Index Industry Association

Measurable Impact: Asset Managers on the Challenges and Opportunities of ESG Investment

IIA 2021 International Survey of Asset Managers

iia index INDUSTRY ASSOCIATION

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Headline Messages

- The IIA's 2021 survey provides a unique insight into the role of the asset management industry in driving ESG investing, based on 300 interviews with chief investment officers, chief financial officers, and portfolio managers in France, Germany, the United Kingdom and the United States. The survey confirms the centrality of ESG to the asset management industry, with 85% of respondents saying ESG is a high priority for their company's overall investment offering or strategy. This finding holds across a broad spectrum of asset classes, fund size, and active versus passive fund types.

- Investors' growing focus on ESG factors is driven by a strong alignment between financial and societal goals—put simply, asset managers see it as good for their clients and good for society. According to our survey, the main factors driving ESG investment are client demand (54%), desire for increased return (44%), portfolio diversification (42%), investment policy (40%), concern for ESG factors (40%), and reputation or regulatory risk (36%).

- ESG now appears to have strong momentum within the asset management industry. Eighty-seven percent of our survey respondents expect ESG to become more important to their company over the next three years, a finding that holds across active and passive funds. On average, the companies we surveyed expect the proportion of ESG assets in their portfolios to climb from 26.7% in 12 months' time to 43.6% in five years' time.

- Asset-management companies across all four countries highlight the critical role of index providers in driving comparability of ESG standards and channelling capital to areas of strong ESG performance. Market indexes rank alongside internal data as the key sources of quantitative data used by asset-management funds to track and measure ESG strategies, used by 55% of companies surveyed. They play a key role in capital allocation decisions, with 80% of respondents agreeing that indexes help direct investment quickly to companies and sectors with strong ESG performance; 78% agree that indexes give them greater confidence in the reliability of ESG data; 75% agree that indexes help them respond quickly and flexibly to new ESG issues and concerns, an important consideration given the tendency of ESG to evolve rapidly in the light of changing societal attitudes and scientific opinion. And indexes are highly trusted to do this job, with 84% saying they trust index providers to push financial services ESG innovation and standards.[1]

- Yet more work remains to be done, and asset managers see some challenges that could stymie their ability to respond effectively to ESG issues and concerns. The main barriers to progress include a lack of ESG data standardization across markets and sectors (89%), insufficient corporate disclosure of ESG data (89%), lack of methodological transparency (88%), lack of regulatory certainty (88%), and the need for acceptance of ESG in more asset classes such as fixed-income (88%). 56% of companies surveyed are finding it difficult to keep up with changing societal expectations around ESG.

- More specifically, there seems to be a significant regulatory disconnect in the four countries surveyed: 65% of US respondents say they are finding it difficult to keep up with new ESG regulations; 73% of respondents in Germany feel that regulators do not pay enough attention to the views of the asset management industry on ESG. Sixty percent of all respondents say that Brexit will make their ESG report responsibilities more difficult.

- Looking ahead, asset-management companies see further ESG regulation on the horizon; 78% say they will need to prepare for further ESG regulation over the next few years, and a similar proportion (74%) say they will need to invest more in their ESG capabilities. Overall, however, the industry favors a market-driven approach to addressing ESG concerns, with 73% agreeing that the market is often better at driving forward ESG than regulators. Within this context, 74% would welcome more help from indexes in improving their ESG capabilities.

[1] 33% a lot, 51% somewhat.

