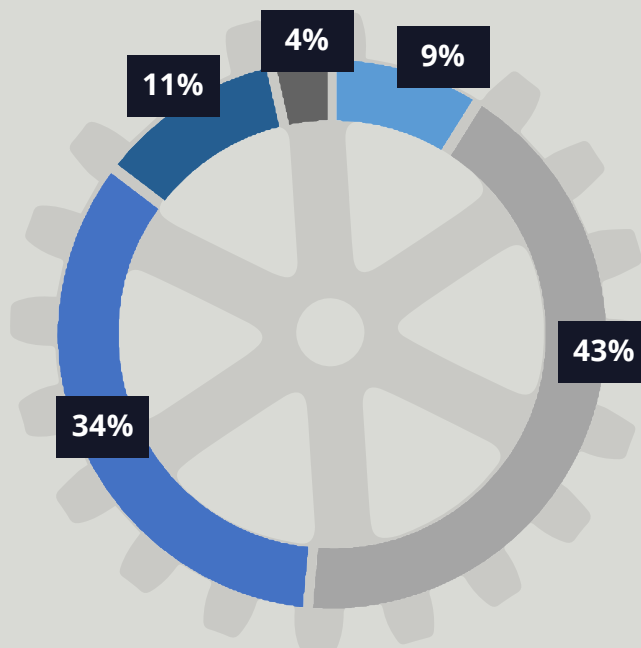
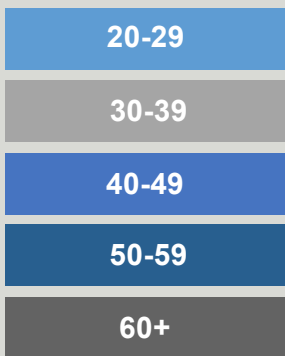
S3 Which of the following best describes your current job role / title?



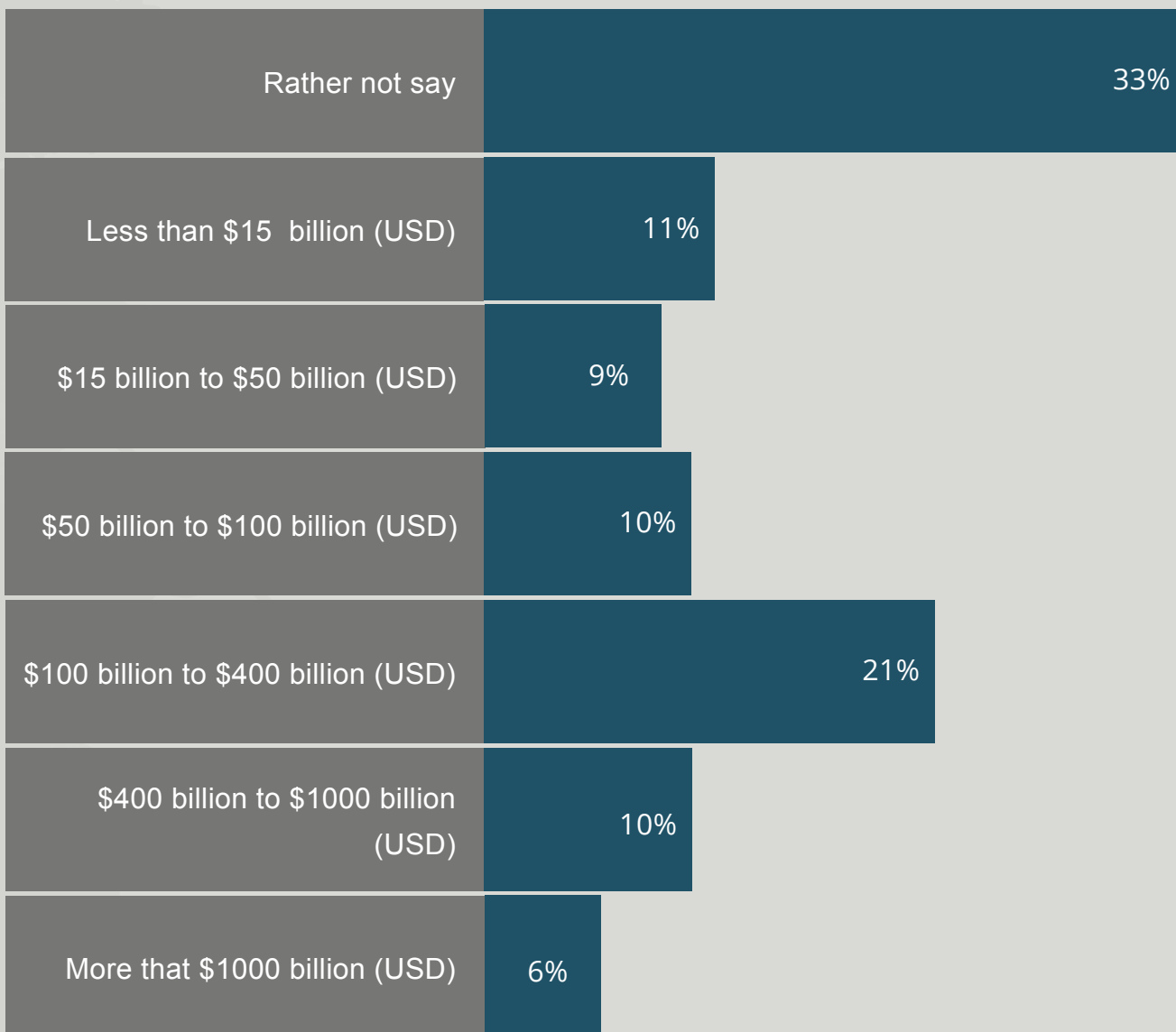
Where are you based?

