

THE ESG GLOBAL SURVEY 2019



**ASSET OWNERS AND
MANAGERS DETERMINE THEIR
ESG INTEGRATION STRATEGIES**



BNP PARIBAS

The bank
for a changing
world

“You cannot get through a single day without having an impact on the world around you. **What you do makes a difference, and you have to decide what kind of difference you want to make.”**

Jane Goodall, Primatologist and Anthropologist



What's My Impact is a BNP Paribas campaign to engage staff on sustainability and build a positive future. Whether that is using re-usable coffee cups, volunteering at a local charity, reducing their own carbon footprint, or investing in renewables as part of their day job, small differences can have a big impact.

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“Exclusion is a very soft way of actually trying to resolve issues, and we think rather ineffective. We are using an active ownership strategy to persuade companies to clean up their act.”

Steffan Berridge, Head of Quantitative and Responsible Investment, Kiwi Wealth

“As ESG becomes mainstream, members are becoming more engaged, and you need to be really clear around what they are doing. ESG still tends to mean different things to different people.”

Sybil Dixon, Senior Investment Analyst, UniSuper

“The driving force behind our ESG integration is to become a better investor - to achieve a stronger long-term return.”

Beth Richtman, Managing Investment Director, Sustainable Investments at CalPERS

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FOREWORD



PATRICK COLLE

—
General Manager
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M

any institutional investors are using their influence to move capital towards investments that will deliver measurable impacts along with financial returns.

One such approach is Environmental, Social and Governance (ESG) integration. We define this as the incorporation of ESG factors into financial analysis and investment decision-making in order to enhance returns and/or mitigate risk.

ESG is no longer a peripheral exercise thanks to investor demand, regulation and greater certainty about the link between ESG risks and long-term financial performance.

Our last report in 2017 looked at institutional investors' great expectations for integrating ESG across different asset classes, geographies and fund sizes. In part, this is coming to fruition. The universe of climate-aligned bonds was valued at \$1.45 trillion in 2018, and issuers globally are focused on meeting investors' demands for sustainable finance products.¹

A majority (78%) of respondents in our 2019 survey state that ESG is either playing a growing role or becoming integral to what they do as an organisation. Yet there are still mixed perceptions as to the level of ESG integration; how it should be governed, and which resources (people, technology) are required to implement a strategy.

The rewards can be great for those who can get this right. According to Bloomberg, investor interest in ESG funds, alongside market appreciation, drove a 37% annual increase in assets in 2017, outpacing the 23% return for the MSCI World Index.² The Global Sustainable Investment Alliance's (GSIA) latest review finds increased demand for sustainable and impact investing – there are now \$30.68 trillion of assets being professionally managed under responsible investment strategies, an increase of 34% since 2016.³

ESG integration represents a profound change in mindset and is bound to create challenges and contradictions. Who should ESG teams report to? How do they develop ESG expertise? Do they have the data they need? Are they making use of new frameworks such as the SDGs? This is what we explore in our 2019 survey.

1 <https://www.climatebonds.net/resources/reports/bonds-and-climate-change-state-market-2018>

2 <https://www.bloomberg.com/professional/blog/sustainable-investing-grows-pensions-millennials/>

3 http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf

01

INTRODUCTION



From optimism to pragmatism

Historically, institutional investors screened and excluded companies that did not adhere to ESG principles. Today, ESG investing is widely understood to cover the integration of ESG factors into investment processes and decision-making – across different asset classes, industries, geographies and fund sizes. Yet while a larger proportion of investment practitioners view ESG as integral to their strategies, the tools and resources to achieve their goals are still in development.

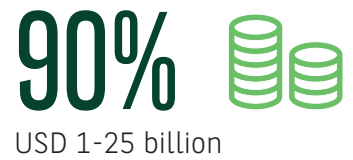
The driving force behind this survey is to explore how institutional investors are (in reality) embedding ESG principles and practices into their day-to-day activity. We explore whether the great expectations for ESG that they reported in our 2017 survey have come to fruition and what needs to change over the next two years as they continue to find their feet.

The findings are based on a global survey of 347 asset owners and managers whose organisations incorporate ESG into their investment decision-making process. Respondents include ESG practitioners and those who ultimately decide on the sustainable investing strategy and vision: the C-suite. The research is complemented by a series of in-depth interviews with senior industry figures (see 'About the research').

Respondents by region



Assets under Management (AUM)



HEADLINES

Capturing the opportunities

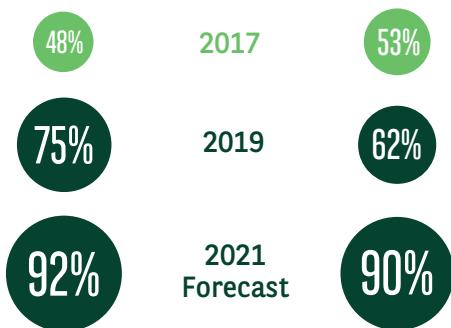
1 >25% of funds invested in ESG/RI funds



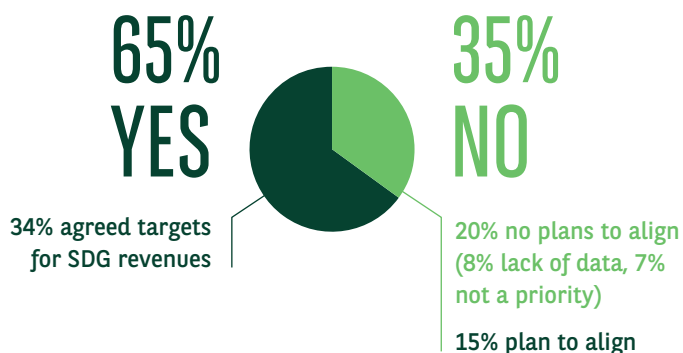
ASSET OWNERS



ASSET MANAGERS



2 Is your investment framework aligned to the SDGs



1 ESG – still great expectations

In our 2017 survey, we found that asset owners and asset managers had great expectations for ESG integration. Their optimism continues in this year’s survey.

2 The UN SDGs – a new compass?

Increasingly, asset owners and asset managers see responsible investing as a way to make a positive contribution to the United Nations Sustainable Development Goals (SDGs). For the first time, impact Key Performance Indicators are being built into investment frameworks.

3 Investor motivations

Long-term returns, brand and decreased investment risk feature among investors top three drivers.

4 New needs. New jobs

Analysing performance against non-financial factors requires different perspectives. Our survey shows a growing tendency to upskill employees and create new jobs by recruiting from non-traditional backgrounds (i.e. from NGOs or consultancies) over the next 12 months.

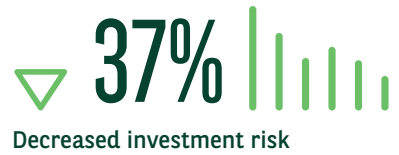
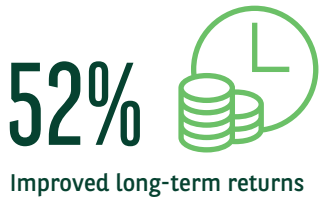
5 The key barriers

As was the case in 2017, data remains the biggest barrier ahead of costs, a lack of advanced analytical skills and the risk of greenwashing.