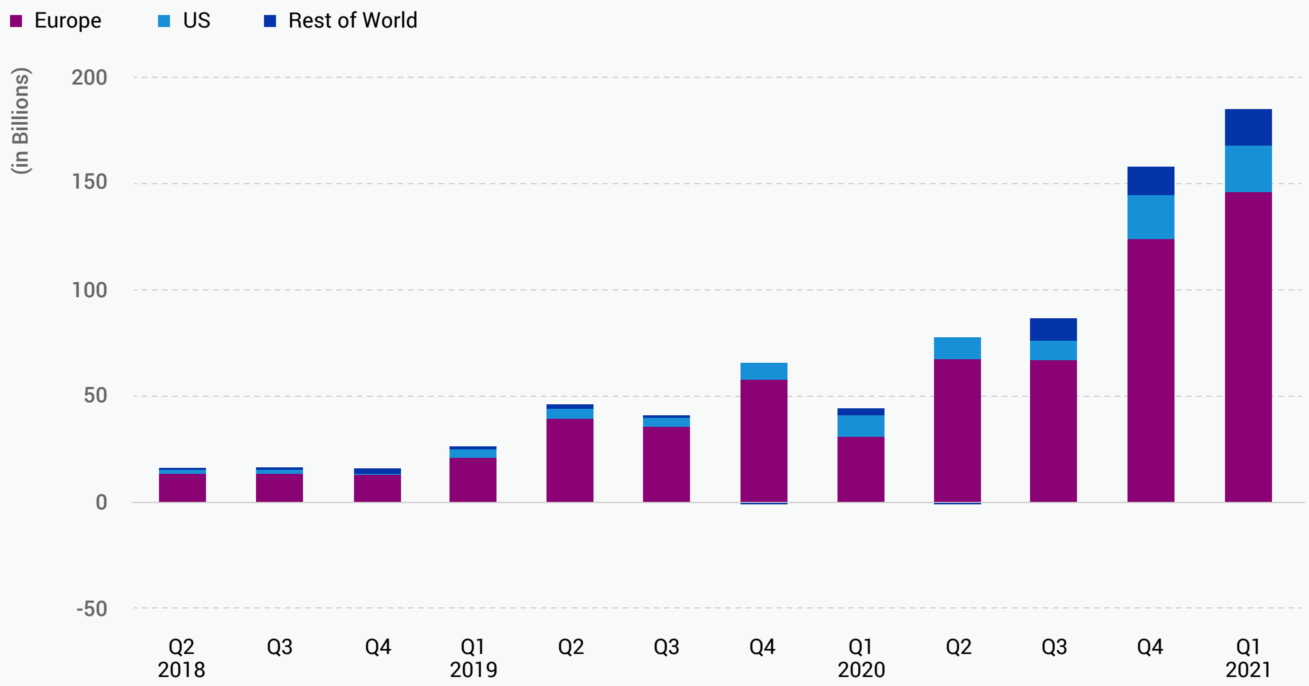
Introduction

The pivot to ESG investing

Environmental, Social and Governance (ESG) investment has witnessed spectacular growth in recent years. According to Morningstar, global inflows into sustainable funds reached an all-time high of just over USD 185 billion in the first quarter of 2021.[2] Europe accounted for the lion's share of these inflows, about 79%. Globally, assets in sustainable funds stood at a record-breaking USD 1.94 trillion in the first quarter of 2021, almost double the value from the same period in 2020.[3]

Figure 1

Quarterly Global Sustainable Fund Flows



Source: Morningstar Direct, Manager Research.

Policymakers in Europe and the US have also become increasingly active on ESG issues. The EU has strengthened ESG reporting for corporates through the Corporate Sustainability Reporting Directive (CSRD) and for asset managers through the Sustainable Finance Disclosure Regulation (SFDR). The EU's €1.8 trillion post-COVID recovery package makes climate change, biodiversity protection, and gender equality a cornerstone of the reconstruction effort within Europe. Similarly, the Biden Administration in the US has signalled a strong commitment to environmental sustainability, re-joining the Paris Climate Agreement and making clean energy and infrastructure a key plank of the broad 'Build Back Better' agenda.[4]

2 Morningstar Direct, Manager Research..

3 Ibid.

4 The White House, 'Build Back Better'.

This year is also likely to see important ESG announcements at the inter-governmental level, notably the 26th Climate Change Conference (COP26) in Glasgow on 1-12 November, and the UN Biodiversity Conference in Kunming, China, scheduled for October 2021.

Given their key roles as influencers of corporate standards and as allocators of capital, ESG funds will be at the heart of this transformation. This report aims to shed light on how asset managers view the changing ESG landscape, the factors driving their decisions, the challenges they face, and the role that market indexes can play in driving more effective and innovative ESG solutions and outcomes.

What is ESG?

The constellation of ESG issues is constantly evolving in the light of shifting societal attitudes and the scientific understanding of risk. In its recent ESG framework, the World Economic Forum identified core and expanded definitions of ESG coverage.[5]

	Core Issues	Expanded Metrics
E	Greenhouse gas (GHG) emissions; land use and ecological sensitivity; water use	Paris-aligned CHG emissions, air pollution, single-use plastics and circular economy (re-use, recycle, extend, sharing) measures
S	Diversity and inclusion (age, gender, race); risk for incidents of child, forced or compulsory labor; health and safety, and training	Human rights, pay gap, living wages and employee well-being.
G	Setting the purpose of the corporation; the composition of the governing body; anti-corruption; identification of material issues affecting stakeholders; ethics advice and reporting mechanisms; and integrating risk and opportunity into business process decisions	Purpose-led management, remuneration; risk and opportunity oversight; and economic, environmental and social topics in capital allocation

[5] World Economic Forum, 22 September 2020. "Measuring stakeholder capitalism: Towards common metrics and consistent reporting of sustainable value creation".

Survey Coverage and Methodology

Getting the views of asset managers

To get a better view of how ESG is changing the asset management landscape, the Index Industry Association commissioned Opinium to carry out a detailed survey of 300 Chief Investment Officers (CIOs), Chief Financial Officers, and portfolio managers in four markets: France, Germany, the UK, and the US. Fieldwork was carried out in March 2021.[16] As can be seen from Figures 2 to 4, the survey sample covers a broad spectrum of fund sizes, types and asset classes.

