ESG COMING INTO THE MAINSTREAM

By Sarah Norris

We have seen a sea-change in investor mentality over the last decade, resulting in multifaceted approaches towards ESG investing. These range from integrating material ESG related considerations at the asset level into investment decisions through to utilising an SRI screening processes to set parameters on what their investments should or should not be involved with or do.

ESG investing among institutions is on the rise and according to a recent survey of institutional investors by State Street Global Advisors, 80% of institutions now incorporate an ESG component within their investment strategies, with more than two-thirds of these institutions stating that the integration of ESG has significantly improved their returns[1].

Investors are increasingly using the Sustainable Development Goals (SDGs) as a platform on which to base investment decisions. More companies are incorporating the UN's Goals within their reporting frameworks to show how their operations support the UN's Agenda. Over 2017, we saw the continued application of the SDGs among companies, regulators, civil society groups and investors. Impetus behind the 17 goals, which seek to address targets ranging from education to clean energy by 2030, continues to gather pace. We have been at the forefront of these developments in product innovation and company engagement.

As investors seek out ways to employ capital for good in ethical, sustainable and impact strategies, governments are similarly considering how to tackle some of the more pressing social and environmental issues. The decision of the US administration to exit the COP21 Paris agreement led some commentators to speculate that other participants may withdraw. However, countries with heavy fossil-fuel reliance, such as India and China, along with individual US states reaffirmed their commitment to the agreement. The Financial Stability Board (FSB) established the Taskforce on Climate-related Financial Disclosure (TCFD) in 2016 to encourage and develop consistent disclosures from companies on the financial implications of climate change. It sets out what constitutes effective financial disclosure from companies in all sectors. During 2017, we submitted our views to various consultations produced by the TCFD and used its guidance to further develop our understanding of the climate change risk within our portfolios and our investee companies.

Impact investing, the latest development within the sphere, can also utilise the SDGs as a way to define the world's problems and to help identify the areas that need capital. However, it is distinct from other forms of values-based investing in that it directs capital in a way that seeks both a financial and social return. Impact investment means investing in entities where there is explicit intentionality to deliver a measurable environmental or social outcome. The most important difference between 'ESG', 'SDG' and Impact Investing is measurement - which is crucial.

The world continues to face a number of environmental and social challenges. Rising inequality is also a key concern and investors will be looking for companies that seek to improve people's lives through health and education. Changing regulation in these areas will force companies to develop ever more creative solutions to help solve these problems. The number of companies that shift their business models towards delivering measurable solutions to these global challenges is only set to increase and investors now expect asset managers to consider material ESG issues in combination with balance sheet items when making investment decisions. They now realise that the spectrum of factors that impact an asset go far beyond traditional metrics. «

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1 'ESG Institutional Investor Survey: Performing for the Future.' State Street Global Advisors, 2017.

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