ESG investing under fiduciary management

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About this report: Why, what and how?

The past few years have seen a dramatic global shift in attitudes towards ESG investing — considering environmental, social and governance (ESG) factors when allocating capital. Over the same period, growing numbers of UK pension schemes, endowments and foundations have begun using the services of fiduciary managers.

EY believes that considering ESG factors is crucial to meeting the needs of current and future investors, and that fiduciary managers are uniquely placed to help asset owners achieve this goal. We are therefore delighted to present this paper, which aims to identify how fiduciary managers and asset owners currently work together on ESG; to identify the challenges they face; and to suggest how co-operation could be enhanced.

In preparing this report, we have drawn on the views of UK fiduciary managers representing over 95% of the UK fiduciary management industry by assets under management, gathered via a detailed questionnaire and selected follow-up telephone interviews[1]. We are very grateful to all the respondents for their time and insight.

We hope this paper will make a meaningful and tangible contribution to the evolution of ESG capabilities in the UK's fiduciary management sector.

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1 See Appendix — Our research

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Executive summary

Fiduciary management and ESG investing, both comparatively little known concepts in UK investing a few short years ago, are growing in influence and — in our view — increasingly complementary as both cover long-term risk management.

EY research shows that UK fiduciary managers are focused on investors' growing interest in ESG investing, and on their own ability to understand and meet those needs. Firms are rapidly developing their in-house capabilities, and are working closely with external asset managers on ESG.

While many fiduciary managers aspire to 'ESG integration', most still have some way to go to achieve this goal. No individual firm is setting the standard for others, but some clearly have further to travel than others.

> **"While many fiduciary managers aspire to 'ESG integration', most still have some way to go to achieve this goal."**

Briefly summarised, the key findings of our research are:

- Fiduciary managers believe that ESG investing can add value for clients, and are actively working to clarify investors' needs and, where necessary, to provide them with education and support.
- Asset owners' focus on ESG investing is growing, and is increasingly having an influence on fiduciary manager selection — albeit with significant variations. Asset owners are encouraged to seek help in articulating their ESG beliefs and requirements.
- The growing ESG capabilities of fiduciary managers, and the third party asset managers they appoint, are making it easier for asset owners of all sizes to implement ESG investing.
- The quality and availability of ESG data remains a major challenge, but fiduciary managers are developing their analytic abilities and are increasingly confident they can identify useful signals.
- Each firm takes its own approach to ESG implementation, with variations in risk modelling and different attitudes to asset classes, ESG factors, execution methods and assessment techniques.
- Collaboration across the value chain is essential to successful ESG investing. Fiduciary managers are engaging closely with clients, third party asset managers and other organisations.

In short, fiduciary managers show relatively strong consensus over the value, nature and growth of ESG investing, and on the challenges it presents. However, they have very different views on how to overcome those challenges and implement ESG investing.

It is too early to say whether these variations will persist as the sector evolves. What does seem to be clear is that fiduciary managers are moving in the right direction, and that asset owners seeking fiduciary help with ESG investing have an increasing range of options open to them.

Armed with enough information and some targeted questions, we see no reason why any asset owner should not benefit from the ability of a fiduciary manager to help them implement ESG investing.

