The Surging Volume and Velocity of ESG Investing

BY HANK BOERNER

How quickly has ESG investing accelerated and how big has it become? What are the priorities of ESG-based investors? Learn the answers from a new industry survey.

The continuing implementation of environmental, social, and governance (ESG) investing strategies, policies and methodologies by investors, lenders, insurance companies, and other financial players continues to reshape the corporate competition for capital.

In 2021, ESG is no longer a niche activity for U.S. professional money managers. Institutions with ESG approaches include BlackRock (the world's largest asset manager), State Street/SSgA, Vanguard, T. Rowe Price, TIAA-CREF, CalPERS, CalSTRS, New York State Common Fund, New York City's pension funds, and the world's largest sovereign wealth fund (Norway, managed by Norges, with $1 trillion-plus AUM and investments in thousands of equity issues). The Norway Sovereign Wealth Fund has inspired other sovereign wealth managers to embrace ESG investing approaches – this is an estimated $7 trillion market for assets under management (AUM).

ESG Investing Reaches New Heights

How can we understand better the details of the increasing volume and velocity of sustainable investing and the impact on U.S. publicly traded enterprises?

Every other year, the trade association of asset managers focused on sustainable investing – the U.S. Forum for Sustainable & Responsible Investment (US SIF) – through its foundation publishes a trend report charting the professionally managed ESG-related AUM by financial institutions and their money managers.

The figures are based on data and information collected from hundreds of interviews with financial professionals who manage money. The latest results were presented in November 2020 in the "Report on U.S. Sustainable and Impact Investing Trends 2020." Key findings include:

- At the start of 2020, professionally managed assets in the United States following ESG methodologies and practices totaled $16.6 trillion.
- ESG-based investing represents one of every three dollars of professionally managed assets held by institutions, money managers, or investment companies in the United States (accounting for $16.6 trillion of the $51.4 trillion total AUM of all managed U.S. assets).
- ESG-based investing increased 43 percent over the results shared in the 2018 Trends report, which charted $11.6 trillion in ESG-managed funds at start of that year.
- Demonstrating the steady growth and expansion of this investment trend over time, the 2020 results were 25 times the amount reported in the first Trends report in 1996 when "sustainable and responsible investing" was beginning to accelerate. (In that first Trends report, the total AUM was identified as just over $600 billion.)
- From 1996 to 2020 this represents compounded growth of 14%. The most rapid growth has been since 2012.
- Asset and money managers said they were considering ESG issues in their management of funds across a range of assets, and many managers also filed shareholder-sponsored resolutions on ESG issues.

The US SIF Foundation survey was conducted throughout the year 2020 and was released in November. Despite the many challenges presented to corporate management teams and capital markets professionals in the COVID-19 pandemic and accompanying economic dislocations and civil protests, these challenges did not slow down or deter ESG investment – the opposite happened. The crisis caused investors to look more closely at "human capital management" policies and practices of public companies.

The expected shifts in federal policy after January 2021 is another factor; President Joe Biden identified dealing with climate change as one of his administration's four top priorities. The civil unrest in 2020 and intensifying focus on diversity and inclusion are other ESG issues drawing the attention of investors.

While the SEC has proceeded cautiously on requiring ESG-related disclosures in recent years, institutions have steadily pressured the agency for action, such as requiring certain corporate ESG disclosures. The SEC response included some recent adjustments in the formalized updating of Reg S-K in 2020.

For example, Amendments of Items 101, 103 and 105 include "Human Capital" (management) disclosure requirements, or at least "green lights" to expand discussion (principles-based). This could include measures of objectives management focused on managing the business – assuring greater diversity, expanded employee training, workplace safety, and wellness. What happened in 2020 in the corporate sector in human capital management will be of keen interest to investors examining corporate reporting in 2021.

Investor Priorities

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Asset owners, for example, described how they were working to improve diversity and inclusion policies and practices in their own firms while also assessing how various ESG investments, investable products, and expanded shareholder engagement can make an impact on these issues.

Some survey respondents described the adoption of ESG strategies as a way to help their asset managers identify the more responsible, well-managed companies that will be resilient over the long term, for investment.

