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ESG Research

Takeaways From Asset Managers' ESG Panel

Thematic Research | Environmental, Social and Governance (ESG) Research

Environmental, Social and Governance (ESG) Research

Credit Suisse Environmental, Social and Governance (ESG) research seeks to focus on sustainability and accountability factors that are then integrated into the investment process.

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As part of the Credit Suisse 22nd Annual Financial Services Forum on Friday, we hosted an ESG panel with Michelle Dunstan (Global Head of Responsible Investing at Alliance Bernstein) and Jennifer Anderson (Co-Head of Sustainable Investment & ESG at Lazard). On the back our recent note *Tidal Wave Forces Behind Sustainable Finance*, the conversation provided clear insight that traditional fundamental analysis and ESG integration are converging into one process with the new phase of sustainable investing focused on having tangible environmental and/or social impacts. Below we provide our key takeaways from the panel discussion:

- **ESG 3.0 is focusing on real-world impacts:** For Alliance Bernstein and Lazard, ESG integration (i.e., incorporating financially material environmental, social, and governance factors) is already embedded across both firms' actively managed products and increasingly a prerequisite to gain new business from asset owners (particularly in the EU). The emerging next leg of demand growth is for investment products that make an active contribution to Sustainable Development Goals (SDGs). Michelle noted that AB's "Portfolios with Purpose" product is the firm's fastest growing area (AUM +60% YoY in 2020) with an emphasis on SDGs related to climate, health, and empowerment.

- **Asset owners are demanding "very strong" evidence of ESG integration and active ownership**: This means portfolio managers and analysts (rather than an ESG specialist) need to not only be able to discuss the key 'E' and 'S' issues within their portfolios but also report on the related outcomes and impact. In addition, asset owners are also increasingly expecting asset managers to align engagement with how they vote on ESG-related shareholder proposals, which are likely to dominate this upcoming proxy season (particularly related to climate action/disclosures, human capital management and board diversity).

- **Europe is still the clear leader, but the US and Asia are accelerating:** Europe remains the clear leader on both the institutional and retail channels. The focus on the institutional side has been on climate risk management while the retail side is more focused on sustainable investing. The latter is expected to accelerate due to the intergenerational transfer of wealth and financial advisors being *required* to ask their clients about preferences around sustainable investing. Meanwhile, demand from the US and Asia is "lagging behind" (Europe) but accelerating, which is consistent with recent ESG-labelled fund flow activity.

- **The need for standardized disclosures AND proprietary analysis:** Both panelists noted the need to standardize ESG-related disclosures which will go into effect in the EU starting next year; the US and China are also moving in this direction. However, what will differentiate asset managers is their *interpretation* of this data with the use of proprietary frameworks, alternative data sources and views on ESG materiality weighting. This sits squarely in the wheelhouse of active management as it requires a deep understanding of company fundamentals and strategy, and how they are influenced by ESG factors in the future. Meanwhile, ESG ratings are used just as "starting points" as the analysis is backward-looking, and too reliant on the level of company disclosure (via web scraping).

- **The forthcoming EU regulations will have global ripple effects:** The conversation offered a fresh reminder of the EU's sustainable finance regulations, which are set to kick off on March 10th with the EU Disclosure Regulations for financial services firms. Specifically, investment/financial advisors and fund managers based in the EU (or those that market financial products into the EU) will need to begin publishing how sustainability risks and ESG considerations are part of their investment decision-making process and also how their investments are impacting sustainability factors. Jennifer – who is based in London – noted that the UK is likely to follow. She believes that marketing funds/strategies into Europe that are labelled as "non-sustainable" (Article 6) will be a challenge, and at a minimum will need to incorporate ESG integration (Article 8) and increasingly have a very clear environmental and social objective (Article 9). For more details and timeline on the other EU sustainability regulations beginning YE2021 and 2022, please refer to slides 15-16 in our slide deck here: *Global ESG Research: A New Era of Sustainability*
- **Engagement a critical part of ESG integration:** The increasing focus and demand from asset owners to engage with companies in a way that brings about change was a common theme throughout the discussion. Similar to how the ESG conversation with clients/asset owners increasingly needs to be led by portfolio managers and analysts, both panelists emphatically acknowledged the same applies when engaging with companies given the importance of tying it back to financial results (i.e., benefits all stakeholders) and to drive company action. Michelle noted that last year AB launched an engagement campaign identifying their 350 largest holdings that did not have climate change targets tied to executive compensation and asked for this to be implemented in 2021 and will publish a progress report on the outcomes. Jennifer noted she is also seeing companies proactively ask what they can and should do on ESG and CEO to CEO engagement to collectively address issues.

Disclosure Appendix

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