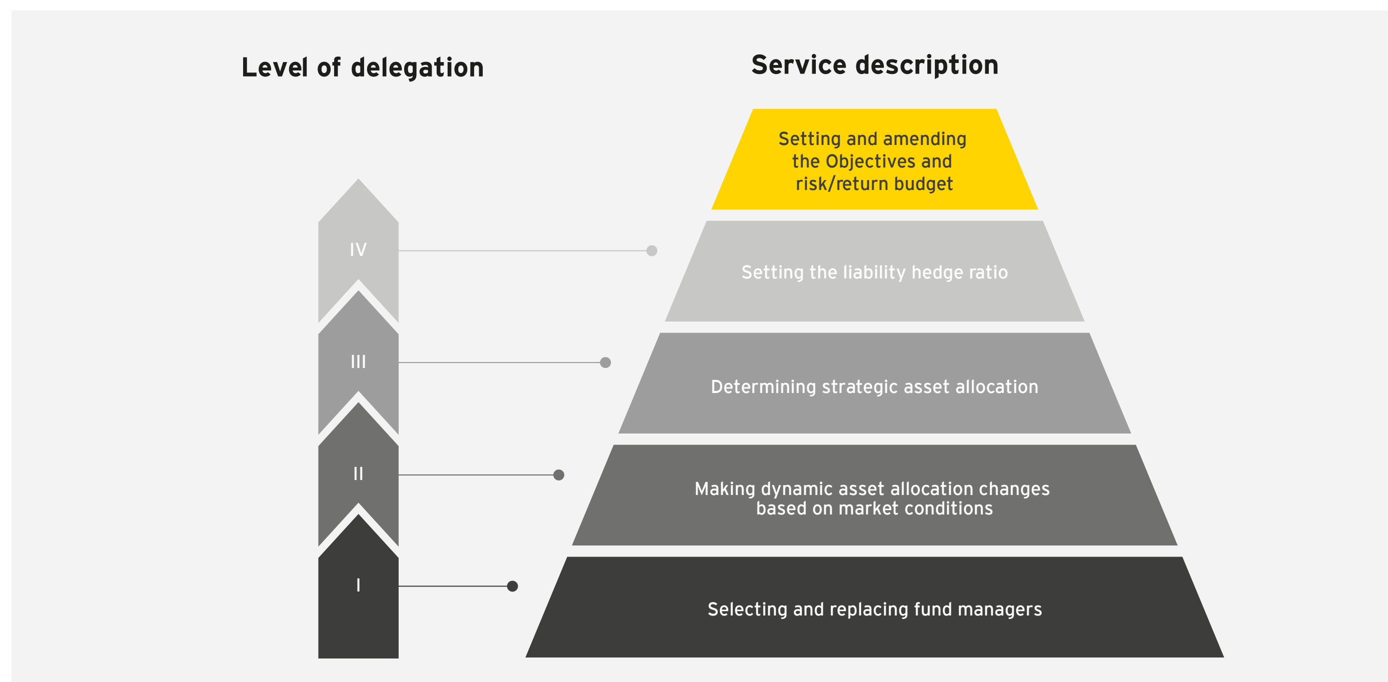
Background: Fiduciary management and ESG

Fiduciary managers provide a broad set of investment governance services, including consultancy and portfolio management, to pension scheme trustees and other asset owners.

Clients can typically choose how much of the investment process they wish to delegate to a fiduciary manager (see Figure 1).

Fiduciary management is growing rapidly in the UK. The CMA states that the UK market has trebled in size since 2011, although it is currently used by far fewer pension schemes (13%)[2]. More than fifteen firms including banks, asset managers and investment consultants offer fiduciary management services.

Figure 1: Fiduciary management pyramid



The past few years have also seen ESG investing[3] enter the global mainstream. Investor demand for ESG investing is growing fast, and investment managers are responding rapidly. It is estimated that over US$20t worldwide is now invested in assets or funds with some ESG-focused characteristics.[4]

Key drivers of growth to date include:

- Growing academic evidence of the benefits ESG investing can bring to risks and returns.[5]
- International co-operation on climate change, most notably the Paris Accord of 2015.
- Widespread investor satisfaction with ESG investing performance, reported at 90% of institutions by one recent survey.[6]

Looking ahead, we expect legal and regulatory factors to accelerate demand for ESG investing in the UK. This is particularly true for pension schemes, where changes include:

- IORP II, which requires pension schemes to consider ESG factors and disclose their approach.
- The Pensions Regulator's guidance that defined benefit (DB) and defined contributions (DC) trustees.
- The Department for Work Pensions (DWP)'s requirement for occupational schemes trustees to add ESG factors to the financially material risks they must consider and to set this out within the statement of investment principles from October 2019.

EY believes there is a natural and growing overlap between the goals of fiduciary management and ESG investing. We see more reasons than ever for asset owners to implement ESG investing, and more opportunities than ever for fiduciary managers to help them achieve their goals.

2 "The CMA's market investigation into investment consultants", presentation given at Transparency Taskforce Symposium, 26.07.18

