

The Race to Harness *ESG and Sustainability*

Sustainability and environmental, social and governance (ESG) considerations have been top of mind for more and more people this year, due to a global pandemic, increasing impacts of climate change and increased awareness of racial injustice. A recent BNY Mellon client survey shows that sustainability and ESG are a priority for the financial industry as well. Including asset owners, asset managers, alternative asset managers, banks, broker-dealers, and insurance firms across EMEA, APAC and North America, the survey explored:

- how respondents are implementing ESG, including screening, integration and engagement
- how investors are using ESG data and standards frameworks
- how sustainability and ESG considerations are being applied to investment across different asset classes

The results show that ESG and sustainability are important to the survey respondents now – and will increase in significance in the future. Respondents expect to continue using multiple methods of applying an ESG or sustainability lens to investing, at various stages in the investment process. As ESG integration becomes more sophisticated, investors will need both better data and better ways to harness the data. Although ESG integration still has hurdles to overcome, it is encouraging to see how companies across industry sectors are making an effort to have a positive impact on people, communities and the planet.

Key Takeaways

- A majority of respondents have adopted or will adopt more active methods of ESG implementation going forward, indicating that market participants may be moving away from passive approaches, namely screening methods, as the predominant method of applying ESG and sustainability considerations to the investment process.
- Respondents showed a strong future commitment to sustainable investing and impact investing. However, the current lack of clear, consistent data is a barrier to sustainable investment adoption, or improved methods of adoption.
- A small number of surveyed participants map investment information against taxonomies and ESG standards frameworks, while a greater number would consider using a solution to do so.
- The use of proxy voting as a mechanism to influence firms was popular with just over half of the respondent universe. However, only 16% use proxy voting records to assess the influence that active engagement has on the financial and/or sustainability performance of investment.
- Projected commitment to ESG integration over the next 3-5 years could signal more requirements for ESG disclosure within alternative asset classes - particularly private equity and real estate - as well as derivatives.

Screening, Integration and Impact

Our survey indicates that ESG integration and impact investing are likely to grow in popularity among our client base over the next 3-5 years. According to survey responses, screening (negative, positive, norms-based) will remain in place over that period, although it could decline in importance or become a “minimum safeguard” over time as ESG programs become more sophisticated.

- 75% of respondents said they would implement or continue to implement ESG integration over the next 3-5 years, compared to 46% who are integrating ESG today.
- 63% said they will conduct or continue to conduct sustainability-themed or impact investing, compared to 32% who conduct impact investing and 47% who conduct sustainability-themed investing today.
- 49% said they are likely to apply screening (negative, positive, norms-based) to some or all of their portfolios over the next 3-5 years. 49% apply negative screening to their portfolios today, while 32% and 31% apply norms-based and positive best-in-class screening, respectively.

Figure 1. ESG investment practices likely to be implemented or continued in the next 3-5 years.