Figure 2

Distribution of UK respondents by size of AUM (GBP £)

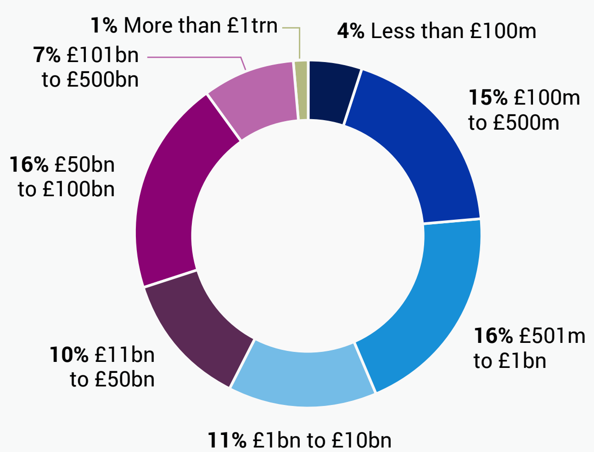


Figure 3

Distribution of US companies by size of AUM (USD $)

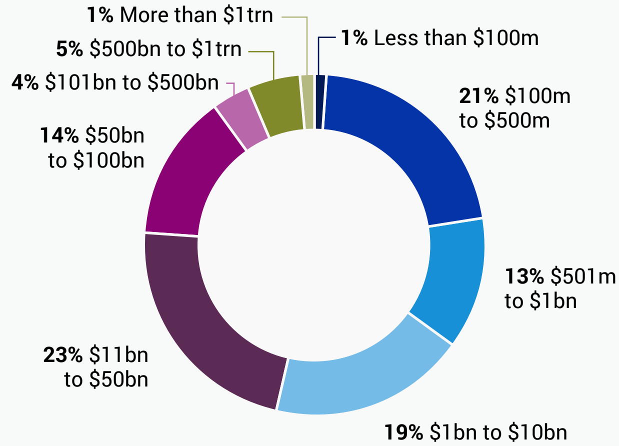
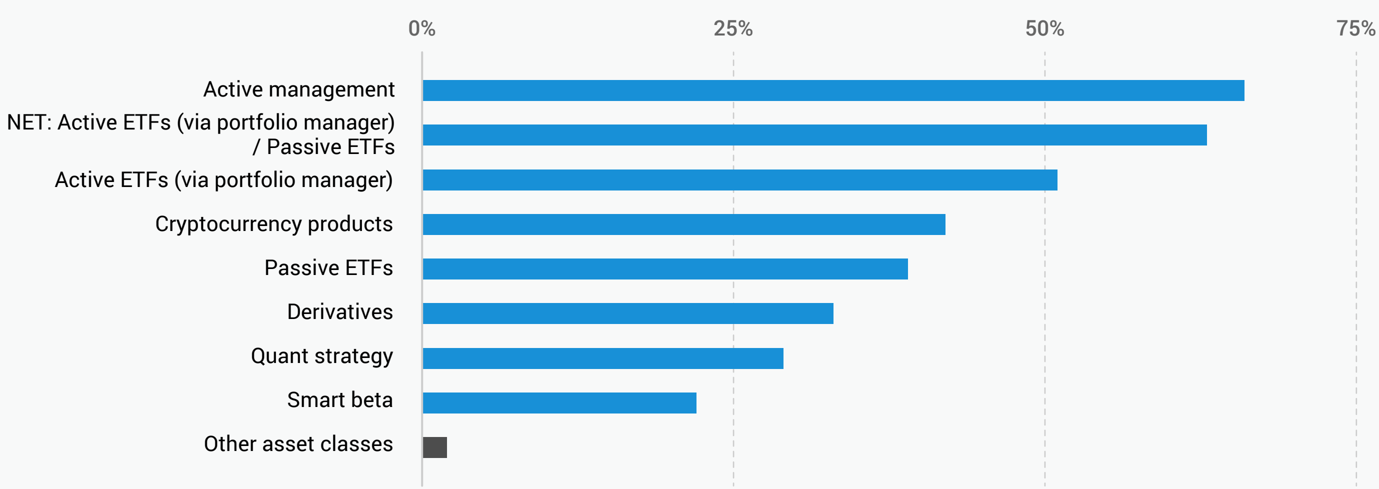


Figure 4

Fund types offered by respondent companies



16 For ease of reference, we will refer to all respondents, regardless of title, as asset or fund managers in reporting the survey results. Where results apply specifically to portfolio managers, this will be indicated.

The Investor Pivot to ESG

ESG investing is increasingly central to asset managers

The 2021 IIA survey confirms the increasing centrality of ESG factors in the asset management sector, with 85% of companies surveyed saying ESG is a high priority for their company's overall investment offering or strategy (Figure 5). Thirty-seven percent say it is a "very high priority", rising to around 50% for respondents in the US and Germany. In terms of respondent role, CIOs and CFOs were somewhat more likely than portfolio managers to assign "very high priority" to ESG factors, although support generally was very high.