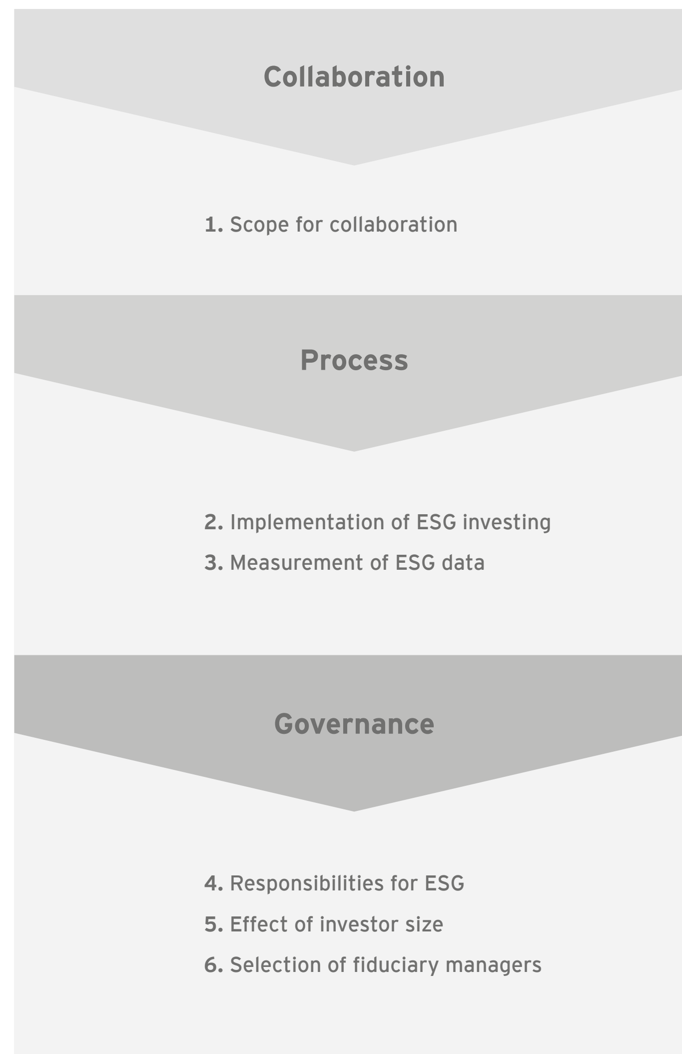
3 See Appendix – Glossary of ESG Terminology for further details
4 ThinkAdvisor, "Advisors, not their clients should lead on ESG investing" 17.09.18

5 See Appendix – Further reading "From the Stockholder to the Stakeholder"
6 Pensions & Investments, "90% of investors think ESG portfolios perform as well or better", 02.10.18

Key findings

EY research into fiduciary management and ESG investing aimed to explore three areas, divided into six key sections (see Figure 2). This framework formed the basis for the questionnaire sent to fiduciary managers. In this section of the paper, the research findings are summarised under headings that correspond to the six key questions.

Figure 2: Conceptual framework of our research



01 ESG Governance

Who is responsible for ensuring that ESG factors are considered?

In summary: Most fiduciary managers believe that ESG creates value, implying they have a duty to consider it. But client attitudes – which seem to be more varied – clearly have an impact too. Managers, and investors are working more closely to clarify responsibilities and, where needed, to educate trustees about ESG.

All the fiduciary managers the team contacted believe that ESG factors have some impact on long term risks and returns. Several emphasise that recent academic research points to ESG having a positive to neutral impact. A few were more categorical: "in terms of evidence around the financial value of [sustainable investing] and ESG, we have high conviction in its materiality and the opportunities it presents for investors" said one firm.

In the shorter term, some fiduciary managers see the likelihood of a global 'transition' to greater sustainability as another reason to prioritise ESG. "Social and environmental issues are increasingly material… they are directional, not mean-reverting" commented one, adding that "negative externalities generated by companies are being internalised faster than before."

Given these views, it was no surprise that all fiduciary managers feel they have a duty to consider ESG factors – and not only when directed by trustees. Even so, responses suggest that asset owners' fluctuating attitudes to ESG can affect the prioritisation it receives.

As one manager put it, "client engagement on this topic has tended to be reactive in nature – for example, prompted by the DWP consultation – which can lead to a burst of activity being followed by a lull." A number of firms also said that uncertainty over the materiality of ESG factors can lead to the issue being de-prioritised. That is a potentially significant factor, given the difficulties of quantifying ESG data (see Section Four). Overall, effective two-way communication appears essential to clarifying responsibilities over the governance and implementation of ESG investing. Several managers highlighted the importance of discussing ESG beliefs at the start of every engagement. One firm's definition of good engagement was that "this means understanding the topic, thoughtful dialogue on the key issues, and then an ability to turn this discussion into a clear set of beliefs and objectives that are communicated to the fiduciary manager." This resonates with our own experience; we are working with an increasing number of schemes to develop clear ESG beliefs and objectives.

A number of firms actively encourage clients to engage with ESG; 85% of firms have been asked to provide some sort of trustee training around sustainability. During 2018 alone, one manager said it has delivered training sessions, modelled climate change scenarios, compiled beliefs frameworks and reviewed governance policies.