6 A thirst for higher quality data

As investors become more sophisticated in their ESG integration strategies, so the data challenges are coming to the fore.

3 Top motivations for ESG investing



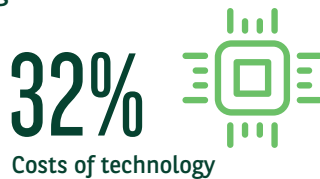
4 Developing ESG expertise



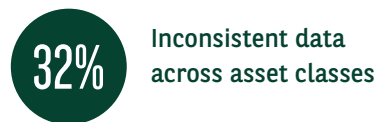
* Survey respondents could choose more than one option.
49% of respondents chose one of the two responses above.

Managing the challenges

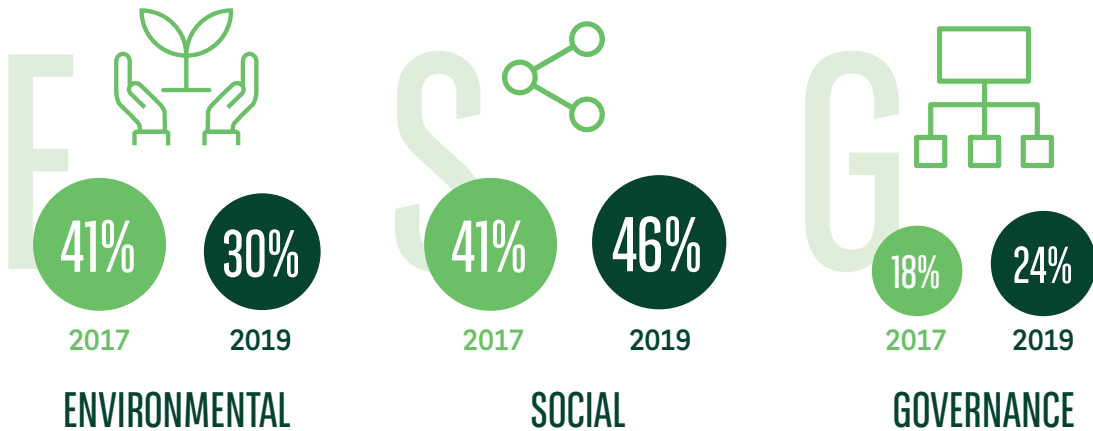
5 Top barriers to ESG integration



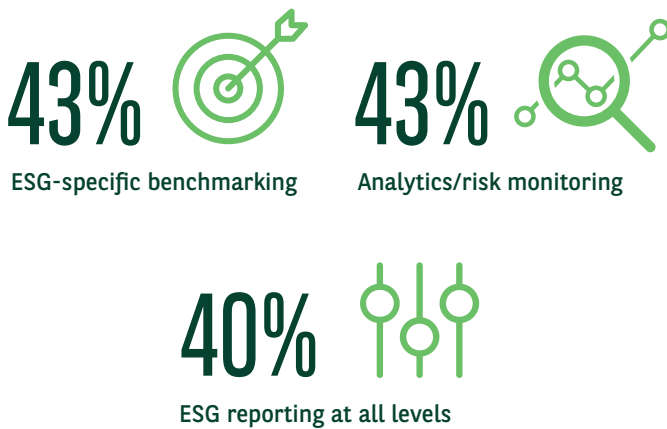
6 Challenges in transforming data into insights



7 Investor opinion: Which factor is the most difficult to analyse and integrate?



8 The key custodian services that support an ESG strategy



7 The 'S'- middle child predicament

While experts are getting to grips with the 'E' in ESG, the 'S' remains the most difficult pillar to analyse and incorporate into investment analysis – a key part of the data challenge.

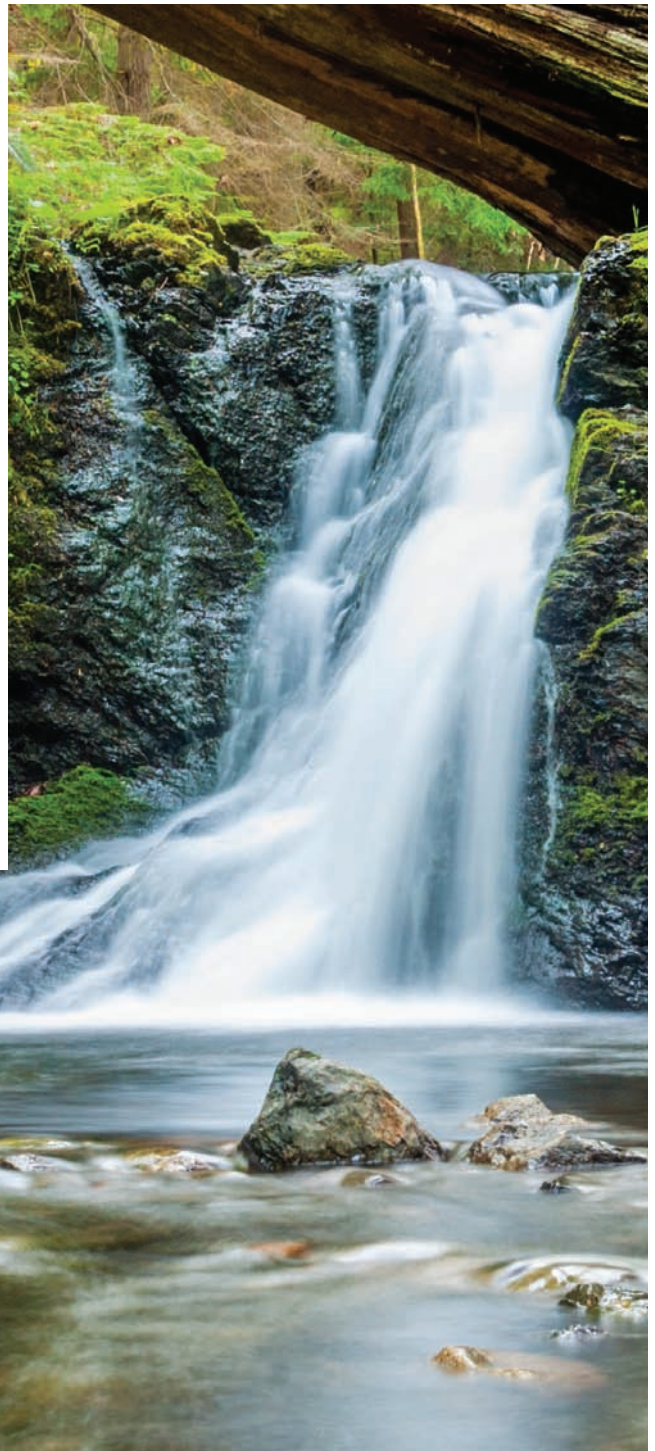
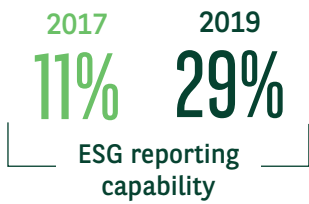
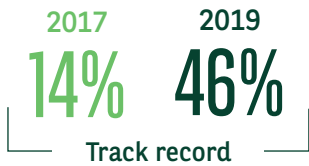
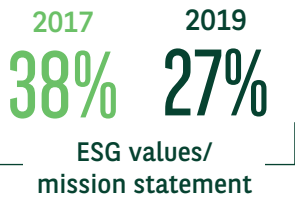
8 Tech and custodians to the rescue

Custodians are racing to evolve their ESG reporting capabilities, adding big data analytics and AI/ machine learning tools to their arsenal of reporting solutions.