Figure 5

Priority of ESG within your company's overall investment offering or strategy

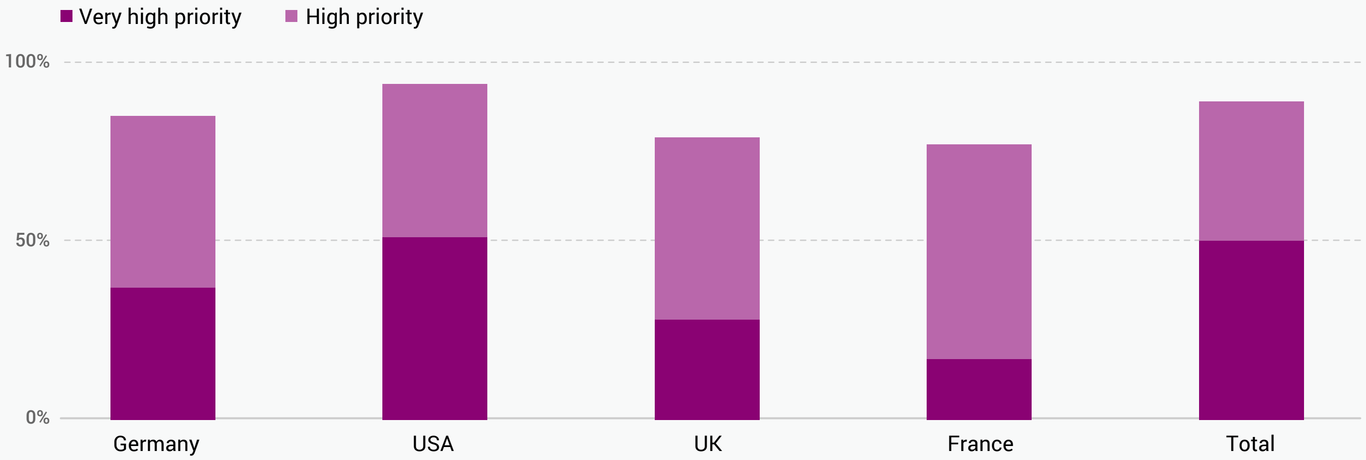
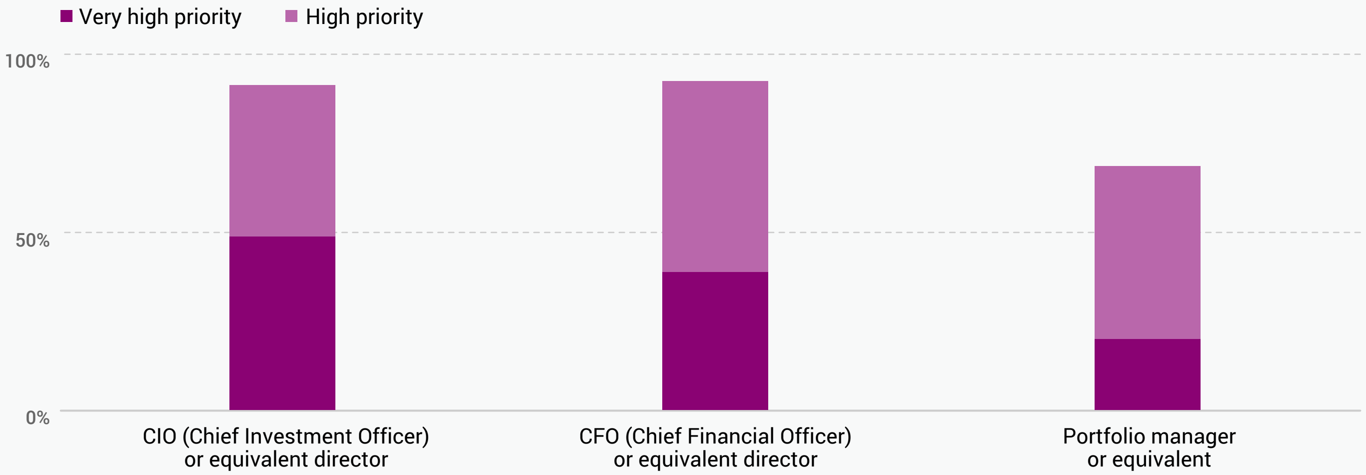