> **"Social and environmental issues are increasingly material… they are directional, not mean-reverting"**

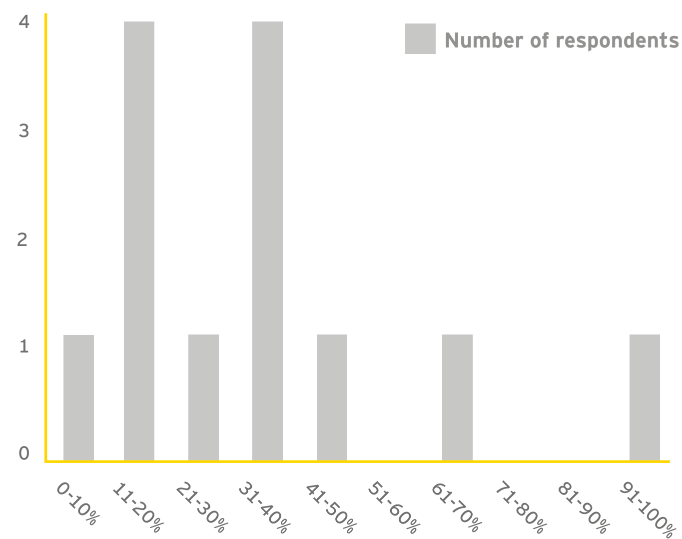
02

Are trustees factoring ESG capabilities into fiduciary manager selection?

In summary: Trustees' varying focus on ESG carries over into their selection of fiduciary managers. The composition and size of boards seems to be a key driver of attitudes. Even so there is no question that, encouraged by regulation, asset owners are becoming rapidly more engaged with ESG.

Asset owners' varying levels of engagement with ESG are equally evident when it comes to fiduciary manager selection. When asked about the proportion of client tenders that specifically mention ESG, managers' responses varied from zero to 100%, with a simple average of around 33% (see Figure 3).

Figure 3: Proportion of client tenders that specifically mention ESG



Firms see board consensus as a crucial driver of engagement.

As one firm put it, "those with divergent views tend to deliver vague statements." Two factors stand out as drivers of consensus, specifically:

- **The size of boards**. Smaller boards can deliver clearer views, either because the views of individual ESG advocates have more influence, or simply because "large boards can find it harder to agree a common position."
- **The nature of sponsors.** The attitudes of fund sponsors can have a major influence, especially where boards are seen as being ahead of the curve on ESG. Charities or public bodies can be particularly engaged but the focus of pension funds is growing too, "particularly where there are strong social and/ or environmental elements to the corporate business," said one fiduciary manager.

On average, there is no doubt that trustees' focus on ESG is increasing. Many firms reported that boards are asking more — and more searching — questions about their ESG capabilities. Key areas of focus include risk avoidance, divesting carbon-heavy assets, pro-active queries about ESG integration and specific investment opportunities such as renewable energy. Regulation is clearly playing an important role in 'shifting the curve', and that is especially true in the pensions space. More than one firm commented that the DWP's strengthening of trustee duties around ESG is pushing the issue up board agendas.

03

Can smaller asset owners derive value from ESG investing?

In summary: Smaller asset owners do face some additional potential hurdles to implementing ESG investing. Those barriers seem to be falling. By pooling assets and connecting clients with external managers, fiduciary managers are well placed to help small asset owners to benefit from ESG investing.

Smaller asset owners can find it harder than larger investors to implement ESG. They face similar challenges, but typically have less in-house knowledge, expertise and resources. They also lack investment weight, making asset managers less likely to offer them segregated mandates.

Fiduciary managers' responses to our questionnaire also hold encouraging news for smaller asset owners.

First, there is no sign that smaller funds are at a disadvantage when it comes to setting ESG goals and policies. In fact — as already discussed — a small fund with a unified board and a supportive sponsor could easily have a clearer view of ESG than a larger fund.

Second, experience suggests that there is no conceptual reason why smaller funds cannot implement ESG. As one fiduciary manager explained, "We expect ESG to be the default for investors and asset owners globally, rather than largely the preserve of the largest asset owners or niche interest areas as it is often now."

Third, the increasing range of ESG-themed investment funds — including exchange-traded funds (ETFs) — is making ESG investments more accessible to smaller investors.

Finally, the growth of fiduciary management should help smaller UK funds to acquire 'synthetic' scale by:

- Supporting their ESG governance capabilities.
- Pooling assets when constructing in-house portfolios.
- Identifying external managers that can manage smaller funds' capital alongside that of larger clients.

So while smaller asset owners may need to tailor their approaches to ESG investing differently to larger funds, there is no reason why fiduciary managers cannot help them to identify clear ESG policies, to implement ESG investing and to ultimately derive value from ESG.

"We expect ESG to be the default for investors and asset owners globally..."

04

How easily can fiduciary managers identify, measure and report on ESG factors?

In summary: The availability and quality of ESG-related data is a challenge to every investment firm. But the situation is improving and fiduciary managers are developing their capabilities, even if there is no consensus on 'best practice'. The sector is gaining confidence in its ability to help clients identify useful signals from ESG data.

Like many organisations, fiduciary managers find it hard to consistently quantify ESG-related data. Respondents welcome industry initiatives designed to enhance reporting standards, even if "this continues to be a work in progress". Firms view the greatest challenges as:

- The lack of definitive ESG terminology and taxonomy.
- The inconsistency of investment level disclosure and reporting – such as on carbon emissions.
- The inconsistency of manager level disclosure and reporting – such as on resources and methods.
- The difficulty of incorporating ESG factors into existing analytical and valuation models.