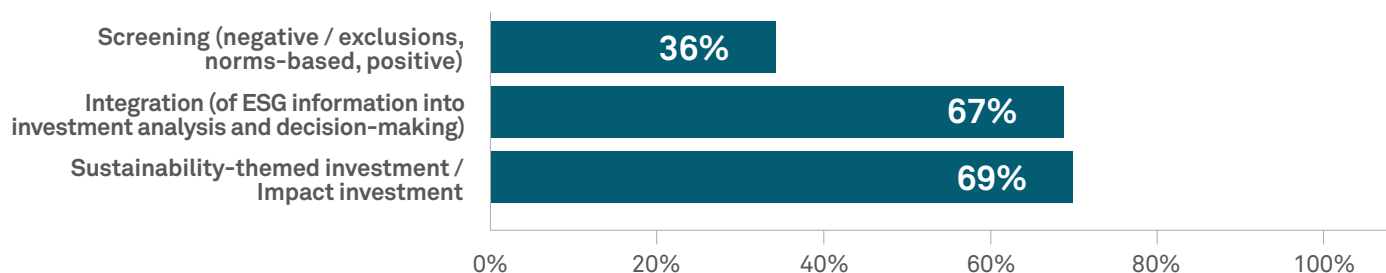
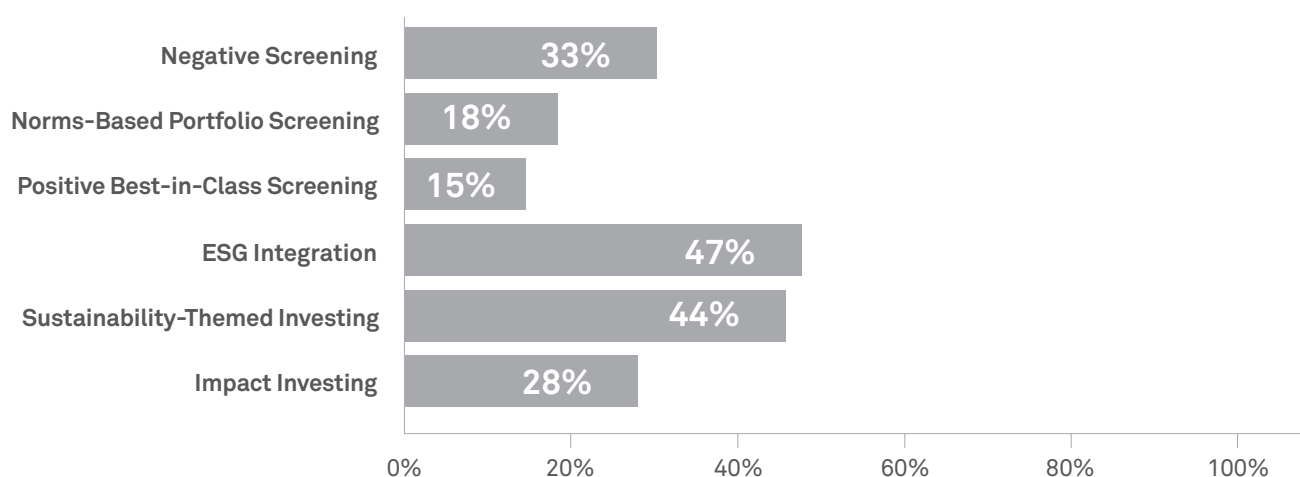


Figure 2. Percentage of respondents implementing ESG investment practices by method.



Engagement

A majority of survey participants use engagement with investee firms as a method of ESG implementation. Just over half of respondents use proxy voting as a mechanism to influence firms. However, the use of proxy voting records to assess whether active engagement influences the financial and/or sustainability performance of investment is not widely used.