Money managers described various ways to support companies and creation of investable products that can help advance environmental and social issues – including investment beyond the large money center banks into institutions such as community banks and credit unions.

ESG investing was described as being on an accelerating growth path in 2020, a period in which sustainable equity funds and sustainable taxable bond funds were very often outperforming their peers, according to the US SIF Foundation analysis.

Top Concerns of Sustainable Investors

What were the top ESG concerns of these investment professionals in 2020?

Respondents cited climate change and carbon emissions of companies (this was the number-one issue for many asset managers). Other issues cited included anti-corruption measures of companies, boardroom issues (especially the diversity of boards), executive compensation, conflict risk (including the risk of terrorism and firms doing business in nations with repressive regimes, and resulting social issues that arise), and sustainable natural resources and agriculture-related issues.

Some of the managers interviewed are also with firms that are active in filing shareholder proxy resolutions on ESG issues.

Climate Change: The 2021 Top Issue

In terms of asset-weighted issues, climate change ranked number one among money managers. These investor concerns are certain to increase as the Biden Administration refocuses on climate change issues in 2021.

Keep in mind that the federal government is the largest buyer of goods and services in the nation. The shift to a new administration sharpens the focus on ESG issues in government operations and for many firms presents challenges and opportunities to become preferred suppliers to the federal government. Investors will respond to that in examining risk and opportunity in portfolio companies.

The "Fourth National Climate Assessment Vol I + II," published in November 2018 by ClimateChange.gov, will be the primary knowledge source for federal government action (assessment of risks and facts for decision-making). This is worth scanning for the potential impact on risk and opportunities for public companies to prepare for conversations with investors.

Investors will be carefully watching the new administration's moves on climate change and related issues as the United States rejoins The Paris Agreement.

The climate change moves early in the Biden Presidency could further accelerate the growth of sustainable investments in various asset classes in 2021 and 2022. Think about the "greening" of infrastructure projects and continuing shifts in federal, state, and local policies on renewable energy and energy conservations.

The Low-Carbon Economy

The buzz in the capital markets of North America and Europe has steadily increased about a "lower-carbon economy" and what that means for public companies and the capital markets.

For example, this could mean more emphasis on production of electric vehicles and a move away from manufacturer reliance on traditional fossil fuel-powered engines, the possibility of more solar and wind installations to power utilities as part of a federal or state infrastructure stimulus, and perhaps greater emphasis on energy conservation in facility and transport operations.

Federal financial investment could accelerate the growth of "green finance."

Each of these moves would affect investors as they weigh risk and opportunity in their portfolio.

The US SIF Report as Guidance

For capital markets professionals in various asset classes, the numbers revealed in the US SIF Trends report and the issues identified by survey respondents traditionally become widely used foundational references and have tended to accelerate the moves by investing in adopting ESG investing approaches.

The impact on the policies related to corporate disclosure in turn reflect the response of corporate boards and management teams to investor "needs and wants" of ESG information.

Beyond the disclosure of the financials in the traditional corporate disclosures (such as in the Form 10-K and proxy statement), the positioning of one's company as sustainable, resilient, responsible – and suitable for ESG investing – is an important consideration for IR professionals, boards, and the C-suite to keep in mind in 2021.

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US SIF Survey Respondents

The investment professionals surveyed by the US SIF Foundation in 2020 included managers at independent asset management firms, index and benchmark managers, public employee pension systems, insurance companies, educational institutions (such as endowments), foundations, broad-based healthcare institutions, faith-based institutions (many are members of the Interfaith Center on Corporate Responsibility), family offices, and community-based not-for-profit organizations.

The survey generated responses from nearly 400 money managers, more than 500 institutional managers, and more than 1,000 community investing organizations.

The respondents were investment professionals managing funds for retail customers ($4.6 trillion) and institutional owners ($12 trillion). Managers of mutual funds, exchange-traded funds, and annuities accounted for $3.1 trillion. Private equity, venture capital, and alternative investment vehicles comprised $700 billion in AUM. Almost $1 billion was held in money market assets.