RESPONSIBLE INVESTING

# Sophisticated institutional investors demanding more from ESG

*By: John Farley | November 13, 2020*

**Washington -** The institutional investing landscape has come a long way from the early days when there were few options available for those looking to incorporate environmental, social and governance (ESG) principles. As indicated by the recent Institutional Investors Study from Schroders, we are at a point where fiduciaries are more sophisticated in what they are looking for in ESG investments - and what still needs to change.[1]

The Schroders study, conducted in April 2020, incorporated the perspective of 650 institutional investors from 26 countries, responsible collectively for $25.9 trillion in assets. Results appear to indicate that institutional investors increasingly recognize the alpha-generating opportunities derived from ESG investments as a complement to the risk mitigation impacts traditionally observed in ESG strategies.

Globally, 67% of respondents stated a preference for ESG integration into the investment process, as compared to 64% in the 2019 survey. Positive screening was cited by 61% (up from 44% in 2019) and active company engagement and stewardship was at 59% (from 38% in 2019). This is notable when considered alongside the new rule from the Department of Labor disclosed earlier this month regarding retirement plan fiduciaries regulated by the Employee Retirement Income Security Act (ERISA). The rule states that ESG investing requires that fiduciaries "must never sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals." The Schroders study would appear to indicate that this is exactly what institutional investors are looking for in ESG investments - a way to improve investment outcomes.

**The importance of materiality**

The focus on a more inclusive approach to ESG investing highlights the importance of financial materiality. Calvert has culled the thousands of data points at our disposal to come up with approximately 300 key performance indicators (KPIs) with a clear focus on financial materiality. When vendor KPIs are lacking, we create custom indicators from the underlying data to fill the gap and emerge with a dataset that we believe impacts company performance. We then quantify these risks using a proprietary scoring model that rates and ranks companies within their peer groups. Calvert ESG analysts further evaluate the final scores, drawing upon their deep sustainability expertise.

We also found it interesting that the most common challenges cited in the Schroders' study for investing in sustainable investments were greenwashing and lack of transparency and reported data. Calvert has long made disclosure and transparency a priority in our engagement process, because access to information makes it easier for investors to gauge which companies are taking meaningful action on material ESG issues and which ones are failing to do so and, thus, are more likely to have increased risks going forward. Performance falls below both of these concerns in the Schroders survey, which seems to indicate that given the right information, the opportunity for desirable performance outcomes exists.

**Bottom line:** As institutional investors have become more sophisticated, their needs have predictably shifted to a more advanced level of data and evaluation. This coincides with Calvert's research and investment processes designed to uncover opportunities for long-term growth.

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*1. Schroders, "Institutional Investor Study 2020."*

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