Figure 6

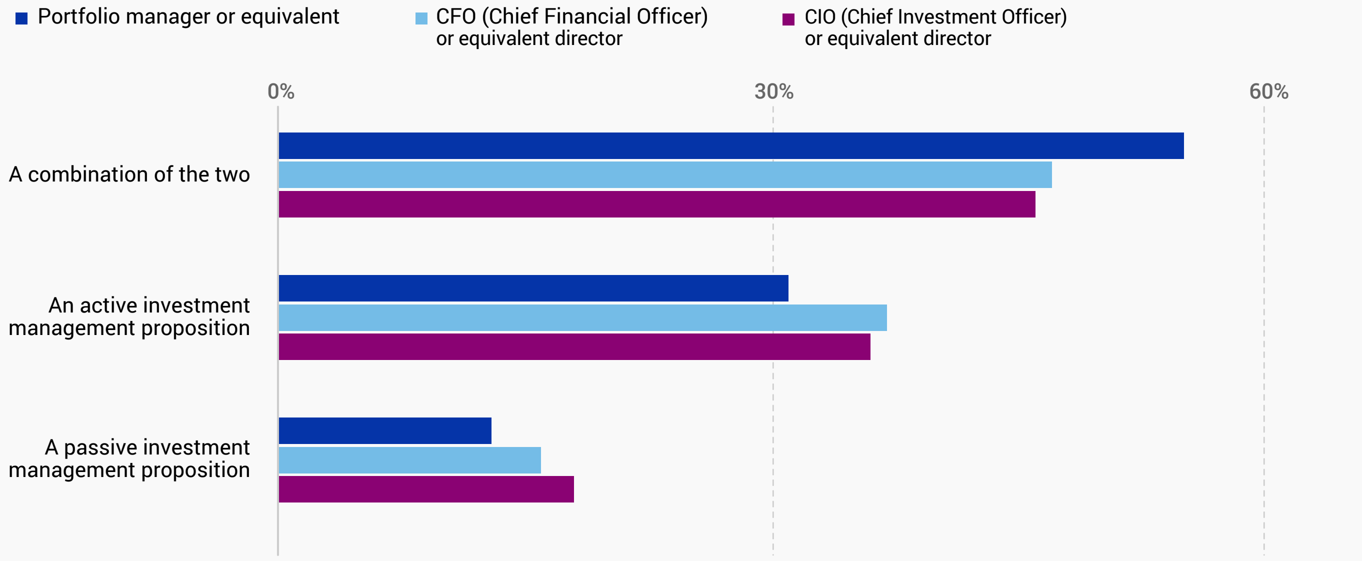
Priority of ESG by respondent role



ESG investing is sometimes thought of as a more active type of investment strategy: funds where investment managers selectively pick stocks and other assets on the basis of ESG factors and other characteristics such as risk and return. However, our survey respondents overwhelmingly see ESG investing as a combination of active and passive investment propositions (49%), highlighting the broad-based appeal of ESG (Figure 7).

Figure 7

Do you believe ESG is an active or passive investment proposition? (by respondent type)



Main factors driving ESG investment

There is now a broad array of evidence showing a positive link between performance on ESG indicators and measures of corporate performance such as profitability, shareholder returns, return on capital and share-price volatility.[17] Various explanations have been advanced for this relationship. Some theories suggest that attention to ESG factors helps firms mitigate future externalities affecting their business—for example, paying attention to water quality or scarcity can help protect a key future resource for food and beverage producers. ESG can also help ward off reputational or regulatory risk, a key factor affecting a firm's cost of capital and ability to secure finance. Other explanations highlight the role of ESG in creating shared value for both shareholders and wider society, for example through creating products and services for lower-income consumers, redesigning supply chains to reduce energy usage and costs, reducing packaging and water use, investing in local producers, and providing health and training for workers.[18] In the words of Michael Porter, the idea is that businesses "do well by doing good". More recently, the concept of the circular economy has provided the underpinning for the E part of ESG: the idea that recycling, re-use, re-design and sharing of products can create savings for producers while delivering important environmental gains.[19]

[17] See, for example, Clark G. et al, 2014. "From the stockholder to the stakeholder: how sustainability can drive financial outperformance".

[18] Porter, M.E and Kramer, M.R, January-February 2011, "Creating Shared Value", Harvard Business Review.

[19] Ellen MacArthur Foundation. "What is a circular economy?"

This interplay between business benefits and societal gain comes across strongly from our survey of asset management companies. As can be seen from Figure 8, the main factors driving adoption of ESG products and strategies by asset-management companies are client demand (54%), followed by desire for increased return (44%), a need for diversification (42%), investment policy (40%), concern about ESG factors (40%), and reputation or regulatory risk (36%). The dual importance of both financial and societal factors in ESG held across all types of funds and asset classes (see Figure 9).