Frustrations are particularly acute when dealing with third party asset managers. "Data interpretation can be a challenge at times, as each firm represents information in unique ways" was a typical comment. Most firms would like to see more consistent and detailed reporting from external managers (see Section Six).

In response to these challenges, fiduciary managers are developing their internal and external ESG data resources. All appear to make some use of third party ESG ratings of companies and funds, such as those produced by Sustainalytics or MSCI (RI). However, a few cautioned against over-reliance on any single set of ratings.

A majority of managers also use a combination of external ratings and 'raw' corporate data as the basis for further, proprietary analysis. Dedicated teams of ESG specialists often generate their own in-house rankings, but processes vary significantly.

For example:

- Some firms integrate their ESG specialists into portfolio management teams, while others provide a separate 'overlay' across all asset classes.
- Some apply internal rankings at manager level, others at fund level, and others at entity level.
- Some set minimum ESG targets for all their investments; others 'weight' their portfolios towards higher ESG-rated stocks; while others exclude those that score poorly on ESG.
- Some avoid quantitative rankings entirely, preferring to apply ESG considerations qualitatively.

The good news is that fiduciary managers see the limitations of ESG-related data – though still significant – as reducing. Industry standards are evolving fast and several managers are optimistic about the potential impact of working groups such as the Taskforce on Climate-related Financial Disclosure (TCFD).

It is also encouraging that many managers do not see the lack of 'perfect data' as a reason to ignore ESG altogether. In one large firm's view "the majority of these challenges have been overcome, or are settled to a sufficient degree to allow action. Indeed we see an early mover advantage in some of those instances." It seems that growing numbers of fiduciary managers feel they can help investors to make sense of the ESG jungle.

05

How do Fiduciary Managers implement ESG Investing?

In summary: When it comes to ESG implementation, there are significant variations between different firms' approaches. Many talk about integration, but in reality that remains a goal for the future. The wide range of approaches implies that investors should seek firms with views that align with their own needs or beliefs.

Most fiduciary managers say they pursue an 'integrated' approach to implementing ESG, but few define this in detail. In reality, there are as many approaches to implementation as there are firms. Our research suggests that ESG implementation choices are often shaped by:

- **Ownership models** – whether the firm is independent or owned by a consulting, banking or asset management parent.
- **Business models** – whether portfolio management is conducted in house, by one external manager, on a multi-manager basis or via a combination of approaches.
- **Legacy models** – whether the firm has developed ESG capabilities organically, or by acquiring and integrating specialised ESG advisors.

We see five key variations in the way that different fiduciary managers implement ESG investing.

1. Investment stages

A minority of fiduciary managers include ESG considerations at a high level, via portfolio construction and strategic asset allocation. For example, one firm analyses climate change as a portfolio level risk, and plans to incorporate other systemic factors such as involuntary migration into its asset allocation process. However, the challenges of this approach mean that most firms prefer to implement ESG factors at manager or fund level.

2. Asset classes

All fiduciary managers say that they seek to implement ESG factors across asset classes. Even so, their detailed responses show that many are still in the process of building out their cross-asset capabilities.

Unsurprisingly, **public equities** received more discussion than any other asset class. In part this is due to the wide range of ESG factors that can impact listed equities. But it also reflects the overlap between the 'governance' element of ESG and the importance asset managers attach to 'active ownership' – engaging with company management, using voting rights and collaborating with other investors.

In contrast, several managers highlighted **fixed income** as a challenging area for ESG. Some emphasised the differences in the applicability of ESG between, say, green bonds and sovereign bonds.

Opinions also vary over the value of ESG factors when investing in corporate debt. "Whilst much ESG practice in the industry focuses on equities we have put equal focus on fixed income" said one, but others questioned the value of ESG for short maturing bonds.

Turning to **alternatives**, the picture is even more mixed. Hedge funds are seen as particularly challenging. "Once derivatives are introduced, the investment rationale and [responsible investment] imperative becomes blurred," commented one firm. However, other firms highlighted the relative ease of applying ESG factors to private investments and real assets, especially where a general partner has significant control and close involvement in day to day management.

In short, fiduciary manager seem to be struggling to reconcile investors' desire for cross-asset consistency with the benefits of a more tailored, asset-specific approach.

3. ESG factors

Few fiduciary managers make formal distinctions between different ESG factors — or the various sub-factors that make them up (see Figure 4). But their comments suggest that the priority applied to different factors can vary significantly in practice.

