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SUSTAINABILITY SUMMIT 2018: THE EVOLUTION OF ESG

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WHAT'S NEXT FOR RESPONSIBLE INVESTING?

On 1 March 2018, we attended the Pensions Age Sustainability Summit to discuss the increasing emphasis that investors are placing on environmental, social and governance (ESG) factors. Many of the presentations discussed the fundamentals of ESG analysis and highlighted how such considerations can be incorporated into the investment process. Against a backdrop of increasing emphasis on such considerations, there has been growing interest in sustainable investing, and it was on this topic that we chose to focus.

ESG BEST PRACTICE

Initial discussions at the summit centred on the extent to which asset managers analyse ESG factors as part of the investment risk-mitigation process. Academic and industry research[1] was cited, highlighting not only that companies with positive ESG credentials perform better, but also that those companies with the worst ESG scores are more likely to have below-average financial performance.

The conversation then turned to discuss how ESG analysis can best be implemented. The consensus appeared to be that ESG analysis works best at the company level, when it is incorporated into the standard analysis of a company's fundamentals. Some speakers advocated for considering ESG risks at a portfolio level, and called for asset-management firms to put pressure on their portfolio managers to be more active in engaging on ESG issues.

While many asset managers now incorporate ESG considerations into their investment process, sustainable and 'impact' strategies (investments made to generate a measureable social or environmental impact) are far less commonplace. At Newton, responsible investing has been a key part of our investment process for a long time, and we see sustainable investing as a natural evolution of this. Sustainable investment strategies move beyond ESG integration, putting ESG factors at the forefront of decision-making, and, to our mind, should give responsible investment team specialists the final veto on investment decisions.

[1] Source: Journal of Sustainable Finance and Investment - ESG and financial performance: aggregated evidence from more than 2000 empirical studies https://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917

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SUSTAINABLE 'RED LINES'

During our presentation, we explained what we believe to be the key ways to approach sustainable investing:

1. Giving responsible investment (RI) specialists veto power in the stock-selection process, enabling them to prevent a sustainable fund from holding a particular company. This transfers the ultimate discretion from a portfolio manager, where it traditionally lies, to specialist RI analysts. We see this as a subtle but important shift, signalling a change in the priorities of the considerations that shape a portfolio – both to an investment team and to the external world.
2. Alongside the portfolio manager, the RI team establishing engagement plans with set timelines, for companies that can be helped improve through engagement.
3. The use of 'red lines' to rule out certain companies from being considered for investment in sustainable strategies, such as those companies that are not aligned with the UN Global Compact Principles of sustainable corporate performance, or with the aim to limit global warming to well below 2°C.

We regard such considerations as becoming increasingly important as client demand for ESG-oriented and sustainable strategies increases. We believe this is especially relevant in the case of the millennial generation, as recent studies have found that this cohort cares more deeply than previous generations about ESG issues, in the belief that corporations can have as much influence as national governments in tackling social issues.

Investors may feel that sustainable and impact investing comes with considerable challenges, in particular the difficulty of measuring the positive impact of an investment, as data provided by companies can be unreliable and often difficult to collect in rural or developing areas.

However, we think ESG factors and sustainable investing are likely to become increasingly significant for investors as time goes on, and therefore the importance of addressing such issues ever more critical.

Want to find out more?

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