9 Track records count

Tangible track records have therefore become more important to asset owners when choosing an asset manager. This can help those asset owners who are particularly concerned about brand and reputation among other ESG barriers.

9 Most important factors when selecting an ESG manager



02

THE INTEGRATION IMPERATIVE



As shown in our headline finding on page 8, the proportion of asset owners holding 25% or more of their investments in funds that incorporate ESG has risen by 27% since our 2017 survey and the proportion of asset managers has also risen by 9%.

The challenge of securing growth in a volatile and uncertain investment climate is a major driving force behind ESG. "If you look at the industry as a whole, there aren't that many growth themes around," says Hans van Houwelingen, CEO at ACTIAM. "The alternatives bucket has been pretty stable over time due to the search for yield, especially in Europe. But it's the ESG and passive themes that are the two that show double-digit growth."

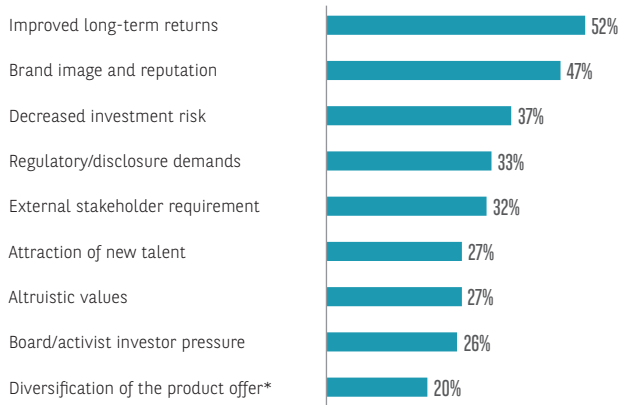
The key drivers of ESG investing
Long-term performance

Our survey shows that long-term investment performance remains the main driver of ESG strategies. Over half (52%) of respondents rank improved long-term returns within their top three reasons for incorporating ESG into their investment decision-making.

“Incorporating ESG into our decision-making helps us make sure that our investments are sustainable in the long term. Some of our customer relationships may last up to 50 years, and we need to ensure that we continue to serve our customers in the future.”

Zelda Bentham, Group Head of Sustainability, Aviva

Drivers behind ESG integration



*option for asset manager respondents only

Please rank (1-3) why you incorporate ESG into your investment decision-making

Brand and reputation

Looking good might just be the reason to do good. The concept of a 'trusted brand' is becoming central to asset managers' strategies as they look to engage with a growing base of investors. Almost half (47%) of respondents rank this within their top three reasons for adopting an ESG strategy. And yet only 16% of asset managers in our survey say they apply ESG investment strategies to at least 50% of their mutual funds for retail investments (which could be considered the acid test for commitment to ESG). This rises to 43% of respondents over the next two years.

Lowering investment risk

More than a third (37%) of respondents incorporate ESG to lower investment risk. Sybil Dixon, Senior Investment Analyst at UniSuper, highlights why: "ESG integration involves considering ESG risk – making sure it is priced in. It doesn't have to be about divestment or about ethics," she says. "It is about identifying risks associated with ESG and then making fully informed investment decisions."

ESG performance attributed to multiple factors

There is growing belief in the link between incorporating ESG into investment decision-making and better risk-adjusted returns. This link has been acknowledged in key studies, such as the UN PRI's ESG and alpha study, published in March 2018,⁴ which found that ESG information offers an alpha advantage in equities portfolios across all regions.

60% of all respondents expect their ESG portfolios to outperform over the next five years and 52% of respondents cite longer term outperformance as a key reason for ESG investing.

Yet, 54% of all respondents also agree that outperformance cannot be attributed to ESG factors alone. This may well point to a maturity in ESG analysis, with practitioners using ESG data to complement traditional financial analysis.

Even though ESG has been proven to deliver better risk-adjusted returns, there are clearly a number of influencing factors. Fortunately, there is a growing volume of research in this area, with an increasing number of factor indices and regulatory guidelines being created to inform investment strategies and promote the integration of ESG.

“Generally accepted ethical investment norms are shifting quickly, and the whole industry has to shift with it. What is today labelled as ESG proof will soon become the minimum requirement to be in business.”

Hans van Houwelingen, CEO, ACTIAM

4 <https://www.unpri.org/listed-equity/the-pris-esg-and-alpha-study-/2740.article>

5 https://ec.europa.eu/clima/news/sustainable-finance-commissions-action-plan-greener-and-cleaner-economy_en

6 <https://www.ipe.com/news/esg/european-commission-unveils-sustainable-finance-legislative-proposals/10024869.article>

7 https://www.esma.europa.eu/sites/default/files/library/esma34-45-569_consultation_paper_on_integrating_sustainability_risks_and_factors_in_the_ucits_directive_and_aifmd.pdf

8 <https://www.ftadviser.com/pensions/2018/09/11/pension-schemes-mandated-to-disclose-esg-risks/>

View from the Regions

Europe pushes for regulatory change

In Europe, 64% of respondents are planning to dedicate more resources to ESG as a result of regulation (slightly lower than APAC at 65%, but higher than North America at 52%).

The biggest regulatory push in Europe comes from the European Commission's Action Plan on sustainable finance. Unveiled in March 2018,⁵ new regulation is intended to clarify investors' roles and responsibilities, establish a common taxonomy and reporting standards to help minimise greenwashing, and investigate how products can achieve 'green' certification. Under the proposal, all financial entities that manage investments on behalf of their clients or beneficiaries will have to inform the European Commission of how their activities are impacting the planet and local environment.⁶

The European Securities and Markets Authority (ESMA) has stated that the rules on integrating sustainability risk assessments into the UCITS and AIFMD frameworks will not be prescriptive but principles-based to give the industry flexibility.⁷

In addition, under new regulation passed by the UK Department of Work and Pensions (DWP) in September, UK pension schemes with more than 100 members are required to disclose risks to their investments, including those arising from ESG considerations, by October 2019.⁸

By continuing to shine a spotlight on ESG issues, such regulatory changes will drive a greater level of ESG integration within the industry in both the short and long term.

