The green revolution : ESG and Asset Management

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Lead the ESG integration: trends, innovation and challenges

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Defining Responsible Investment and ESG integration

Responsible investment is an approach that aims to integrate environmental, social and governance (ESG) factors into investment decisions combined with financial return component in order to generate sustainable, long-term returns.

Responsible Investment (RI), Socially Responsible Investment (SRI) and impact investing

Responsible Investment includes investment approaches such as Socially Responsible Investment (SRI), impact investing, sustainable investment or green investment.

What are environmental, social and governance (ESG) factors?

Examples of ESG factors include:

Environmental

- Climate change
- Fossil fuels
- Water management and use
- Renewable energy
- Pollution levels
- Carbon footprint
- Restoration of the planet

Social

- Product safety concerns
- Worker satisfaction
- Union relationships
- Stance on health issues
- Employment equality and opportunity

Governance

- Transparency and anti-corruption
- Composition of company's board
- Female share of seats on boards
- Political activity and donations
- Tax strategy
- Bribery
- Fraud
- Antitrust violations

ESG integration involves including ESG information into investment decision-making, to ensure that all relevant factors are accounted for when assessing risk and return. It generally includes following practices:

Quantitative and qualitative analysis

- Integrating ESG information into quantitative and qualitative analysis which could result in making adjustments to areas such as **selection, weighting or asset allocation:**
  - Fundamental analysis of company value in equity investing or
  - Assessment of creditworthiness in fixed income investing
- **Monitoring overall ESG risk** within the portfolio, for instance by measuring the portfolio's carbon footprint

Engagement & Voting policies

- **Engaging**, either individually or alongside other investors, with investee companies/entities on the ESG factors identified as relevant to them
- Using **shareholder voting rights to influence company behaviour**
- Encouraging investee companies/entities to **disclose information** on the ESG factors that do or could affect them

AM Industry

- Contributing to the shaping of investor-relevant public policy
- **Promoting wider acceptance and use of responsible investment within the investment industry**

Key drivers for ESG inclusion into investment management

ESG impacts all parts of the investment management value chain, from manufacturing to investment fund distribution. The global momentum for ESG integration is driven by several factors.

Key Stakes

- Increasing demand from **institutional, retail and private banking investors** to invest in sustainable businesses, coupled with **growing public expectations** around corporate responsibility, are placing a greater focus on companies they invest in to address **environmental, social and governance (ESG) concerns.**
- **Green investment including climate change aspects** are likely to be the main drivers over the next years as they will imply an ever growing asset owner's scrutiny and a genuine risk of « stranded assets ».

What are the key drivers for ESG inclusion into investment management?

Increased momentum for sustainable finance

- Recognition in the financial community that ESG factors play a material role in determining risk and return
- Concern about the impact of short-termism on company performance, investment returns and market behaviour

Awareness of increasing demand from investors

- Understanding that incorporating ESG factors is part of fiduciary duty to their clients and beneficiaries
- Pressure from competitors seeking to differentiate themselves by offering responsible investment services as a competitive advantage

Growing pressure from multiple investors

Institutional, retail and private banking investors generally becoming increasingly active and demanding transparency about where and how their money is being invested

Reputational risk

Value-destroying reputational risk from issues such as climate change, pollution, working conditions, employee diversity, corruption and aggressive tax strategies in a world of globalisation and social media

Regulatory pressure

- An overarching set of regulations for sustainable finance
- Legal requirements protecting the long-term interests of investors and the wider financial system

As a result, capital flows into ESG funds are accelerating and asset managers are under mounting pressure to integrate ESG considerations into their investment approaches. From 2016 to 2018, capital flows allocated to sustainable investment have increased by 34% in the world*.

* Source: Global Sustainable Alliance

Moving towards a common European Regulatory framework

The European Union is strongly supporting the transition to a low-carbon, more resource-efficient and sustainable economy and it has been at the forefront of efforts to build a financial system that supports sustainable growth.