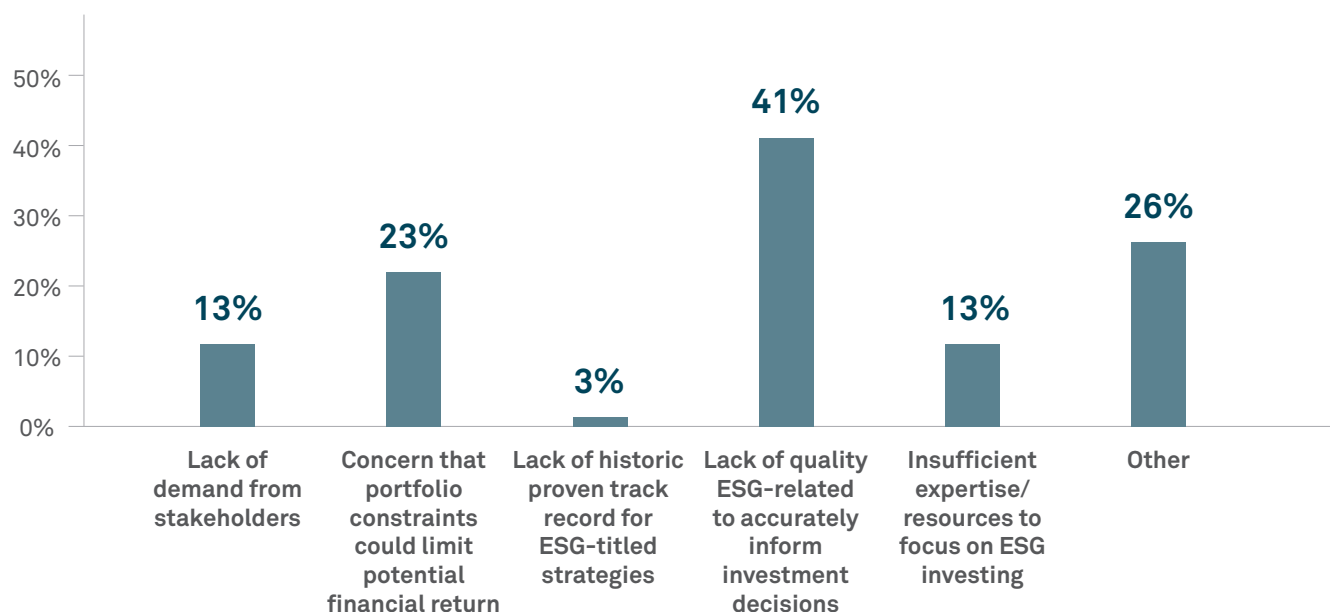
- 69% of respondents actively engage with investee companies on sustainability issues.
- 52% use proxy voting to influence decision-making of corporate boards on ESG matters.
- 16% assess proxy voting records in relation to investment's financial performance and/or sustainability outcomes.

Data

Client concerns related to ESG integration, reflected in our survey, mirror ongoing industry dialogue: ESG data issues continue to be at the core of investors' challenges. A small number of survey participants map investment information against taxonomies and ESG standards frameworks, while a greater number would consider using a solution to do so. Out of those who conduct impact investing, a majority have a formal measurement process in place, although close to a third do not.

- The “lack of quality ESG-related data [available] to accurately inform investment decisions” was considered the greatest hindrance to ESG integration among surveyed participants.
- 15% of respondents use common taxonomies to map information for analysis; 40% currently do not but would be interested in a solution.
- The most common ESG standard frameworks used by respondents include SASB and the UNI PRI, as well as GRESB for real-estate portfolios.
- The most common norms-based frameworks used by respondents include the UN Global Compact, the International Labour Organisation (ILO) and the OECD Watch List.
- While 32% of respondents conduct impact investing, only 22% of respondents are in a position to formally measure outcome.

Figure 3. Issues preventing respondents from applying ESG integration methods to the management of some or all portfolios.



ESG in Alternatives

More than half of the respondents to our survey currently seek ESG or sustainability-related information on private investments. Commitment to ESG integration moving forward could signal more requirements for ESG disclosure within alternative asset classes – particularly private equity and real estate – as well as derivatives.

- 55% of respondents seek disclosures on ESG issues from the private investment entities/structures in which they invest.
- Among respondents, ESG integration is the most used method for applying sustainability considerations to investment within alternative asset classes and derivatives.
- When investing in alternatives, respondents most commonly integrate ESG considerations into private equity and real estate decisions.
- 75% of respondents said they are likely to implement, or continue implementing, ESG integration in the next 3-5 years (across one or multiple asset classes).

Figure 4. Asset classes in which respondents currently apply ESG integration.

