Responsible Investing

ESG investing in 2021: Advancing data capture and impact measurement

By: John Streur | January 22, 2021

Washington - Adoption of environmental, social and governance (ESG) strategies by investors and corporations globally has risen significantly in recent years. Today, $17 trillion — or one of every three dollars professionally managed in the U.S. — is invested in sustainable investment strategies, according to the US SIF Foundation's biennial Trends Report.

We can see many companies changing their practices because they understand the importance of ESG to their brands and operations. The critical, imminent nature of many ESG challenges like climate change and inequality has become move evident today, and market competitive forces are driving innovation and change.

The dramatic shift toward ESG investing, however, will not be sustained unless we address a fundamental weakness in the market infrastructure, or framework, for capturing and reporting ESG data that is decision-useful to investors. Current information from issuers available to investors when making their ESG investment decisions is inadequate in its breadth, depth and quality. Regulators are lagging behind the needs of investors and have so far failed to create the necessary infrastructure. We expect regulators to attempt to catch up in 2021, but we believe the real progress will be made by leading market participants, who will shift the data paradigm from disclosure of ESG risk to analysis of the impacts that issuers have on people, society and the environment.

Regulatory progress

Even if there had not been a change in the U.S. administration, we expected progress in the first stages of building the infrastructure to capture issuer data and disclosure of financially material ESG information. At this juncture, we anticipate some level of regulatory oversight of this process, with a strong role for the Sustainability Accounting Standards Board (SASB) standards, as well as the Task Force on Climate-related Financial Disclosures (TCFD) framework, which is designed to improve and increase reporting of climate-related financial information. Further, we expect the recent DOL rule on the use of financially material ESG information to be clarified to level the playing field for ESG investment strategies as part of newer regulatory guidance.

Broadening ESG focus

In addition to progress in improving market infrastructure and data systems, we believe investor focus will shift from ESG risk avoidance to ESG risk reduction as well as impact measurement and management. Further, investors and companies will broaden their focus from the climate and environment to emphasize racial and gender diversity, inclusion and equity, human capital management and a set of human rights issues. Finally, greater attention will be given to ESG performance beyond public companies, with real consideration of private companies — especially those that are large or in the supply chains of public companies.

Engagement as a catalyst for change

As data systems and market infrastructure evolve to support decision-useful ESG data, investors will provide constructive direct feedback to companies, through stronger forms of shareholder engagement. We will see changes to proxy-voting patterns, as well as increased board oversight of ESG performance, later in the year and into the 2022 annual general meeting (AGM) cycle.

The combination of crisis-level scenarios across multiple risk vectors in climate, inequality and human health will drive the change necessary to rapidly address the data and market infrastructure needs that exist in our global capital markets. Many investors are already using research processes and corporate engagement strategies to this end. As data systems transform, we believe the ESG investing paradigm will shift, with innovative leaders moving into impact measurement and management. Calvert is collaborating with and advising the Impact Weighted Accounts Initiative and developing novel impact measurement tools at this time. We intend to continue to push the edge of the envelope and maintain a competitive advantage as the ESG segment grows and competition intensifies.

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