Figure 4: ESG factors and selected sub-factors

Environmental	Social	Governance
Climate change and carbon emissions	Labour relations	Board diversity
Energy efficiency	Diversity agenda	Auditor independence
Pollution	Employee safety	Corruption and bribery
Use of natural resources	Product safety	Anti-money laundering
Waste management	Human rights	Business ethics
Clean energy and technologies	Child labour	Cartels and price fixing
Biodiversity	Working conditions	Compensation policies

Taken together, the most important drivers of this variation seem to be:

- **Equity bias.** As already mentioned, the 'stewardship agenda' within active asset management can lead to a particular focus on governance factors, especially for listed equities.
- **'G' force.** Some firms see sound corporate governance as an indicator of lower environmental and social risks. "To a large degree, the 'E' and 'S' in ESG are contingent on the 'G'," said one.
- **Client preferences.** Whatever fiduciary managers' own views on ESG, the priorities of individual asset owners can inevitably affect the emphasis applied to different factors.
- **The availability of data**. Despite their increasing power to damage corporate value, some ESG risks — especially those that fall under the 'Social' heading — remain very hard to assess.
- **Investment trends.** Media attention on specific issues — such as climate change or plastic pollution — can lead to shifts in the emphasis that investors place on individual ESG factors.

4. Execution methods

When it comes to executing ESG investing in-house, it was notable that several firms seem to combine technical approaches to execution — such as divestment or tilting — with philosophical approaches such as impact investing. The following responses provide a flavour of this:

- "Broadly speaking, there are three methods of ESG investing: Screening for inclusion or exclusion, shareholder activism, and community building."
- "[Our firm] considers responsible investing to be comprised of four specific sub-categories…. Socially responsible investing, impact investing, ESG and mission-related investing."
- "Our responsible investing activities fall under the following four categories: ESG integration; exclusion; active ownership; and positive impact."

Only one fiduciary manager seems to draw a clear and explicit distinction between investment techniques that seek market rates of return and 'concessionary' approaches that accept lower returns. This firm included alignment, integration and thematic investing in the first category and philanthropy in the second, with impact investing spanning both categories.

One strategy — exclusions — generated more comment than any other. Exclusions can be simple and easy to implement client preferences. But they are a blunt tool.

Some ESG factors (such as tobacco litigation) are easier to exclude than others (such as carbon emissions), and totally excluding a sector limits diversification. One firm that prefers 'tilting' to exclusions said: "the integration of ESG-related criteria… is not intended to result in any negative or exclusion lists. Rather it aims to enhance our ability to discern between likely out and under performers within each sector."

5. Performance assessments

Measuring the effectiveness of implementation is vital to effective ESG investing. But the lack of robust methodologies for quantifying ESG-driven over- or under-performance means that most fiduciary managers struggle to perform portfolio-level assessments. The varying degree of ESG customisation demanded by different clients also makes comparisons difficult.

In contrast, questions on qualitative measures of effectiveness generated a wider range of responses. Some firms had little to say in this area, but others identified a number of possibilities including:

- **Tracking engagement.** A number of fiduciary managers gauge their ESG effectiveness by tracking the impact of investee engagement. This typically involves keeping a record of specific interactions, and logging ESG-related changes that result as 'engagement milestones'. A few have created impact-specific metrics: "We jointly agree with managers on a core set of quantitative impact metrics that the manager will track and report on an annual basis," explained one firm.
- **External recognition**. "We judge [effectiveness] by external recognition, and by feedback from clients," said one firm that had been awarded an 'A+' grading by the United Nations' Principles of Responsible Investment (UN PRI). Another firm cited industry awards, such as the Independent Research in Responsible Investment survey, as a measure of their ESG effectiveness.
- **Memberships and associations.** A number of firms cited their commitment to the UN PRI, or their involvement in ESG-related industry bodies such as the Global Carbon Disclosure Project, as an external indicator of their commitment to ESG investing.

To conclude Section Five, it is clear that fiduciary managers take a wide range of approaches to when, where and how they seek to implement ESG investing. No single firm stands out as representing 'best practice', but some clearly have further to travel than others. Given these variations, and ongoing developments in ESG data and analysis, it may be more helpful to view 'full ESG integration' as a journey rather than a destination. There a range of methods in which ESG can be adopted by a pension fund, and a key element as discussed earlier is the ability to have clear objectives and beliefs on ESG.

06

What is the scope for collaboration in ESG Investing?