Asia Pacific pushes for regulatory change too... and ESG optimism soars high

In 2017, Asia Pacific was shown to be more bullish on ESG than Europe or North America, with 84% of respondents likely to incorporate ESG into their decision making and 78% stating they had an ESG policy as part of their organisational strategy.

In 2019, this conviction continues, with Asia Pacific respondents more likely to align their investment framework to the SDGs (76%), to award a mandate to a manager based on their ESG capabilities (64%) and to expect their ESG portfolios to outperform (70%). Asia Pacific respondents also look to have at least 50% of their investments in funds that incorporate ESG, again well ahead of North America and Europe.

Local regulators are beginning to implement their own ESG frameworks. A number of Chinese policies are geared towards

green finance developments, making it more likely that ESG integration will proliferate. Monetary Authority Singapore (MAS) has signalled its commitment to sustainable practices by encouraging financial institutions to adopt ESG best practices, while simultaneously supporting green bond issuances as part of its Green Bond Grant Scheme which launched in 2017.⁹ Hong Kong's SFC has also announced that it will create a mechanism for asset managers to disclose to their clients the nature and to what extent they factor environmental criteria into their investment processes and risk assessments.¹⁰ In Australia, action on regulatory reform is being driven by the recommendations of the Task-force on Climate-related Financial Disclosures (TCFD). Australia's Senate Economics References Committee has recommended that the government act on taking account of carbon risk, including the implementation of the TCFD recommendations.¹¹

The US is taking ESG integration seriously

According to a recent US SIF report, asset managers now consider ESG criteria across \$11.6 trillion in assets, up 44% from \$8.1 trillion in 2016.¹² A combined 374 US asset managers, asset owners and other investment organisations had signed up to the UN-supported Principles for Responsible Investment (PRI) as of June 30 2018, up from 303 a year earlier.¹³ This emphasis on integration is reflected in our survey: 29% of respondents say that their ESG capability is embedded throughout their organisation, compared to 23% globally. To increase this number will require greater training and upskilling. Our findings show that the US is ahead of the global average in terms of ESG training. While just 16% of all respondents have between 50-74% of their investment team trained in ESG, this figure rose to 21% among US respondents.

Our survey highlights that the search for higher quality, consistent data is a key priority for asset managers and asset owners. In response to this need, fintech start-ups have developed solutions using Artificial Intelligence (AI) to screen companies at a more granular level on ESG issues. The US results reflect a strong appetite for AI. Almost half (45%) of US respondents are planning to acquire new machine learning/AI systems in support of ESG investing over the next two years, compared to 37% globally. Increased granularity and detail of ESG specific data for research is the main priority for technology investment – 41% of US respondents chose this compared to 35% globally.

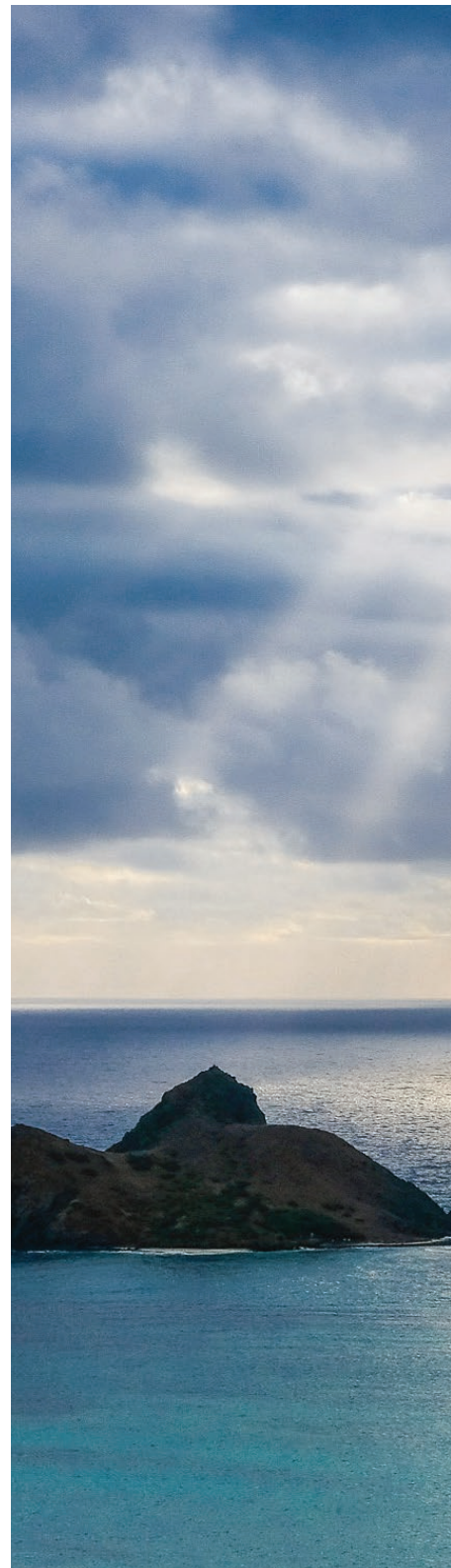
9 <http://www.mas.gov.sg/News-and-Publications/Speeches-and-Monetary-Policy-Statements/Speeches/2018/Future-Planning-for-the-Future-Generation.aspx>

10 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR110>

11 https://www.cdsb.net/sites/default/files/sustainability_aus_report_web.pdf

12 US SIF. Report on US Sustainable, Responsible and Impact Investing Trends 2018

13 <https://www.pionline.com/article/20180903/PRINT/180909992/more-institutional-investors-putting-money-on-esg>





“Over the last couple of years we have seen a step change in the quality and quantity of questions coming from our clients about our approach to ESG. Not only is regulation driving clients to assess how their managers are integrating ESG into investment strategies and processes, but we also see new interest from members about what they are invested in.”

Catherine Ogden, Manager,
Sustainability & Responsible
Investment, Legal & General
Investment Management

03

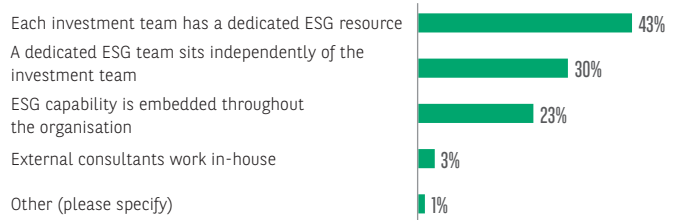
IN SEARCH OF GREATER DEPTH





Our research suggests that only a minority of institutional investors have transformed their operating model, investment approach and engagement strategies to embed ESG principles across the organisation. For instance, less than a quarter (23%) of respondents state that ESG capability is embedded throughout their organisation i.e. is part of the culture of the organisation – from analysts to the C-suite, from front office to compliance. Nearly a third (30%) say that the ESG team sits independently of the investment team.