Figure 8

Total factors driving your adoption of ESG products and services

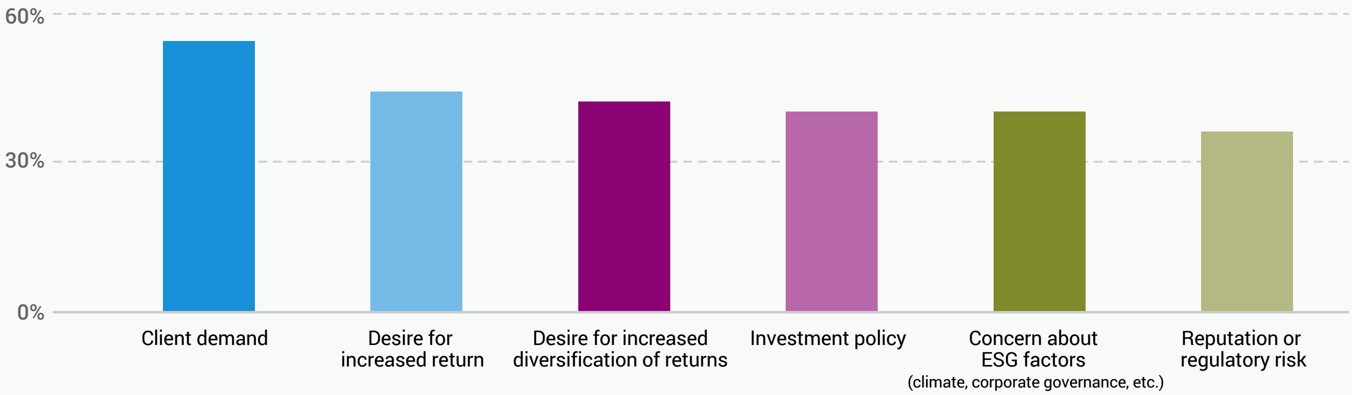
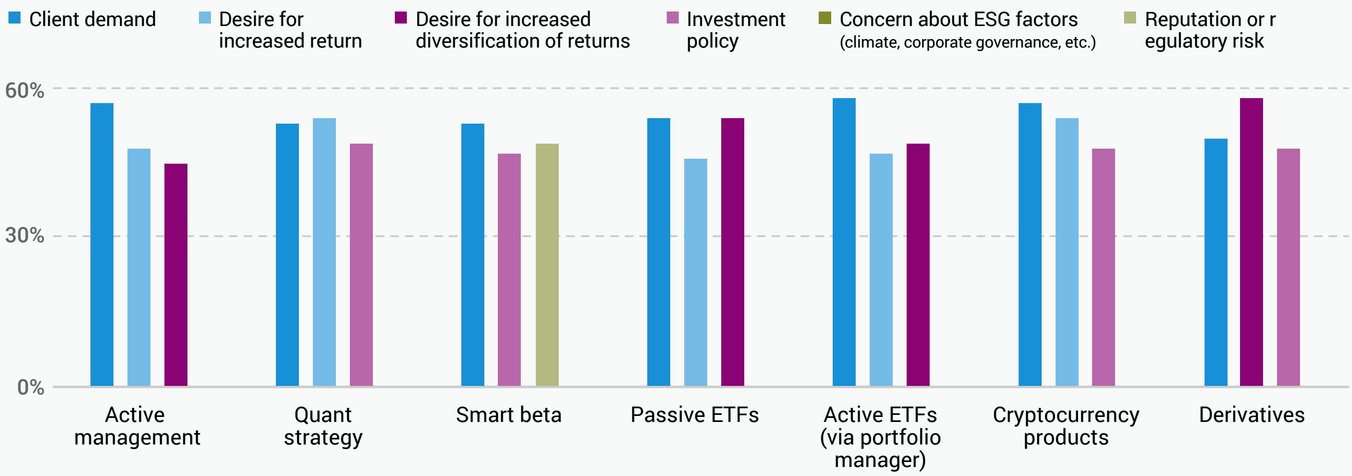


Figure 9

Top 3 factors for each category driving ESG adoption by asset class



Types of ESG investment strategies

Our survey also investigated how fund managers are integrating ESG factors into their capital allocation processes. A variety of approaches to ESG integration are possible. A traditional approach was exclusion—removing or eschewing specific equities or other assets from sectors associated with perceived societal or environmental "bads"—fossil fuels, tobacco, gambling, etc. However, exclusion could drastically undermine the return or risk profile of a fund. More pertinently, it also takes away incentives for the sectors in question to find ways to improve their overall ESG footprint. An alternative is ESG tilting, where fund managers allocate more capital to those stocks or assets with strong ESG performance and relatively less to those with weak ESG performance.[20] This approach preserves incentives for companies to improve their ESG performance—they get more capital and stock-price growth—while ensuring that investors can benefit from a broad portfolio of assets. ESG tilting involves weighting assets in a portfolio by an ESG score, so it requires very comprehensive and up-to-date data on the ESG performance of companies, typically by using index-based tools.

Other approaches are possible, however. These include socially responsible investment, where funds are optimised for dual goals of financial returns and societal investment. Best-in-class approaches aim to maximise investment in companies that are leaders in certain ESG criteria. Other strategies take a thematic approach—a focus on renewable energy, or water infrastructure—or focus on achievement of a particular ESG impact—reducing carbon emissions, for example.

The survey results show that ESG tilting is now the most common method of ESG investing, used by 48% of companies we interviewed (see Figure 10). Socially responsible investing (46%), Best in class (44%), thematic investing (43%) and impact investing (42%) were also widely employed. Traditional negative screening, however, is used only by around a quarter of asset-management companies we surveyed. Figure 11 shows that ESG tilting using indexes is especially important for those companies where ESG is a core part of all of their portfolios (61%) or part of most of their portfolios (44%).

Figure 10

Which of the following does your company use as part of its ESG strategy?