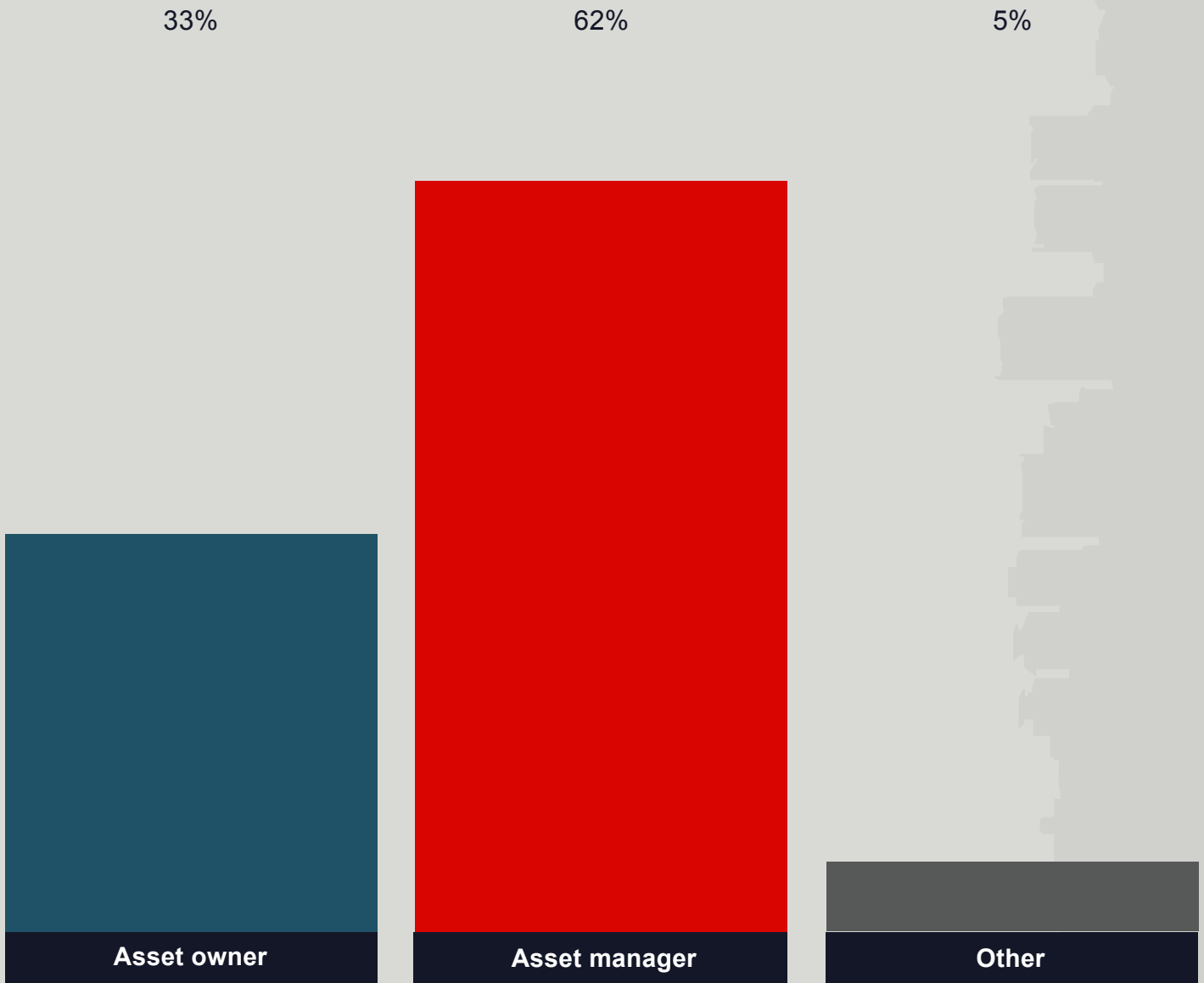


Q15 What is your age?