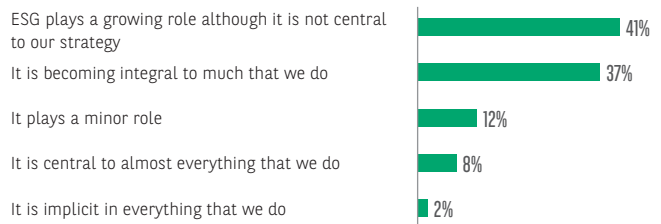
Where ESG capability is found in the organisation



Which of the following best describes how ESG capability is positioned within your organisation?

While ESG is gaining in importance (78% of respondents states that it plays a growing role or is integral to their strategy), there remains work to be done before organisations can say they are fully embedding it across their functions. Only 26% of respondents feel that their organisation is able to integrate ESG strategy across all aspects of their operations.

ESG strategy – at the periphery or the core?



Which of the following best describes the role of ESG in your organisation's investment strategy?

Over the next two to five years, the next wave of ESG integration will serve as a true test for investment professionals.

Hans van Houwelingen identifies three layers to ESG integration and believes few organisations are at the most advanced stage. “The first layer is about ethical exclusions, which does not take into account financial consequences. The second layer is active engagement with portfolio companies and enhanced securities selection on ESG criteria. The third layer is deep ESG integration into the investment process. We see people doing this in various ways with varying degrees of intensity and conviction. ACTIAM, for example, enriched the third layer with alignment on 15 UN Sustainable Development Goals (SDG), as well as portfolio constraints aligned with the planetary boundaries.”¹⁴

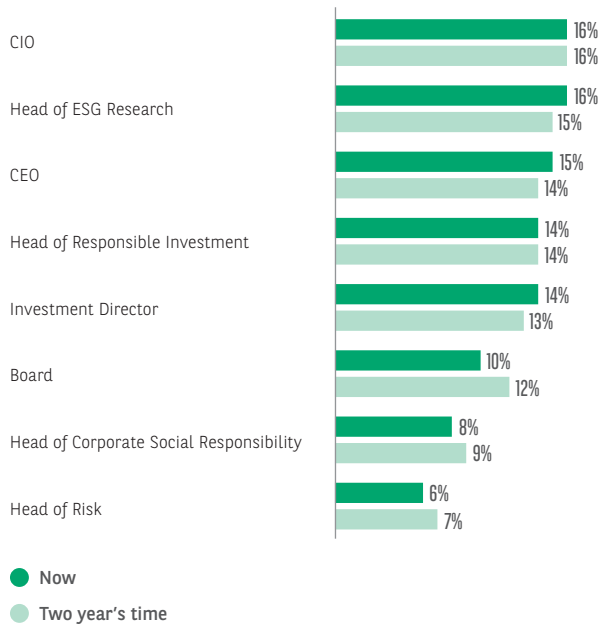
Steffan Berridge, Quantitative Strategist at Kiwi Wealth, echoes this need for an integrated approach: “We’re moving from an exclusion strategy to integrating ESG factors into all investment decisions,” he says. “That’s absolutely something our clients want.”

Aligning the organisation to ESG

One way for firms to close the ESG integration gap is to redesign their internal reporting structures and align their hierarchies to enable integration from top to bottom within the organisation.

This year’s survey highlights that there is no consensus on where the strategic responsibility for ESG lies within an organisation. This was spread evenly among CIOs (16%), Heads of ESG Research (16%) and CEOs (15%) with minimal change desired by respondents.

Where does strategic responsibility for ESG primarily lie in your organisation and in two year’s time?



¹⁴ The planetary boundaries concept presents a set of nine planetary boundaries within which humanity can continue to develop and thrive for generations to come. See <https://www.stockholmresilience.org/research/planetary-boundaries.html>

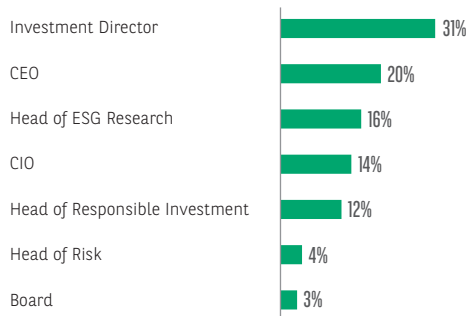


“If there isn’t an understanding at board level as to where strategic responsibility for ESG lies, it creates challenges all the way down the business.”

Zelda Bentham, Group Head of Sustainability, Aviva.

Furthermore, only a minority (20%) of ESG teams or individuals report to the CEO. We did not find any major difference in ESG commitments or approaches between ESG teams reporting to the CEO (20% of respondents) versus not reporting to the CEO. This suggests that ESG teams’ reporting lines do not have a significant impact on ESG integration – at least not in the eyes of survey respondents.

Direct reporting lines of ESG teams/individuals



Who do your ESG team/investment individuals report to?

04

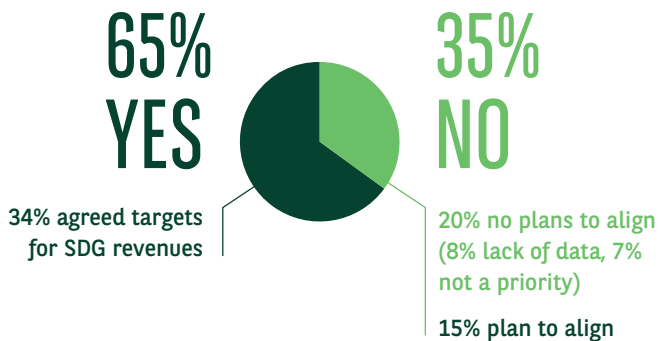
THE SDGs AND THE 'S' IN ESG



“The SDGs were written for governments and policymakers, not for investors. Yet they are an important framework for what we do. We and, I think, so many others are mapping investments we do with regard to the SDGs.”

Anne-Charlotte Horngard, Senior Manager, AP3

Investment frameworks aligned to the SDGs



The UN SDGs - a new compass?

The UN SDGs have become an important lens: 65% of respondents align their investment framework with the SDGs. Asset owners are leading the charge, with 71% aligning with the SDGs, compared to 58% of asset managers. Among the regions, Asia Pacific leads with 76%, compared to 64% for Europe and 54% for North America. The favoured approach is to set an agreed target of investee company revenues that stem from meeting the SDGs (34% of all respondents).

The SDGs have drawn widespread interest from the investment community since their implementation in 2015. The 17 SDGs form an agenda “to end poverty, protect the planet and ensure prosperity for all” by 2030. There are 169 targets linked

to the goals, along with 230 individual indicators to monitor implementation.