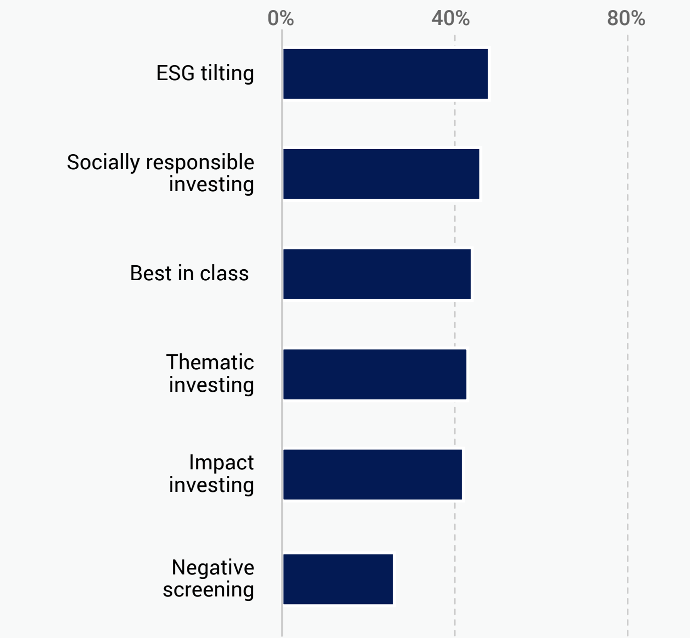
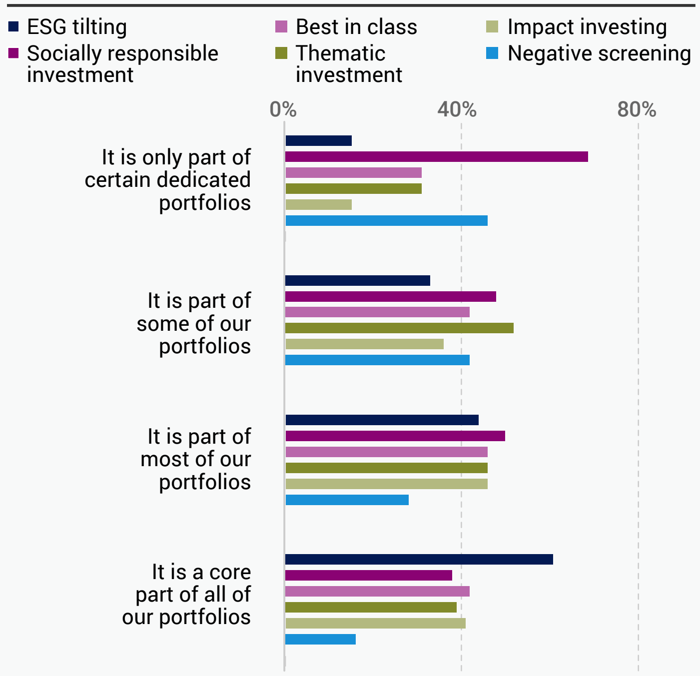


Figure 11

Methods of ESG investing by core or non-core nature of ESG in portfolios



[20] Zaher F, et al., October 2020, 'Index Investing: lifting the lid on ESG integration'.

Challenges of ESG implementation

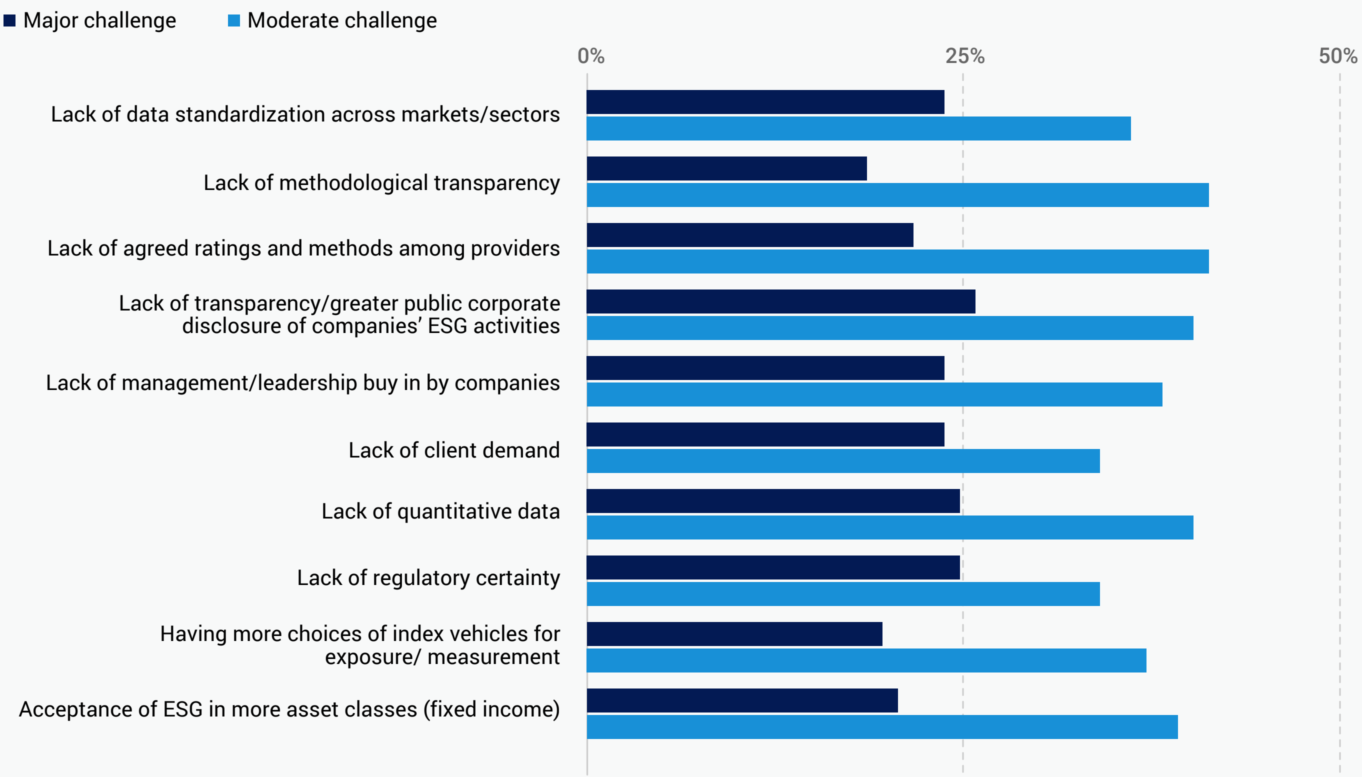
Need for better data and standardization

