



Why Sustainability is important in the Asset Management Industry

In 2019 climate change and sustainability became two of the most important boardroom opportunities and challenges facing businesses. The next decade will see the climate change become a major focus for businesses, as investor preferences change and pressure from regulators for businesses to disclose more information on how they are impacting the climate agenda.

As business leaders contemplate their response, this paper focuses on why Environmental Social and Governance (ESG) should be a key focus for the asset management industry.

The climate crisis and its impact on financial markets

As with any era of disruption, climate change is creating and will continue to create risks and drive opportunities

for asset managers. Climate change is happening, how severe the impact depends on action now. Our environment is at risk, the risk of global warming and the change to our climate will also have social and economic effects across the world.

"Significant opportunities and challenges for Asset Managers"

At the World Economic Forum in 2020 the theme was focused on "Stakeholders for a Cohesive and Sustainable World". For the first time climate and environmental risks are listed as the top five global risk areas, edging out other significant issues such as regulation, reputational and cyber risk.

Growth of Sustainability movement

At the World Economic Forum (WEF) in 2020 the theme was focused on "Stakeholders for a Cohesive and Sustainable World".

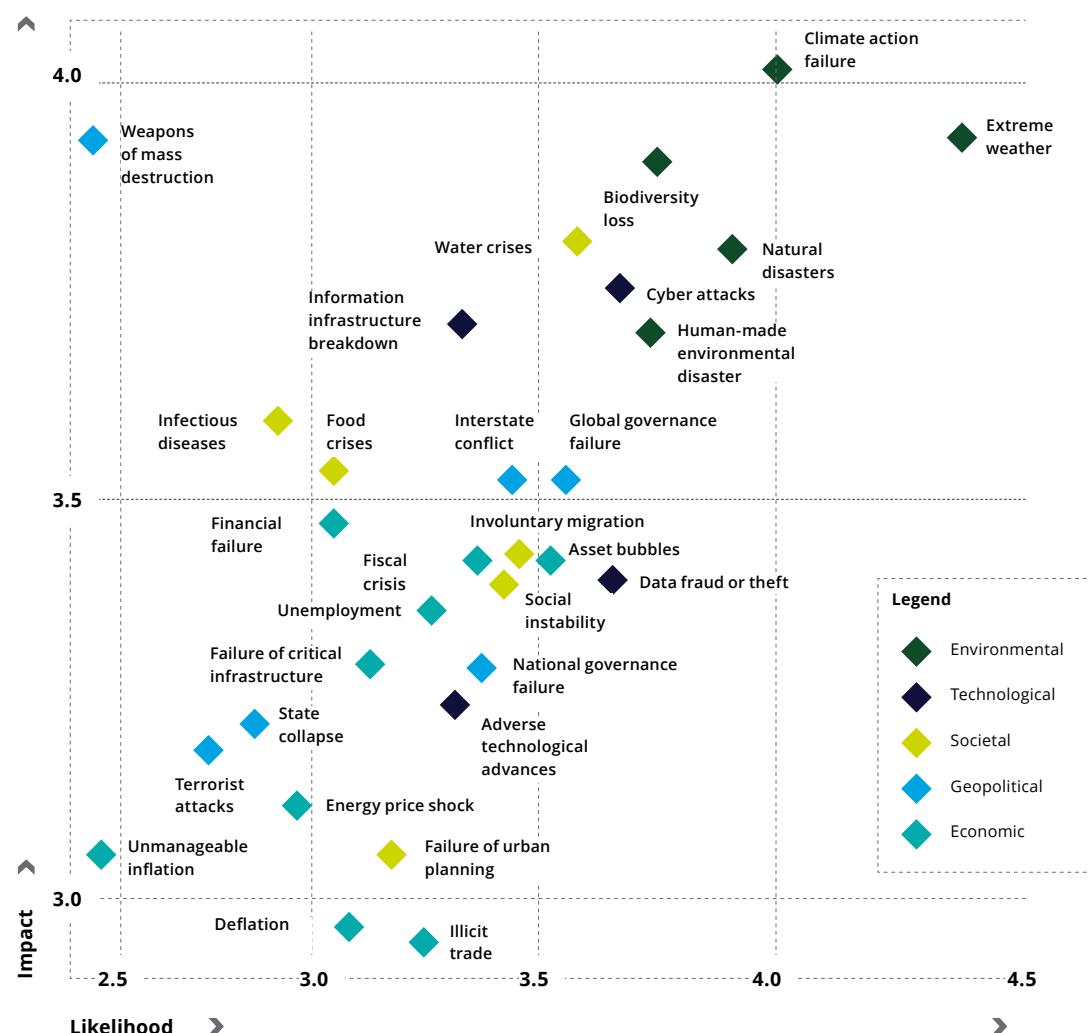
For the first time climate and environmental risks are listed as the top five global risk areas, edging out other significant issues such as regulation, reputational and cyber risk¹.

