UPDATE

The power of investors to evoke meaningful change in the ESG movement

Update prepared by Felicia de Laat and Charlotte Bascombe (Jersey)

Asset management is ultimately about creating wealth for investors, which might seem diametrically opposed to the challenge of addressing environmental and social inequality. However, most of today's landowners are, in effect, you and me. By value, most commercial property in the UK is owned by vehicles such as pension funds - not high net worth individuals or aristocrats. With this in mind, do investors wield enough power to give those that manage their funds greater licence to invest in environmental, social and governance (ESG) funds?

History has proven that it is well within the power of investors to drive positive change. There are indeed several historic milestones which are celebrated today. These include the end of South African apartheid in the early 1990s, which is one example whereby investors successfully pressured companies around the world to cut ties with South Africa's apartheid regime.

In a time marked by multiple, interrelated crises, namely the COVID-19 pandemic, environmental challenges, and deepening social inequalities; we are seeing greater focus on ESG activities.

Investors now increasingly recognise that issues such as climate change, human rights abuses and inequitable social structures seriously threaten the long-term performance of economies, investors' portfolios, and the world in which their clients and beneficiaries live.[1] And as a result, many investors are demanding that businesses not only deliver financial performance, but also show how they make a positive contribution to society.[2]

Only earlier this year, BP braced itself for a shareholder revolt at its annual general meeting as some of the UK's biggest pension funds planned to ratchet up the pressure on the company after it rolled back its emission reduction targets.[3] During the Q&A portion of the meeting, the BP board were pressed to answer questions from investors about the company's change in stance towards its ESG strategy. Whilst the resolution to align BP's ESG strategies with the Paris Climate Agreement ultimately failed, investors remain concerned and will continue to engage with BP, outlining their concerns and encouraging them towards sustainable business decisions.[4]

The launch of the United Nations Principles for Responsible Investment (PRI), the world's leading proponent of responsible investment, denoted a visible turning point in the number of sustainable funds available to investors. When PRI launched in 2006, there were 60 sustainable funds available to investors.[5] By the end of 2022, there were estimated to be 7,012 globally.[6] PRI brings together more than 5,300 investors worldwide

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[1] Principles for Responsible Investing, Strategic Plan 2021-24
[2] Larry Fink, Chairman and Chief Executive Officer of Blackrock in his annual letter to CEOs 2018: "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."
[3] "BP facing green rebellion at annual shareholder meeting," theguardian.com: https://www.theguardian.com/business/2023/apr/24/bp-facing-green-rebellion-annual-shareholder-meeting
[4] Katharina Lindmeier, Senior Responsible Investment Manager at pension fund Nest.
[5] "ESG Investing Comes of Age," Morningstar, accessed Apr 20, 2022: https://www.morningstar.com/features/esg-investing-history
[6] Morningstar Direct, manager research data as of December 2022.

[7], who share the common belief that integrating ESG factors into their investment decision-making can reduce risk and increase returns; particularly over the longer term.

Whilst investors have the power to shape society and act as a powerful catalyst for change, they cannot do this alone. Governments need to provide clear pathways and a consistent taxonomy for sustainability policy, regulation, and disclosure across markets.[8] If we take a closer look at the statistics, we can see a concentration of investment in ESG assets, with Europe accounting for 76 per cent of the sustainable funds available to investors.

According to Hortense Bioy, Global Director of Sustainability Research at Morningstar: "The final quarter of 2022 reveals a divided picture. The rebound in global inflows into sustainable funds was driven by Europe where investor appetite remains strong and supported by a favourable regulatory environment. The US ESG fund market, however, faced headwinds: macroeconomic of course, but also political, with prominent politicians speaking and acting against ESG investing."

In a marked difference to the European investment market, the political backlash against ESG investing is having a notable effect on the enthusiasm for green investments in the US. In April this year, the Financial Times reported that funds marketed with a sustainable label were hit with $12.4bn in net outflows in the US. "The absolute politicisation of ESG in the US is a huge driver" of the outflows, said Luke Sussams, ESG Strategist at the US investment bank Jefferies, adding that the risk of repercussions against asset managers seen to be promoting green strategies is "very, very real".

The article goes on to report that even staunch advocates of sustainable finance are thinking the term is almost unusable. The broader trend is that capital for US ESG products has been drying up, which is very different to the trend we are seeing in Europe.

Turning back to the question in hand: do investors wield enough power to evoke meaningful change in the ESG movement?

All indicators should point to a positive answer - there is a proven track record; there is an increasing demand for change; there is a powerful vehicle in the PRI for collective action. However, to evoke real change ESG must be integrated into financial policy and regulation in core markets.

For investors to be at their most powerful, they must direct their voice at policy makers. Investors must leverage the legitimacy and credibility of the PRI to not only engage with policy makers, but communicate their recommendations for policy change where legal barriers prevent them from making sustainable investment decisions.

Without entrenched regulatory policy, even the voice of the loudest investor will struggle to motivate meaningful change.

[7] Principles for Responsible Investing, Signatory Update – January to March 2023.
[8] Larry Fink, Chairman and Chief Executive Officer of Blackrock, Letter to CEOs 2022.

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