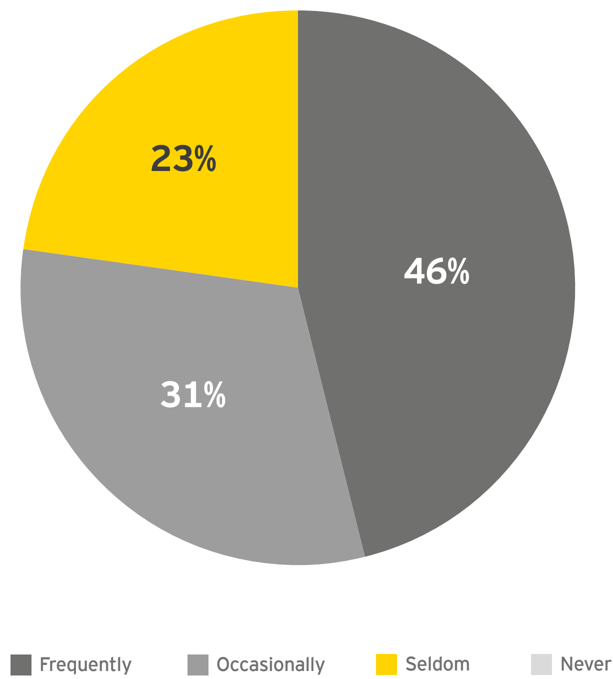
In summary: Collaboration is vital to fiduciary managers' ability to understand and implement clients' wishes. Apart from client co-operation, engagement with external asset managers is evolving fast as both sectors develop their capabilities. Cross-industry knowledge sharing is also seen as a valuable activity.

In EY's view, implementing ESG investing effectively requires ESG factors to be considered at every stage in the value chain. That includes formulating investment beliefs and principles; setting investment guidelines; constructing portfolios; allocating assets; selecting managers; reporting to stakeholders; and obtaining assurance over processes and controls.

It follows that, as discussed in Section One, close collaboration between fiduciary managers and asset owners is essential to maintaining clarity over the responsibilities for every stage.

EY research also shows that third party asset managers play a vital role in helping fiduciary managers to implement asset owners' ESG investment goals. The bulk of firms make some use of external managers, even if that may be limited to specific strategies or assets. Almost all our sample (92%) said they include ESG considerations in performance review meetings with external managers, and almost half (46%) said that the ability to integrate ESG into investment decisions has frequently played a pivotal role in their manager selections within the last year (see Figure 5).

Figure 5: In the past year, how often has ESG integration played a pivotal role in manager selection?



Looking ahead, the majority of fiduciary managers want to see third party asset managers enhance the ESG-related services they provide. Firms' most commonly expressed hope is for more detailed and consistent reporting. One fiduciary manager's wish list for enhanced reporting ran: "ESG objectives linked to investment strategy; investment restrictions and any controversial investment decisions; ESG incorporation objectives; ESG portfolio characteristics; and information on any ESG incidents." Another simply requested "less marketing fluff".

Some of fiduciary managers' other requests of third party asset managers are:

- For a wider range of innovative ESG-focused products.
- For ESG-focused funds not to be priced at a premium to other funds.
- For external managers to use their proxy votes more often, even in passive holdings.
- For more firms to adopt common ESG-related standards, like UNPRI.
- For asset managers to actively pursue ESG-related goals such as staff diversity and inclusion.

It's not all one-way traffic. Several fiduciary managers say they work closely with external managers, including alternatives providers, to develop new ESG-related offerings. One stated that "we have the scale to work with managers to facilitate the creation of new strategies filling in gaps in the ESG space. Our clients have therefore seeded numerous new ESG strategies across asset classes, including in hedge funds where the opportunity set has been more limited."

Looking further afield, the value of industry co-operation emerged strongly from many firms' responses. Possible examples of collaboration and knowledge-sharing range from joining industry bodies such as the Investor Group on Climate Change, to engaging with fund sponsors, to co-operating with data providers. Commenting on its expectations for top-rated asset managers, one firm said that "we would like to see further industry collaboration on the topic to help drive forward better client solutions and market awareness."

An example is the Embankment Project for Inclusive Capitalism (EPIC), which has identified value drivers important for sustainable and inclusive growth, as well as potential metrics to assess them. The report, released in November 2018, is the result of a multi-stakeholder effort and includes contributions from more than 30 global business leaders.

Created by the Coalition for Inclusive Capitalism and EY, this project has brought together a collection of participants with both market strength and diversity across the entire investment chain, representing US$30 trillion of assets under management and almost 2 million employees around the world. The project has focused on finding a measurable, comparable and meaningful way for companies to better articulate how value is created for material stakeholders such as employees, society, business and investors.

Conclusion

EY research shows significant consensus over ESG investing among fiduciary managers.

- One shared view is that the arguments in favour of implementing ESG investing are becoming too powerful to ignore.
- Another is that trustees are increasingly focused on ESG and fiduciary managers' ESG capabilities.
- A third is that the quality of ESG-related data and analysis poses a significant, if decreasing, challenge to success.