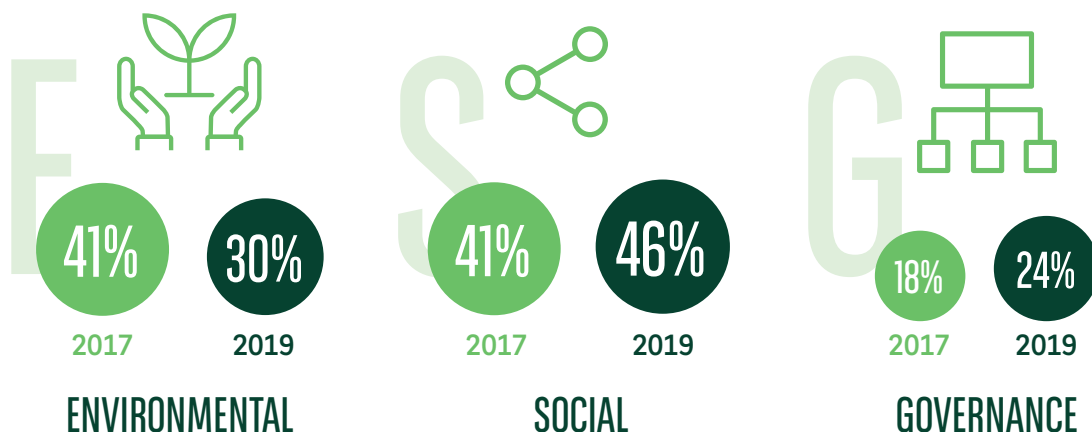
While there is a clear drive within the industry to align investment strategies with these goals, the SDGs have attracted criticism for being difficult to translate into meaningful and impactful KPIs for the investor and investee company. The difficulty to quantify ESG elements relating to the SDGs stems from their design and the technicalities. Originally they were designed for countries, rather than sectors, which may have made them harder to translate to fund management. 20% of respondents do not align their investment framework to the SDGs and have no plans to do so over the next 12 months. A lack of information/data is the biggest barrier to those who are not aligning investment

strategies with the goals – cited by 8% of respondents.

Due to the thematic focus of the SDGs, it can be difficult to assess the material impact of investments. The Sustainability Accounting Standard Board (SASB) has published reporting standards to help organisations assess the material effect of the investments on a sector-specific basis.

In order to align their investment frameworks with the SDGs, organisations have begun to work with consultants to map out a way forward. ACTIAM, for example, has partnered with Oxford-based start-up Util since 2017¹⁵ to refine its approach to portfolio SDG alignment with machine learning algorithms. The custodian is able to help both parties understand the impact of the SDGs on their businesses, and the opportunities they can leverage, through data, analytics and expertise.

¹⁵ <https://util.co/>



Which component of ESG (E, S or G) is currently the most difficult to assess and incorporate into investment analysis?

The 'S'- middle child predicament

While experts are getting to grips with the 'E' in ESG, the 'S' remains elusive. This year's survey found the 'S' the most difficult element to incorporate into investment analysis. Nearly half (46%) of respondents feel that this is the case (versus 41% in 2017 for both the S and the E).

Investors are grappling with the complexity of integrating social factors into their investment analysis and decision-making. A lack of consensus in the industry surrounding what constitutes the 'S' makes it harder to incorporate into investment strategies compared to both the 'E' and 'G'. As such, it often acts as an interaction point between these two elements.

The range of issues sitting under the 'S' umbrella, along with the qualitative nature of social metrics, further contributes to the difficulty of incorporating the 'S' into ESG analysis. A lack of social reporting from companies adds another layer of complexity.

In an attempt to fill this gap in the market to measure the 'S', innovative solutions are being developed. Util, for example, is using natural language-processing technology (a machine-learning technique) to analyse a company's impact across the SDGs.

Meanwhile, the figure of respondents finding difficulty incorporating the 'E' in investment analysis dropped to 30% in the 2019 survey, suggesting that the quality and consistency of data, as well as availability of the skillsets required to analyse it, are improving in this area.



05

WE NEED TO TALK ABOUT DATA



A thirst for higher-quality data

Investment professionals require accurate, timely data to keep pace with the growing client and regulatory demand to measure and assess the impact of an expanding range of ESG factors.

66% of respondents report that data is a barrier to integration, whether it is inconsistent coverage across asset classes, conflicting ESG ratings/indices, or data gaps that prevent scenario analysis.

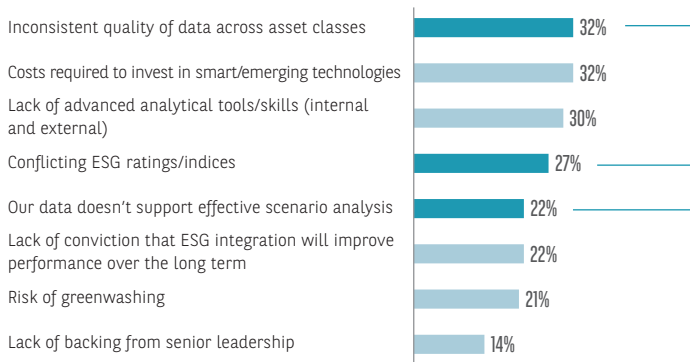
In 2017, data was the biggest barrier to ESG integration (55% of respondents), but one that respondents thought could be overcome, with only 15% stating that data would remain a barrier.

While there is a proliferation of ESG data across the industry, there is a lack of consistency and conformity for credible comparisons across data sets. "I believe data on sustainability is now viewed in a similar way to how financial data was treated around 75 years ago," says Andreas Feiner, founding Partner at Arabesque. "This has resulted in a situation where some companies avoid disclosing some information that would potentially show them in a negative light."

“One barrier that we all are talking about is access to data. There is lots of data. The challenge is finding the right data in the right format and knowing how to use it.”

Charlotte Hormgard, Senior Manager, AP3

Barriers to adoption



66%
of unique respondents see data as a challenge

What are the most significant barriers to greater adoption of ESG across your investment portfolio today? (select all that apply)

Diversifying data

Once companies have acquired the right data, they face the further challenge of analysing this data in-house and applying their findings across a range of asset classes, funds and sectors. “If you’re in emerging markets or small caps, or you go into private markets, these databases are far from complete, says Hans van Houwelingen. “If you want to integrate ESG across all your assets, as we do within ACTIAM, you have to enrich the data, you have to add data yourself, and you have to combine various data

sources. You have to do a lot of work to get a real time ESG view for investment managers within their portfolio management systems, as well as to report exposures and real-world impact to customers.”