In 2015, landmark international agreements were established with the adoption of the **UN 2030 Agenda** and **Sustainable Development Goals** and the **Paris Climate Agreement.**

The **European Commission** has proposed **ESG rules for asset managers**, pension funds, and insurers. Taking the lead on ESG regulation, Commission's proposal includes following four key components:

Taxonomy

Create a **harmonized taxonomy** to categorize environmentally sustainable economic activity

Disclosures

Enhance **disclosures** on how **ESG risks** are integrated into the **investment and advisory** process and impact on **expected returns**

Benchmarks

Create new low-carbon and positive **carbon impact benchmarks** to improve the ability to **assess a fund's ESG performance**

Advice

Require investment firms and insurance distributors to **integrate ESG considerations into the advice given to clients**

12 Dec 2015 — Signature — Signature of the Paris Agreement on Climate Change

31 Jan 2018 — High-Level Expert Group — Report of the High Level-Expert Group (HLEG) on EU wide strategy

The **European Commission** first established a **High-Level Expert Group (HLEG)** to develop a EU wide strategy on sustainable financing who identified the following **two strategies** for Europe's financial system:

- Improve the financial contribution towards **sustainable and inclusive growth**
- Strengthen the financial stability by **incorporating** environmental, social and governance factors **(ESG factors) into investment decision-making**

8 March 2018 — Action Plan — EC published Action Plan on financing sustainable growth

- Based on the recommendations by the HLEG, **EC launched** the **Action Plan on Financing Sustainable Growth**, which lays out a roadmap on how to foster more sustainable investment
- The plan also indicates that the **EC strongly promotes a more active regulatory role** in the market for sustainable investments

24 May 2018 — Concrete Measures — EC published Legislative Proposals for regulations relating to sustainable investments

The package consists of the following **three legislative proposals**:

- Proposal for a regulation on the establishment of a **framework to facilitate sustainable investment**
- Proposal for a regulation on disclosures relating to **sustainable investments and sustainability risks** and amending Directive (EU) 2016/23413
- Proposal for a regulation on low carbon benchmarks and positive **carbon impact benchmarks** and amending Regulation (EU) 2016/10115

Two draft amendments to delegated acts:

- Draft delegated regulation on the Markets in Financial Instruments Directive (**"MiFID II"**) **Amendment of Suitability and Appropriateness Testing**
- Draft delegated regulation on the Insurance Distribution Directive (**"IDD"**) **Amendment for the distribution of insurance-based investment products**

18 June 2019 — EU taxonomy — Technical report on EU taxonomy

The **technical expert group on sustainable finance (TEG)** published its Technical report on **EU taxonomy**. The report contains:

- **Technical screening criteria** for 67 activities across 8 sectors that can make a substantial contribution to climate change mitigation
- Methodology and worked examples for **evaluating substantial contribution** to climate change adaptation
- **Guidance and case studies for investors** preparing to use the taxonomy

Seizing opportunities, overcoming challenges

The growing demand for sustainable investing creates a major opportunity for forward-thinking asset managers. However, several challenges may make it difficult to capitalize on the sustainable investing wave.

What main challenges do Asset Managers face?

Lack of standardized ESG related data	In addition to the significant increase of data related to ESG, it is often too **complex, unreliable, and not standardized, combined with a lack of reporting frameworks.**
Robust ESG strategy and a transparent reporting	Adopting an ESG investing approach raises the possibility that asset managers may be engaging in greenwashing. This leads in **high degree of skepticism** in the market and the need to prove that **integrating ESG is processed in an intelligent, effective, and meaningful way.**
Need for increased expertise and capabilities	Asset Managers have to acquire expertise across the full range of investment and research activities, as well as in key functions such as investor relations and public affairs, **who understand both financial markets and sustainability issues and are able to measure the ESG impact on portfolios but also within their organization.**

What are the keys to success?

Develop a robust ESG strategy and investment approaches

Invest in new tools to harness ESG data and enhance reliability and data quality

Expand ESG offering to an extended range of asset classes

Build the right expertise and capabilities

How 99 Advisory can help

Support your ESG strategy design and implementation

- Help you identify the right priorities, targets and actions to implement the ESG strategy
- Analyze market trends and regulatory landscape
- Conduct peer review and benchmarking
- Incorporate ESG principles into internal operational processes
- Review your product offering
- Assess your compliance to the « Code of Transparency »
- Train your staff

ESG Reporting and Disclosures

- Help you meet your disclosure requirements
- Review your ESG reporting and provide objective recommendations for improvement

99 Advisory provides tailored-made ESG services to match your needs and help you enhance your approach to ESG.

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