The Financial sector will play a pivotal role in transforming our economy to help support the goal to reduce the impact of climate change. Asset managers could be at the forefront of a new standard for investing. We believe companies helping to solve the world's biggest challenge can be best positioned to grow.

"Top 5 WEF Risks:

- Climate action failure
- Extreme weather
- Natural disasters
- Biodiversity loss
- Human made environmental disasters."

World Economic Forum's 2020 Global Risks Landscape affecting companies



1. http://www3.weforum.org/docs/WEF_Global_Risk_Report_2020.pdf

Growth of Sustainability movement (continued)

The market is quickly organising around environmental and social issues.

We are seeing

- Investors pursuing or considering to pursue ESG integration and in some cases insisting on it.
- Environmental and Social related proposals account for the majority at Shareholder AGMs;
- Data providers are providing more ESG criteria and they are adding new ones every month;

- The European Commission is focusing on sustainability and standardisation;
- Corporate Social Responsibility has increased employee engagement;
- Customers changing habits to reduce impact on environment;
- Boards are considering sustainability risks on their overall business;
- The European Supervisory Authorities, including ESMA, are driving the Sustainable Finance Agenda, setting standards for taxonomy, disclosures and benchmarking, with lots more to come.

"Nearly all key stakeholders are integrating and engaging in ESG activities."

Stakeholder driving ESG integration and disclosure



Investors

84% of investors are pursuing or considering pursuing ESG intergration in their investment process²



Shareholders

2019 Proxy Season: 3rd year in a row that E&S related proposals account for the majority³



Raters and rankers

650+ sustainability raters and rankers provide ESG data to the market⁴



Policy and stock exchanges

Stock exchanges committing to sustainability⁵
EU Non-financial Reporting Directive



Employees

Companies engaged in CSR can reduce employee turnover by as much as 50%⁶



Customers

73% would change consumption habits to reduce impact on the environment⁷



Directors and boards

- Sustainability fluent
- Business value at stake from sustainability risks can be as high as 70% of EBITDA⁸



Standard setters

- Global Reporting Initiative (GRI)
- Sustainability Accounting Standards Board (SASB)
- Taskforce on Climate related Financial Disclosure (TCFD)
- International Integrated Reporting Council (IIRC)

2. [Morgan Stanley Sustainable Signals report](#)

4. [www.ratesustainability.org](#)

6. [Project ROI 2015](#)

8. [CERES, Lead from the Top](#)

3. [Harvard Law, 2019 Proxy Season Preview](#)

5. [World Federation of Exchanges Survey 2018: Exchanges Maturing in Their Sustainability Efforts](#)

7. [Nielsen: What Sustainability Means Today](#)

Market Opportunity

Previously defining ESG has not been an easy task because there is no standardisation or single definition of ESG. Even the terminology is often confusing, with ESG used interchangeably with responsible and sustainable investing. However sustainable investing and responsible investing, are the same thing, it is the process of incorporating ESG factors into investment decisions and incorporating ESG criteria into all portfolio management processes.

2019 was a record year for inflows into sustainable funds in Europe which saw assets under management reach €668 billion, and investors' interest in responsible investments shows no sign of slowing down.