In contrast, the findings show that different fiduciary managers are taking very different approaches to addressing the growing demand for ESG investing — and the challenges it presents. Practices and processes vary in a number of key areas, especially when it comes to analysis and implementation.

For asset owners, this range of approaches could make it hard to compare the offerings of different fiduciary managers. On the upside, variety could be seen as the sign of a vibrant sector. It might also give asset owners more choice when it comes to selecting a fiduciary manager well aligned with their own philosophies. In EY's experience, pension fund trustees that have articulated ESG requirements clearly have been more successful in identifying the most appropriate fiduciary manager for them.

Looking ahead, we see a number of positive indicators emerging from the research. One is that fiduciary managers are increasingly able to help asset owners of all sizes implement ESG investing. Another is that every firm, in its own way, is continuing to develop its ESG capabilities. Trustees have more assistance available now than ever before in determining their ESG requirements and influencing the ESG agenda further in line with their own beliefs.

We also detect a strong commitment to co-operation and collaboration. That includes an appreciation of the importance of close communication with clients; of the value of client education; of the need to work closely with external managers; and of the importance of cross-industry co-operation and knowledge sharing.

All in all, the research suggests that no UK asset owner should feel unable to implement ESG investing, or should fear that doing so will compromise their ultimate investment goals. As one fiduciary manager put it, "we believe investors do not need to adjust their financial goals to align their investment strategy with purpose." If true, that is something that will ultimately benefit us all.

How mature is your ESG investing strategy?

Understanding your portfolio from an ESG perspective can play a big part in deciding what you do next.

Increasing regulation, market development and trends, as well as increased demand for ESG accountability (including assurance of this information) requires organisations to understand their ESG performance and maturity. Being clear on meeting compliance and assurance standards from a regulatory, reporting and procedures perspective can be a difficult task. EY ESG Maturity Scanner provides investors with insight, scores, benefits and follow up actions on their ESG framework compared to their peers and upcoming regulation. The ESG Maturity scan has 4 phases:

- Intake and tailoring of the scan.
- Interviews and research.
- Spider reporting of results and benchmarking.
- Action and benefit plan.

Can you measure the long-term value of your organisation?
The value of an organisation is no longer just measured by its tangible assets. The market value of intangible assets has rocketed from 17% in 1975 to over 85% in 2015. Trust in businesses has gone down by two per cent from 2015 to 43% in 2018.

The explosion in data creates enormous revenue opportunities. At the same time, companies who are unable to take a longer-term approach have forgone US$1tn of unlocked value over the last decade.

Contact

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Appendix

The research

EY sent a detailed questionnaire to UK fiduciary managers representing over 95% of the UK fiduciary management industry by assets under management. All the managers provided details written responses. We also held selected follow-up phone conversations with some respondents to help us clarify their views. We are very grateful to all those who participated for their time, effort and expertise.

Glossary of ESG terminology

In this paper EY use the term ‘ESG’ (environmental, social and governance) to refer to a set of investment factors, and the term ‘ESG investing’ to mean incorporating those factors into investment decisions alongside traditional financial analysis.

Unless otherwise stated, we do not believe ESG investing involves accepting ‘sub-market’ levels of risk and return. The EY team therefore views ESG investing as distinct from charitable or issue-driven concepts such as ‘impact investing’ or ‘ethical investing’, which may prioritise non-financial aims over financial performance.

In our view, ‘ESG investing’ can be used interchangeably with ‘sustainable investing’ or ‘responsible investing’ in most contexts.

There is no definitive taxonomy of what constitute ESG factors or ESG investing, but the UN’s PRI initiative provides a good introduction: https://www.unpri.org/esg-issues

Further reading

In this paper does not attempt to re-hash well-worn arguments over the potential benefits of ESG investing. In essence, we believe the evidence in favour is strong, and that the evidence against is unconvincing.

For those that wish to read further on this topic, recent EY publications on this subject include:

- How do you create a positive impact whilst delivering greater returns?
- Climate risk barometer
- Does your nonfinancial reporting tell your value creation story?
- UK financial services survey on going paperless and digital adoption.
- Investing in a sustainable tomorrow – ESG integration in European pensions.
- Climate change – the investment perspective.

The EY team also draws readers’ attention to a few notable recent pieces of academic and commercial research, including:

- From the Stockholder to the Stakeholder, Smith School of Enterprise and the Environment, University of Oxford; Arabesque Asset Management, 2014.
- ESG and financial performance: aggregated evidence from more than 2,000 empirical studies, Deutsche Asset & Wealth Management Investment; School of Business, Economics and Social Science, University of Hamburg, 2015.
- Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies, Morgan Stanley Institute for Sustainable Investing, 2015.
- ESG Ratings and Performance of Corporate Bonds, Barclays, 2016.

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