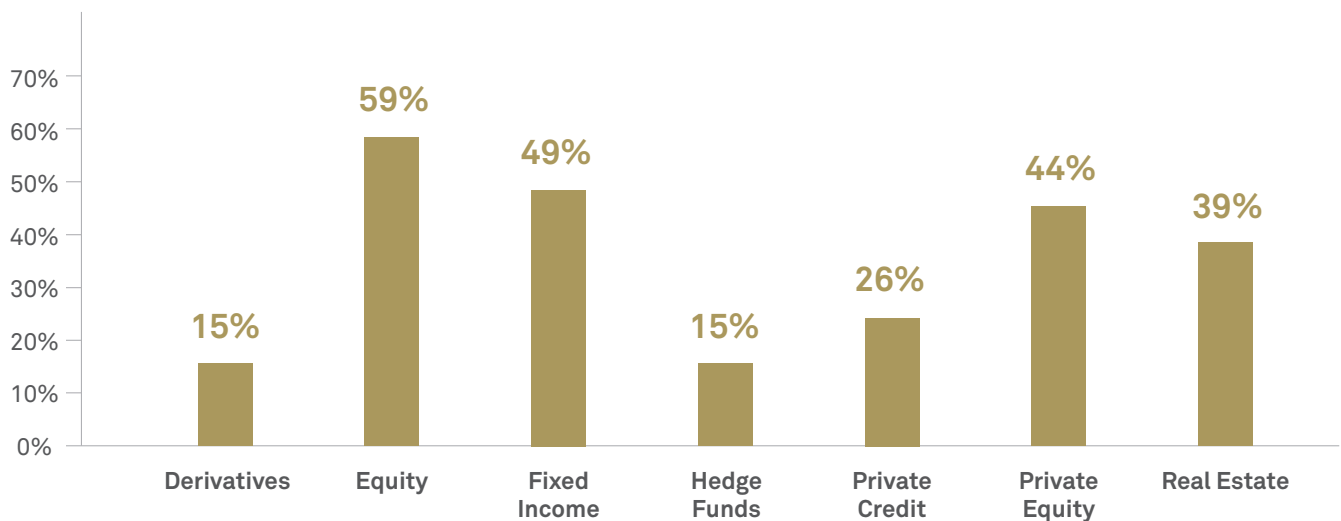
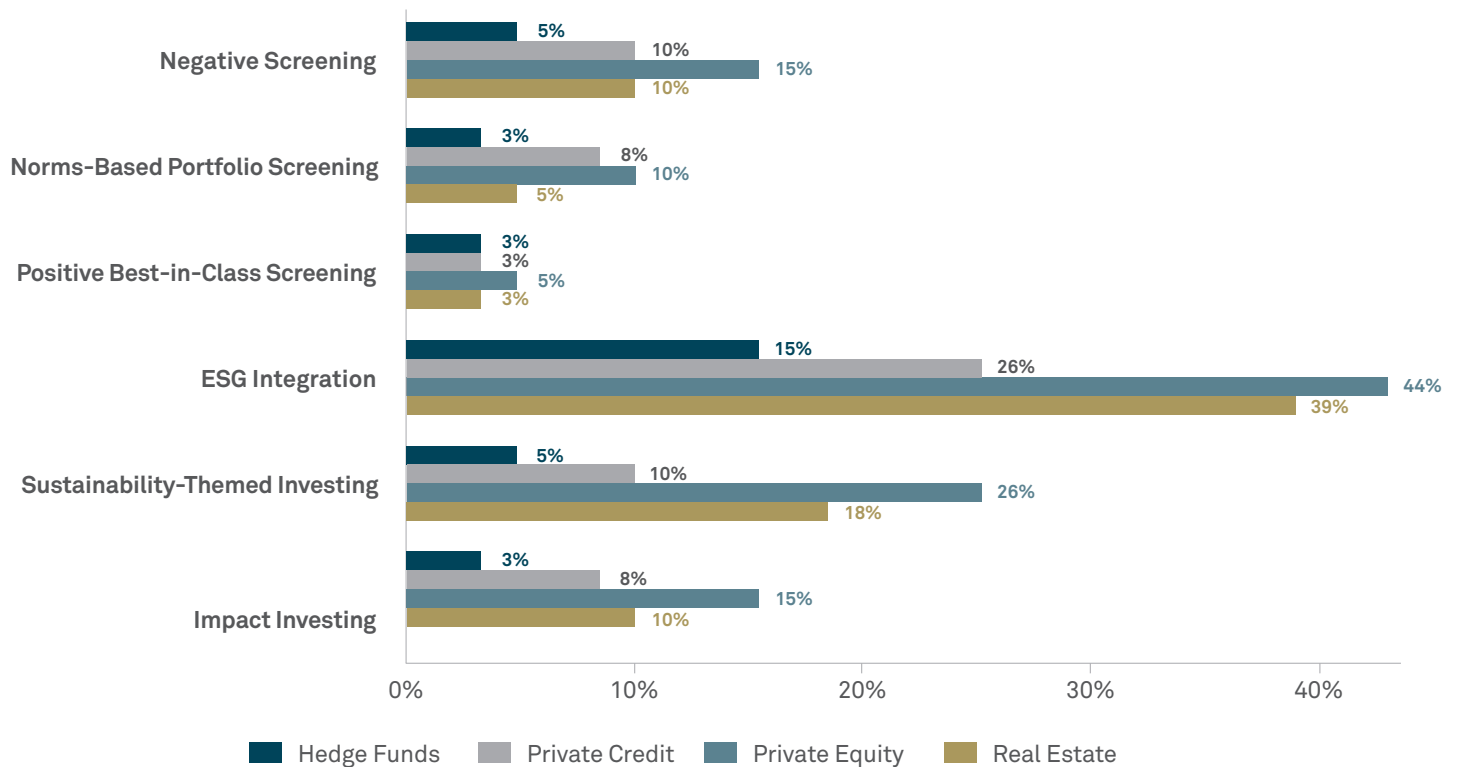