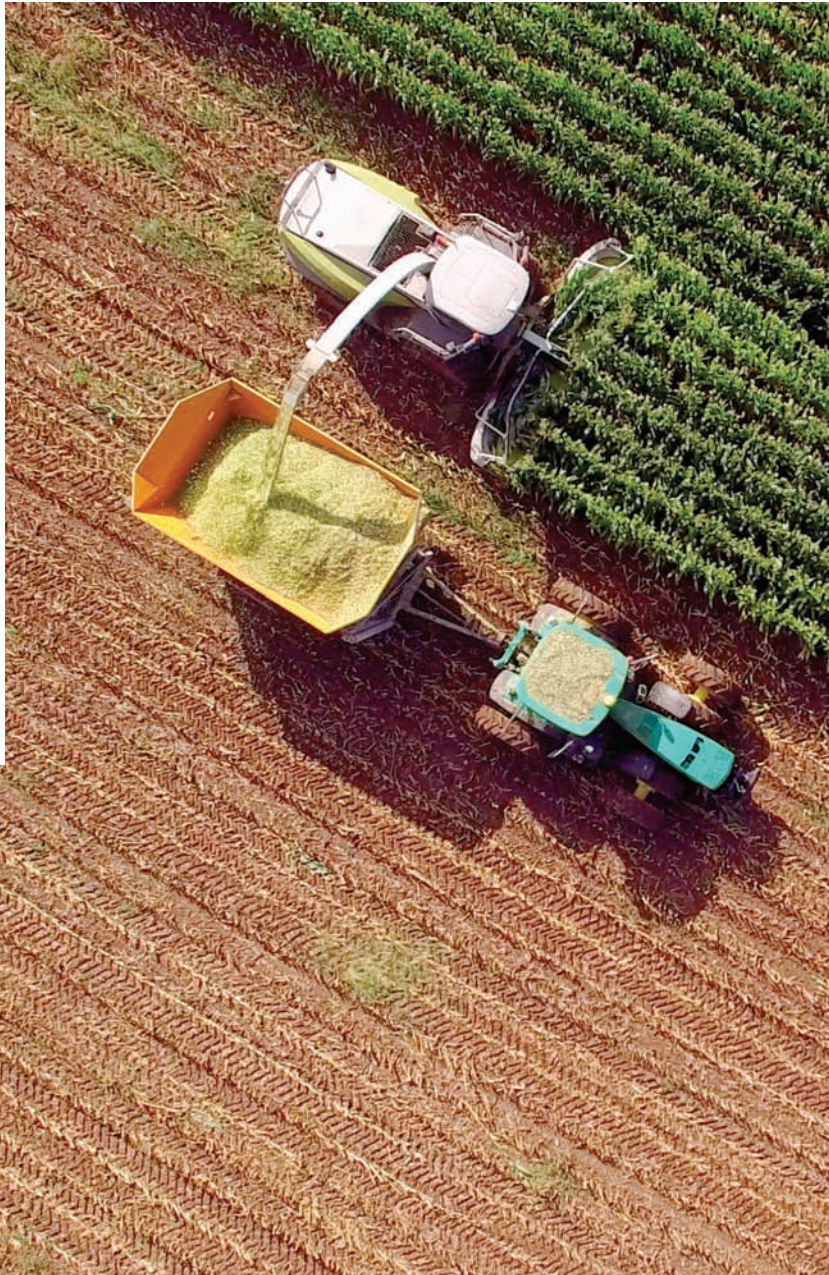
This is the point where the subjective nature of data interpretation comes into play. The plethora of data sources and sheer volume of metrics require a combination of big data approaches, quantitative modelling and ESG expertise.

Investment institutions are increasingly using multiple data

providers in order to build an objective picture of how ESG factors affect their investments. Compared to a standardised, industry-wide methodology for analysing ESG data, the ability to compare multiple data sources is more reliable. “As with all data, you don’t want to take a single data point as being reflective of the story that you’re trying to tell. It’s about putting together a picture that is coherent and consistent,” says UniSuper’s Sybil Dixon.

06

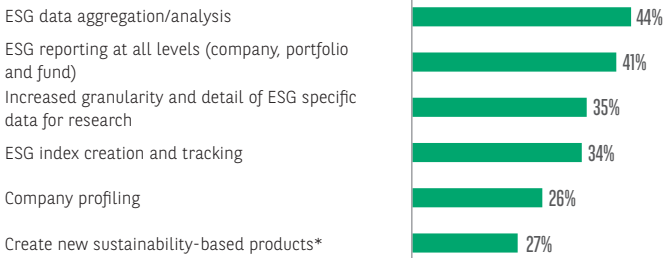
ESG ESSENTIALS - NEW TALENT AND TOOLS



A recipe for ESG reporting – custodians and new tech

Though one-third of respondents cite technology costs as a barrier to ESG integration (doubling from 16% in 2017), respondents recognise the need to spend on technology and where to prioritise that spend. Data aggregation, ESG reporting and benchmarking are focal areas for tech spend, all of which tie in with the natural benefits of custodian analytics.

Prioritising technology investment



*Put to asset managers only

Which of the following areas are the main priorities for technology investment? (select two)

36% of survey respondents view ESG data aggregation as the most important ESG service provided by a custodian. Custodians are key to facilitating a multi-provider approach. “By consolidating and benchmarking various data sources, the custodian plays a central role in helping institutional investors to integrate ESG into their investment decision-making process,” says Florence Fontan, Head of Asset Owners, BNP Paribas Securities Services.

There is a shift in emphasis taking place within the industry, from simply recording data to placing it in a wider context. Big data analytics and scenario analysis are central to this aim – the use of a range of smart technologies has the capability to take ESG to the next level. It enables investors to assess the performance and sustainability of investee companies much more accurately.

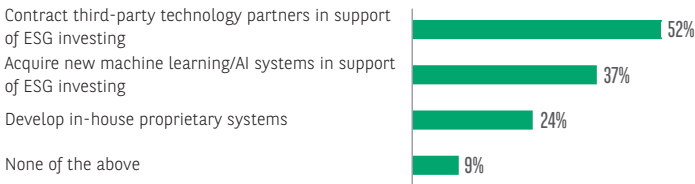
The key custodian services that support an ESG strategy



Harvard Business School has recently published a study using data from Truvalue Labs.¹⁶ The fintech firm uses AI natural language processing to browse through the web on a real-time basis, automatically extracting ESG information on companies. According to this study, the combination of AI-generated ESG data with traditional ratings led to a 4-5% increase in alpha annually.

This explains why more than a third of respondents (34%) are investing time and resources in developing proprietary systems over the next two years.

Build, buy or both?



Over the next two years, is your organisation planning to...

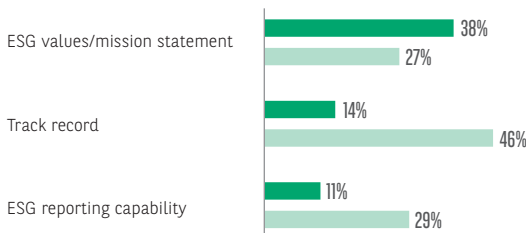
There is great scope for technological advancement in this area. The application of satellite imagery and blockchain technologies has the potential to provide new forms of ESG analysis and radically transform the investment landscape.¹⁷ While still in development, these tools will help investors tackle the next wave of ESG integration.

As custodians race to evolve their ESG reporting capabilities, adding big data analytics and AI/machine learning tools to their arsenal of reporting solutions, the role of a custodian looks set to become pivotal to the ESG strategy of the institutional investors of the future.

In a new industry, ESG track records count

46% of asset owners cite a proven track record as key when selecting a manager for ESG investing – a significant increase from 2017 (14%). ESG reporting from asset managers is also gaining in importance as asset owners’ expectations increase.