S4 How much does your company / organization manage?



Q16 My organisation is an:

About the authors

Harry Hummels holds a chair in Ethics, Organisations, and Society (focusing on impact investing) at the Finance Department of Maastricht University and a chair in Social Entrepreneurship at Utrecht University School of Economics. In addition, Harry is a Special Advisor of the United Nations Office of Project Services (UNOPS) on Impact Investing. He serves on the UNDP/UNSIIF Research Council on Sustainable Development Investments, and on the board of Society Impact in the Netherlands. Harry is co-founder of restaurant Le Souk d'Orient – with a mission to employ refugees – and a member of the advisory board of B Lab Europe. Between 1999 and 2015 Harry held various positions in the financial world, including Director of Sustainable Investing at ING Bank, Director of Responsible Investing and Impact Investing SNS Asset Management/ACTIAM, and European Liaison of the Global Impact Investing Network (GIIN).

Rob Bauer is Professor of Finance (chair: Institutional Investors) at Maastricht University School of Business and Economics in The Netherlands. His academic research is focused on pension funds, strategic investment policy, mutual fund performance, responsible investing, shareholder activism and corporate governance. Rob publishes regularly in professional and academic journals and is a frequent speaker on national and international conferences. Rob is also Director of the European Centre for Corporate Engagement (ECCE) at Maastricht University, and Executive Director of the International Centre for Pension Management (ICPM), at the Rotman School of Management, University of Toronto in Canada. Rob is also founder and managing director of Rob Bauer Consultants in which he advises and supports institutional investors on topics related to strategic investments.

Joyce Mertens holds a master in neuro-psychology and one in human decision-making. She is currently a PhD-student at Maastricht University's Finance Department. Her research focuses on emotions and ageing affecting financial decision-making.

References

- 1** For the purposes of this report we use the term ESG Investing as a reference to both Sustainable Investing and Responsible Investing – two terms that are often used interchangeably to mean the same thing, namely, the inclusion of ESG factors in the investment process. The Global Sustainable Investment Alliance (GSIA), in its latest biennial report, refers to Sustainable Investing as “An investment approach that considers environmental, social and governance (ESG).” Similarly, the website of the Principles for Responsible Investing defines Responsible Investing as, “An approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns.” See Global Sustainable Investment Review 2016, GSIA 2017. http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf and <https://www.unpri.org/>.
- 2** Global Sustainable Investment Review 2016, GSIA 2017. http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf
- 3** The total volume of global assets under professional management in 2016 was estimated to be USD 69.1 trillion. See The Innovator’s Advantage: Global Asset Management 2017, Boston Consulting Group, 2017. http://image-src.bcg.com/Images/BCG-The-Innovators-Advantage-July-2017_tcm9-163905.pdf
- 4** According to the PRI website, as of April 2018 there were 1,961 signatories to the PRI, with a total of USD 81,7 trn AUM. See <https://www.unpri.org/about-the-pri>. Accessed on July 10th 2018
- 5** The Global Impact Investing Network (GIIN) describes impact investing as, “Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.” Among its core characteristics is the concept of Intentionality, which is defines as, “an investor’s intention to have a positive social or environmental impact through investments.” This differs from ESG investing more broadly, which can also involve excluding investments with negative ESG ratings, as well as engaging companies to improve their ESG performance without divesting (see also page 20 on ESG strategies). For definitions see: <https://thegiin.org/impact-investing/need-to-know/#core-characteristics-of-impact-investing>
- 6** See: <https://www.unpri.org/about-the-pri>
- 7** According to the United Nations Conference on Trade and Development (UNCTAD) achieving the SDGs will require annual investments of USD 5 to 7 trn, while analysis by Stanford University, using International Energy Agency (IEA) data, estimates that USD 2.3 trn per year is needed over the next 25 years to limit warming to below 2 degrees. See World Investment Report 2014. Investing in the SDGs: An Action Plan. UNCTAD, 2014. http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf; and, Derisking Decarbonization: Making Green Energy Investments Blue Chip, Stanford Precourt Institute for Energy, 2017. https://energy.stanford.edu/sites/default/files/stanfordcleanenergyfinanceframingdoc10-27_final.pdf?wpisrc=nl_energy202&wpmm=1
- 8** The budget for the US Government for fiscal Year 2018 is USD 3.6 trillion. See: <https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/budget/fy2018/budget.pdf>
- 9** See: Article 173-VI: Understanding the French regulation on investor climate reporting, Forum pour l’Investissement Responsable, October 2016. https://www.frenchsif.org/isr-esg/wp-content/uploads/Understanding_article173-French_SIF_Handbook.pdf
- 10** Last year Japan’s SWF announced it would be allocating 3% of funds to ESG investments, rising to 10% over time. See Japan’s GPIF expects to raise ESG allocations to 10 percent, Reuters, July 14 2017. <https://www.reuters.com/article/us-japan-gpif-esg/japans-gpif-expects-to-raise-esg-allocations-to-10-percent-ftse-russell-ceo-idUSKBN19Z11Y>. Information on other funds – authors’ own knowledge.

