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ESG snapshot: Responsible Investment for asset managers

Sustainable Finance and Responsible Investment

Responsible Investment has, in a few short years, moved from being an outlier in the asset management world to an issue of global importance which is front and centre of political, legal and market priorities.

Although the rise to prominence has been market led, regulation is catching up. This incredible focus on Responsible Investment and the integration of Environmental, Social and Governance (ESG) factors brings both risks and opportunities for asset managers.

This document is intended to give an overview of the key issues, current trends, and aspects to consider when implementing your Responsible Investment strategies.

What is meant by Responsible Investment?

Responsible Investment is an investment strategy that integrates ESG factors into investment analysis and decisions. It recognises that ESG factors can have an impact on the financial value of an investment - that long-term prosperity requires a move away from short-term profit as the only definition of value.

Increasingly, it also recognises the importance the financial markets, and our investments, can have on making positive change in the world – be that in the fight against climate change, the improvement of equality standards or taking a stand against poor governance. This requires action not only at a fund level, but also at a firm level.

In a nutshell, Responsible Investment can be interpreted as investment that creates long-term social, environmental and economic (sustainable) value; investment that combines financial and non-financial value creation, or investment that correctly prices social, environmental and economic risk.

What are some Responsible Investment techniques?

One of the main challenges – and opportunities – for asset managers is that there is no standard strategy in this area. We summarise below a number of the approaches taken by asset managers in the Responsible Investment field. It is crucial to bear in mind that Responsible Investment is not limited to climate change issues, nor does it mean only investing in "green" assets. Equally, financial returns remain the focus. Just some ways in which the industry uses Responsible Investment techniques are:

ESG integration	Systematically including ESG considerations in the investment decision making process – which may or may not lead to different investment decisions but may lead to an impact on risk profile.
Screening	Applying a filter to the available universe of investments to exclude assets which do not meet the investment manager's set criteria for ESG (eg, tobacco, arms, gambling).
Focussed ESG products	Managing portfolios with the active intention of seeking a specific ESG outcome (eg investing only in assets which make a positive contribution to society). As well as the various investment techniques, it is more and more common for fund managers to take active ownership of their investment portfolios.
Engagement	Identifying and discussing ESG issues with companies in order to improve their positions (eg on labour standards). More and more, asset managers are collaborating on active engagement in order to present a bigger voice.
Voting	Using the shareholder benefit of being able to vote on resolutions as a way of actively expressing views on ESG factors, or proposing ESG related resolutions. Proxy voting is become an important tool for asset managers in demonstrating their ESG views publicly.

What are ESG factors?

Responsible Investment is a very subjective topic and although much of the focus has been on climate change and other environmental issues, there is an enormous range of topics that are relevant. It is useful to refer to the UN Sustainable Development Goals for an overview as these are often referenced as the standard for global improvement in all ESG areas.

However, ESG factors can cover:

Environmental

- Greenhouse gas (GHG) emissions
- Biodiversity loss
- Pollution and contamination
- Carbon regulation exposure
- Renewable energy

Social

- Labour practices
- Community displacement
- Human rights
- Health and safety
- Financial inclusion

Governance

- Corruption and bribery
- Reputation
- Management effectiveness
- Board diversity

Timeline of key international regulatory developments

1992
UN member states sign UN Framework Convention on Climate Change.

2003
Financial institutions across the globe agree the Equator Principles.

2005
UN publishes the Principles on Responsible Investment.

2015
Paris Climate Agreement signed.

2015
UN publishes the Sustainable Development Goals.

2016
G20 launches the Green Finance Study Group.

2017
Financial Stability Board (FSB) establishes the Task Force on Climate-related Financial Disclosures.

2018
EU Commission adopts the action plan on sustainable finance.

2018
ICMA launches the Green Bond Principles, Social Bond Principles and Sustainability Bond Guidelines.

2019
UK Government commits to net-zero emissions by 2050 and publishes the Green Finance Strategy.

2019
UN publishes the Principles on Responsible Banking

2020
COP26 to take place in Glasgow in November 2020

2021
EU Sustainability-related Disclosures Regulation to apply in part from March 2021

2021
EU Taxonomy Regulation currently expected to apply in part from late 2021

2022
UK/FCA expected to require all listed companies and large asset owners to disclose in line with TCFD recommendations

What should you be considering and how can we help?

ESG issues are some of the most important drivers of change in the world today. The correct implementation of Responsible Investment strategy is essential from a reputational perspective as well as being crucial for the continued success of fund houses within the sector. To ensure that you are on top of both regulatory change while keeping up with market expectations, you will need to focus on:

Structuring your project:

By supporting innovation and sustainable investment strategies to grow, we support you from the launching phase to help define the most appropriate structure (from traditional investment vehicles, guarantee funds, to PPP - blended finance structures) up to the fund raising, and beyond. We can also assist you to obtain relevant quality labelling in the jurisdiction of choice: Environment, Microfinance, ESG, Climate Finance, Green Bond, Green Stock Exchange.

Implementing your strategy:

We firmly believe that the successful implementation of an ESG strategy must be led from the top. Ensuring that ESG is built into your board reporting and governance structure is key. We can assist with the integration of ESG factors into your investment processes by analysing your current systems. We can further assist with the set up of your fund management, as well as risk management policies and procedures, in light of applicable key regulatory requirements.

Ensuring appropriate disclosures:

A major risk attached to Responsible Investment disclosures to date has been green-washing. It is key that your collateral is verifiable and clear. Your investment strategies, including active ownership, and the impact of these must be clearly demonstrated and supported by evidence. We can assist with reviewing your current disclosures to ensure appropriateness and fitness for the upcoming regulations and helping you to draft the information you will be required to make public.

We have a number of Responsible Investment experts within our funds and investment management teams, who have been helping clients on many Responsible Investment and ESG related matters. if you would like to discuss any of these issues, we have an experienced group of partners who would be happy to advise how a robust Responsible Investment strategy could help future-proof your business.

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