Figure 5. *Application of ESG investment practices by method for alternative asset classes.*



Conclusion

The industry is clearly indicating a need for clarity, consistency and transparency in the management of ESG considerations – and this trend is likely to accelerate. Learn more about how BNY Mellon is putting the **Future FirstSM** by using our global reach, influence and resources not just to power success today, but to help safeguard the future.

Methodology

This document highlights key findings from a recent survey of 288 BNY Mellon clients conducted between October 11 and November 30, 2020. Findings are based on aggregate data representing responses from asset manager, asset owner, alternative asset manager, bank, broker-dealer, and insurance firm profiles, with representation across EMEA, APAC and North America.

Glossary

Negative/Exclusionary Screening

Screening of investments based on an exclusions list. For example, excluding investments in the tobacco or coal mining industries.

Norms-Based Screening

Screening of investments based on compliance with relevant international norms and standards, such as those issued by the OECD, ILO, UN and UNICE, and Global Compact.

Positive Best-in-Class Screening

The best-in-class approach to sustainable investing means investing in companies that are leaders in their sector in terms of meeting environmental, social, and governance criteria.

ESG Integration

Inclusion of ESG issues in investment analysis and investment decisions, or the analysis of all material factors in investment analysis and decision making, including ESG factors. ESG integration encompasses both (i) the inclusion of ESG factors in a traditional investment analysis in order to maximize investment opportunities and minimize risk, and (ii) a front-to-back integration reflecting ESG front office decisions in every downstream process. Downstream process examples include proxy voting, collateral eligibility, securities borrowing eligibility, asset managers selection process, and reporting.

Taxonomy

A classification of data into categories and sub-categories using standard terminology.

Corporate Engagement

Engagement with companies to influence their decision-making in terms of adopting ESG principles in their processes, procedures, and production.

Sustainability-Themed/Thematic Investing

Investment in specific ESG themes, such as renewable energy, waste, and water management.

Impact Investing

Investment in companies, organizations, and funds with the intention of generating a measurable and beneficial social and/or environmental impact alongside a financial return.

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