Most important factors when selecting an ESG manager



- 2017
- 2019

¹⁶ <https://securities.bnpparibas.com/insights/technological-disruption-esg.html>
¹⁷ <https://truvaluelabs.com/blog/serafeim-truvalue-alpha>

“If a company has a leader with a strong understanding of ESG, it changes the whole mix completely. Yet you also need to be careful of relying on an ‘iconic individual’ – the articulation of the company’s purpose and responsibility shouldn’t solely rest with them.”

Zelda Bentham, Group Head of Sustainability, Aviva

Embedding ESG capabilities

Our research shows that investors tend to have a dedicated ESG resource within their investment teams (43% of respondents), rather than ESG expertise being embedded across the entire organisation. And yet, respondents who state that they embed capabilities throughout the organisation are more optimistic about future allocations – 62% expect to invest 50-75% of their investment over the next two years in funds that incorporate ESG.

A lack of a company-wide ESG vision carries the risk of ESG knowledge and capabilities becoming siloed within investment teams. “We’re working on trying to build out a sustainable investment lens/mindset across our entire investment office,” says Beth Richtman, Managing Investment Director, Sustainable Investments at CalPers. “We have recently hired an employee to focus specifically on integration, to build out the communication channels and resources. This will ensure that our approach is widespread and coherent across the whole investment office.”

Such strategies allow for an ESG vision to emerge organically from an organisation, rather than being artificially imposed. Deeply ingrained core values will help organisations avoid the dangers of greenwashing. This cultural shift is highlighted in our survey – 39% of respondents are planning to strengthen ESG practices across their own operations over the next 12 months.

“The big gains for us really come from having responsible investing as a core value across the entire firm,” adds Steffan Berridge, Quantitative Strategist, Kiwi Wealth. “We don’t think it’s right to make a moral judgment for one product but not another. If we’re going to make a judgment it should apply across all products.”

The creation of ‘impact pioneers’ – individuals dedicated to sustainability or CSR – within BNP Paribas has had a positive response with employees, says Antoine Sire, Head of Company Engagement at BNP Paribas. “Six years ago, we had about 65% of our employees that were happy with our CSR and engagement policy. This year this has increased to 75% – a strong figure for the finance industry,” he says.



New needs. New jobs

Central to this drive to integrate ESG capabilities across organisations is the need to build a diverse talent pool to offer fresh perspectives on ESG integration.

Analysing performance against non-financial factors requires different perspectives. Competition for individuals who understand sustainability and finance is fierce. “The idea is to hire candidates with both financial experience and a passion for issues relating to ESG,” says Bertrand Millot, Head of Investment Stewardship at CDPQ. “But this is a rare, rare pearl – and we take great care of the ones we have on our team,” he adds.

Our survey shows a growing demand for a mixture of financial and non-traditional backgrounds. While the trend was to build ESG capability in house, the tendency to hire professionals from non-traditional backgrounds (individuals who do not come from financial services but rather other organisations such as NGOs) is on the rise. Over the next 12 months into 2020, close to a third (29%) of respondents are looking to hire new ESG talent from non-traditional backgrounds and 34% say they will hire or increase the number of external ESG consultants/specialists.



[†]Survey respondents could choose more than one option. 49% of respondents chose one of the two responses above.

Building ESG expertise



*Question put to asset owners only

**Question put to asset managers only

Over the next 12 months is your company planning to...

This reflects an important cultural shift taking place within the financial industry. A broader range of knowledge within an organisation can help investment teams to make tough decisions on ESG-related matters, filling a gap that employees with traditional investment backgrounds, even armed with considerable quantities of data, cannot.

“We need an array of skills and experience on our team for the myriad types of issues that may arise throughout our large and diversified portfolio,” explains Richtman. The onboarding of data science experts who are able to interrogate advanced data sets will become of increasing importance. “Our technology processes over 50,000 sources in 20 languages, and we work with more than 8,000 NGOs,” says Feiner. “This is a vast amount of data. You need good technology scientists who can process this information into something that everybody can interpret and use.”

07

THE PATH TO ESG INTEGRATION





Lead the pack

Investment teams are running out of time to get a handle on true ESG integration. With an overwhelming majority of respondents (78%) stating that ESG is either playing a growing role or becoming integral to what they do, the laggards will need to pick up the pace. 2020-21 will be a critical time to get the right structure, leadership and skills in place.

Embed core values

Financial institutions that use ESG to enhance their brand need to ensure that their commitment to ESG is followed up with action and pragmatism, and that they have the necessary processes to embed their strategy and philosophy. Respondents who state that they embed capabilities throughout the organisation are more optimistic about future prospects – 62% expect to invest 50-75% of their investments in funds that incorporate ESG over the next two years.

Be specific on SDG alignment

Despite challenges to implementation, the UN SDGs are an important framework to consider when developing an ESG strategy. Companies will need to choose the development goals that best align with their strategies, and be aware of which SDGs impact their business, rather than attempting to incorporate them all.

Attain the right skillset

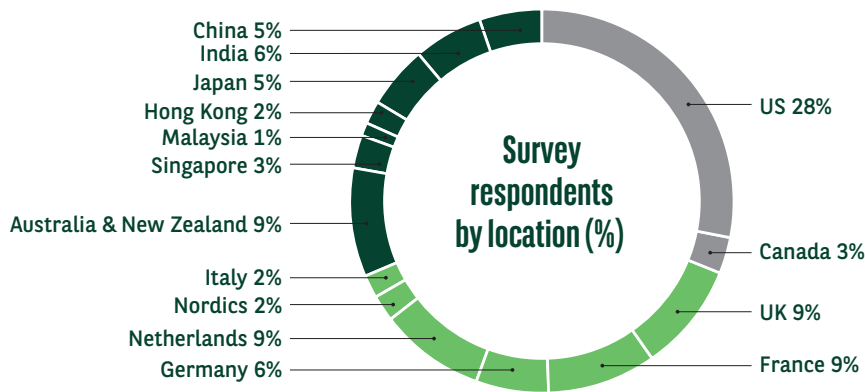
Data across different asset classes is currently inconsistent and its interpretation inherently subjective. It must be interpreted by experienced investment teams and skilled data scientists, highlighting the importance of acquiring a mix of skills. New technologies and tools are offering innovative ways for investors to get the most out of their ESG data. The custodian plays a key role in facilitating a multi-provider approach.

08

ABOUT THIS RESEARCH



Breakdown of respondents by location



COUNTRY	ASSET MANAGERS	ASSET OWNERS	TOTAL
US	47	50	97
Canada	7	4	11
UK	16	16	32
France	15	16	31
Germany	15	5	20
Netherlands	16	15	31
Nordics	1	6	7
Italy	7	1	8
Australia & New Zealand	16	16	32
Singapore	5	6	11
Malaysia	1	4	5
Hong Kong	6	2	8
Japan	10	8	18
India	11	9	20
China	5	11	16

In October and November 2018, Longitude Research, in association with BNP Paribas Securities Services surveyed individuals within 347 institutions. They included asset managers and asset owners (pension plans, insurers, official institutions, sovereign wealth funds and endowments). The survey was conducted by a combination of telephone interviews and online. The results were supplemented by a series of in-depth interviews.

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