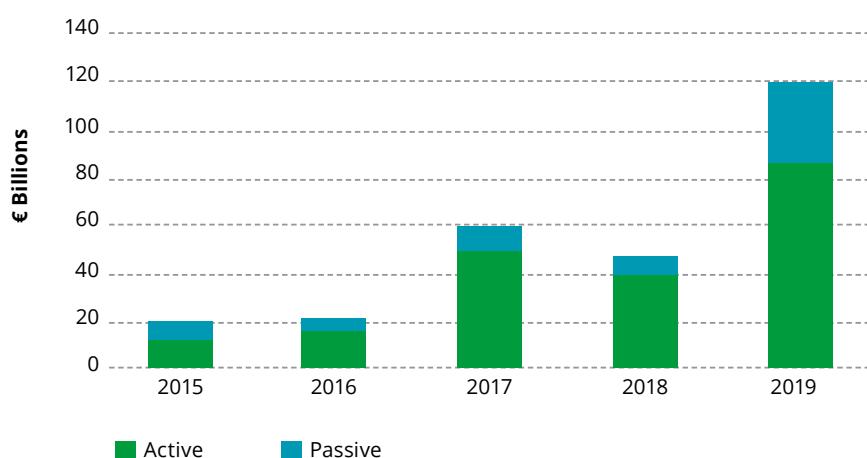
According to Morningstar, investors had record inflows of €120 billion into sustainable investment funds and more than a third of this occurred in the last 3 months as the increase in sustainable investing picked up pace⁹. European sustainable funds now account for €668 billion at the end of 2019, up 58% from 2018. The growth has been propelled by the launch of 360 new products and some of these products had a specific climate oriented mandate. The strong inflows were driven mainly by growing investor interest in ESG issues and investors increasingly want to align their investments with their values and sustainability preferences.

Passive funds have enjoyed significant inflows from sustainable investors. Passive funds account for 21% of sustainable assets across Europe, up from 14% five years ago.

Two Aviva funds made it to the list of best-selling sustainable funds, and the Aviva Investors Stewardship UK Equity fund pulled in almost double the amount as the next best-selling fund with net inflows of €1.4 billion. Of course, inflows were not enjoyed across the board and a number of sustainable products saw outflows during the year.

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Annual European Sustainable Fund Flows (€Bns)



The top 10 outflows in sustainable products accounted for nearly €3 billion. Equities strategies continue to be the most common way for investors to incorporate sustainability into their portfolio, and that is reflected in the number of product launches through the year.

Fixed income is, however, starting to catch up and 21 new sustainable fixed income funds were launched in the fourth quarter of the 2019.

Despite the greater adoption within the investment management community, there are varying approaches to ESG incorporation by investment firms, regulators and investors suggest that the full potential of ESG investing has not yet

been realised. As emerging technologies, such as Artificial Intelligence (AI), enable better quality ESG data and regulatory landscape becomes clearer, investors are expected to increasingly demand ESG factors be applied to a greater percentage of their portfolios.

9. <https://www.morningstar.co.uk/news/199190/record-shattering-year-for-sustainable-investments.aspx>

ESG Risk

We believe asset managers who are pioneers in the ESG space, filtering every commercial and corporate decisions through an ESG prism will ultimately benefit, exposing new and emerging risks. As the amount of ESG data sources grow and better methodologies develop to understand the data, improved data should emerge, making it easier and more cost effective to integrate ESG investment selection criteria and monitoring. Challenges of course will remain with gaps and imperfect data but as reporting gets better and easier to access this will have financial implications on the risk analysis of all asset classes.

If an asset manager is aware of the extent to which climate change and ESG factors drive material risks and opportunities for its business and operations, it can begin to integrate climate-change considerations into its strategy. Asset managers will need to ensure they have the right tools to make the best possible decisions; this means boards and senior executives will need to demonstrate effective governance principles, internal policy and technology changes will need to be considered, and all firms will need to up their game in terms of the quality of the firms ESG disclosures. Without effective climate governance structures in place, a company will struggle to make climate informed strategic decisions, manage climate-related risks and establish and track climate-related metrics and targets in the short, medium or long term.

Looking towards the future

For the asset management sector the goal must be not only that all investors can access sustainable products and services on demand but that ESG factors are included in their corporate, investment and business ambitions for the future. Asset managers are at a point of historic change, a significant shift in thinking is needed by all participants across the whole investment chain, as the results will affect the risks, returns and value for investors. The global impact of which will last for generations to come.

If you interested in hearing more about ESG investing and how Deloitte can support your business please reach out to any of our team.

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