- 11** ESG investing has its roots in the activities of religious groups aligning their investments with their beliefs. Eighteenth century Quaker communities are generally regarded as the first to have been applying ethical standards to investment decision-making. Quakers refrained from investing in economic activities related to the production of arms, alcohol or tobacco, to slavery or to gambling. In the 1960s religious institutions in the US addressed issues like racial discrimination, workers' rights, apartheid and environmental degradation. It was only at the end of the 1990's that the movement started to spread, and developed traction among mainstream investors.
- 12** In 2007 the US Employee Retirement Income Security Act (ERISA) prohibited fiduciaries 'to subordinate the interests of participants and beneficiaries in their retirement income to unrelated objectives'. Generally speaking, conventional asset owners and managers took this prohibition to mean that ESG-data would not have to be considered. See Lydenberg (2014). Reason, Rationality and Fiduciary Duty. *Journal of Business Ethics*. <https://link.springer.com/article/10.1007/s10551-016-3254-z>
- 13** Through its Interpretive Bulletin 2015-1, the Obama administration took a liberal stance, stating: "fiduciaries should appropriately consider factors that potentially influence risk and return. Environmental, social and governance issues may have a direct relationship to the economic value of the plan's investment". <https://www.federalregister.gov/documents/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically>
- 14** The US accounts for three-quarters of recent climate change-related litigations. See: *The Status of Climate Change Litigation – A Global Review*, UNEP 2017. <http://columbiaclimatelaw.com/files/2017/05/Burger-Gundlach-2017-05-UN-Envr-CC-Litigation.pdf>
- 15** According to research by Broadridge and PwC, in the 2017 proxy season, 10 proposals related to climate change disclosure received at least 40% shareholder support—compared to none the previous season. See 2017 Proxy Season Review. PwC (2017). https://www.broadridge.com/_assets/pdf/broadridge-2017-proxy-season-review.pdf
- 16** Recent research by UBS and Harvard University found that 60% of foundations with assets of over USD 1.5 trn reside in the US. See: *Global Philanthropy Report: Perspectives on the global foundation sector*. Hauser Institute for Civil Society at Harvard University. Johnson (2018). <https://www.ubs.com/global/en/wealth-management/uhnw/philanthropy/shaping-philanthropy.html>
- 17** See: <https://www.wearestillin.com/about>
- 18** According to the United Nations Conference on Trade and Development (UNCTAD) achieving the SDGs will require annual investments of USD 5 to 7 trn. See *World Investment Report 2014. Investing in the SDGs: An Action Plan*. UNCTAD, 2014. http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf
- 19** Statement by President Trump on the Paris Climate Accord, June 1st 2017. <https://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/>
- 20** Report on the structured expert dialogue on the 2013–2015, United Nations Framework Convention on Climate Change (UNFCCC), May 2015. Page 9 of the report notes that emissions will have to be reduced between 40 to 70% from 2010 levels to 2050 prevent global temperatures rising above 2 degrees celcius (and for zero and eventually negative emissions thereafter). However, the report also notes that this scenario has just a 66% probability of success, with the risk of overshoot rising each year of delay. The final wording of the Paris Agreement therefore commits to keeping temperatures "well below 2 °C above preindustrial levels" and to "pursuing efforts to limit the temperature increase to 1.5 °C." See <https://unfccc.int/resource/docs/2015/sb/eng/inf01.pdf> and *Adoption of the Paris Climate Agreement*, UNFCCC December 15 2017. <https://unfccc.int/resource/>

docs/2015/cop21/eng/l09r01.pdf

- 21** The Newsweek Vantage Future of ESG Investing Survey was conducted online during March and April 2018. 281 asset owners and managers responded. See Appendix, p.57 for full details.
- 22** Global Sustainable Investment Review 2016, GSIA 2017. http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf
- 23** According to a statement on its website, the aim of the FSB Task Force on Climate-related Financial Disclosures (TCFD) is to, “develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.” According to recent reports, membership of the Task Force, which launched in 2016 and is chaired by former New York mayor Michael Bloomberg, has grown three-fold since the end of 2017 to now cover one fifth of companies. See Investor-led moves to tackle climate change grow, Financial Times, July 3 2018. <https://www.ft.com/content/b3213fac-7e8b-11e8-bc55-50daf11b720d> and <https://www.fsb-tcfd.org/about/>
- 24** Respondents to the Global Impact Investing Network’s (GIIN) Annual Impact Investor Survey 2016 allocated some USD 228 billion to impact investments, compared to USD 23 trillion AUM for ESG investing overall, as estimated by GSIA. See GIIN, 2017, https://thegiin.org/assets/2016%20GIIN%20Annual%20Impact%20Investor%20Survey_Web.pdf and Global Sustainable Investment Review 2016, GSIA 2017. http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIR_Review2016.F.pdf
- 25** See <https://www.triodos.com/en/about-triodos-bank/>
- 26** For more details see: <https://www.triodos-im.com/sri-engagement-report>
- 27** From 2011 to 2015 return on equity for GABV banks was 8.0%, compared to 7.8% for the market as a whole, with a 2.2% standard deviation, compared to a market average of 3.3%. See Real Economy – Real Returns: A Continuing Business Case for Sustainability focused Banking, GABV, 2016. <http://www.gabv.org/wp-content/uploads/2016-Research-Report-final.pdf>
- 28** The MSCI World SRI Index is MSCI’s leading ESG index. The latest performance report comparing data up to June 2018 (and starting in September 2007) can be found here: <https://www.msci.com/documents/10199/641712d5-6435-4b2d-9abb-84a53f6c00e4>.
- 29** <https://www.axa.com/en/newsroom/press-releases/axa-accelerates-its-commitment-to-fight-climate-change>
- 30** <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01>
- 31** The Status of Climate Change Litigation – A Global Review, UNEP 2017. <http://columbiaclimatelaw.com/files/2017/05/Burger-Gundlach-2017-05-UN-Envv-CC-Litigation.pdf>
- 32** This is the total of any respondent stating either E,S or G information is going to become more relevant
- 33** According to latest figures, there are currently 337m people living across South Asia, East Asia and Pacific with incomes on or below \$1.90/day, which is around 43% of the total of the world’s poor. See The 2017 global poverty update from the World Bank, World Bank, October 16th 2018. <http://blogs.worldbank.org/developmenttalk/2017-global-poverty-update-world-bank>
- 34** See SDG Reporting Challenge 2017, PWC 2017. The study finds that the same share – 62% -- of listed companies have a formal SDG policy, but that 63% of organisations over all offer no “meaningful engagement”, either because they don’t report or they don’t report on goals that are material to them. <https://www.pwc.com/gx/en/sustainability/SDG/pwc-sdg-reporting-challenge-2017-final.pdf>

35 In 2016 a group of Dutch and Swedish pension funds and asset managers made a commitment to allocate substantial amounts to the implementation of the SDGs, stating in their press release that they commit to facilitating, "...a steep increase in what we call Sustainable Development Investments (SDIs)." In so doing, they intend to, "...invest in solutions that contribute to the UN Sustainable Development Goals. These investments meet our financial risk and return requirements and support the generation of positive social and/or environmental impact through their products and services, or at times through acknowledged transformational leadership." So far, two funds – the Dutch pension fund asset managers APG and PGGM – have each formally committed around 15% and 10% of AUM, respectively, to the SDIs. See: <https://www.pggm.nl/wie-zijn-we/pers/Documents/Institutional-investment-into-the-Sustainable-Development-Goals-statement.pdf>

36 See <https://www.climateinvestorone.com/nl/investors/>

37 The program, called Zembla, received significant media attention, as highlighted in this English-language article for Dutch News, Pension funds invest in weapons trade, March 19 2007. https://www.dutchnews.nl/news/2007/03/pension_funds_invest_in_weapon/

38 See Aegon Responsible Investment Report 2017. <https://www.aegon.com/contentassets/86f8d3dab5834375b65044bf51ff03f9/aegon-responsible-investment-report-2017-web.pdf.pdf>