The IIA 2021 survey shows that one of the biggest challenges confronting ESG investors is data: getting better, more standardised and comparable data on the ESG performance of companies and asset types. There is currently a dizzying array of different ESG reporting organizations and ESG benchmarks at the international level—for example, the UN Principles for Responsible Investment (UNPRI), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), to name but a few. By one estimate there are over one hundred different organizations producing ESG ratings. The result is that companies vary widely in terms of how they choose to report their ESG activities and metrics.

The challenges of comparability came across strongly from the 2021 IIA survey. As shown by Figure 12, 58% of respondents highlight a lack of data as either a major (23%) or moderate (35%) challenge to ESG implementation; while 61% point to the lack of agreement around how to rate ESG performance. Similar proportions of respondents highlight concerns around a lack of transparency around ESG reporting and insufficient public disclosure by companies of their ESG activities.

Figure 12

To what extent are the following aspects a challenge to ESG implementation for fund and asset managers?

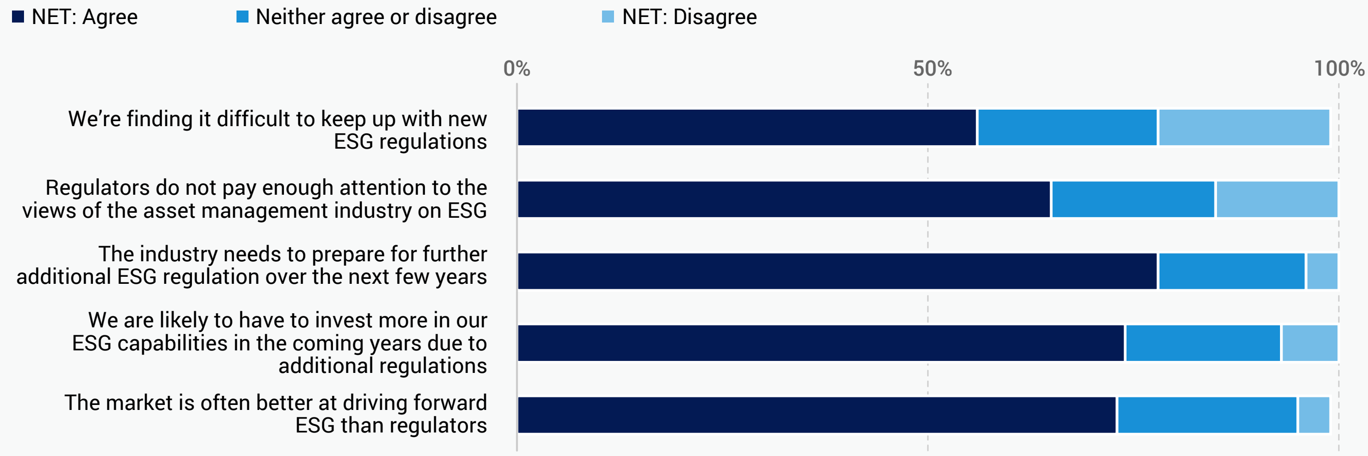


The regulatory disconnect

Fund managers also point to a significant regulatory disconnect hampering innovation in the sector. As noted in the introduction, recent years have witnessed a wave of new ESG regulations, especially at EU level where we have seen new rules such as the Non-Financial Reporting Regulation, the Sustainable Finance Disclosure Regulation, and the EU Taxonomy. Against this background, 56% of respondents say they are finding it difficult to keep up with ESG regulations., while 65% say regulators do not pay enough attention to the views of the asset management industry on ESG issues (Figure 13).

Figure 13

Impact of regulation



Changing societal expectations

ESG itself is a moving target, constantly shifting in the light of changing societal attitudes, technology, and the scientific understanding of risk. Over half (58%) of investment companies we surveyed say they are finding it difficult to keep up with changing societal views and expectations around ESG. (See Figure 14).

Figure 14

We're finding it difficult to keep up with changing societal views and expectations around ESG.

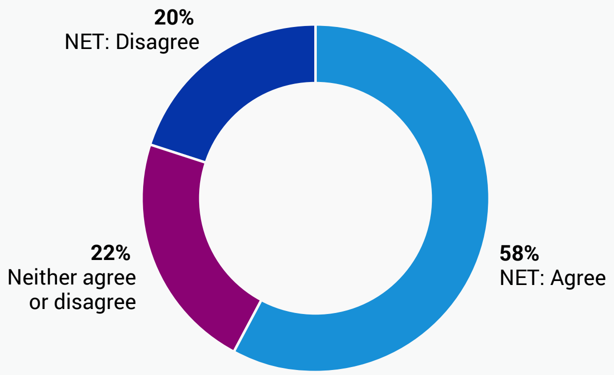
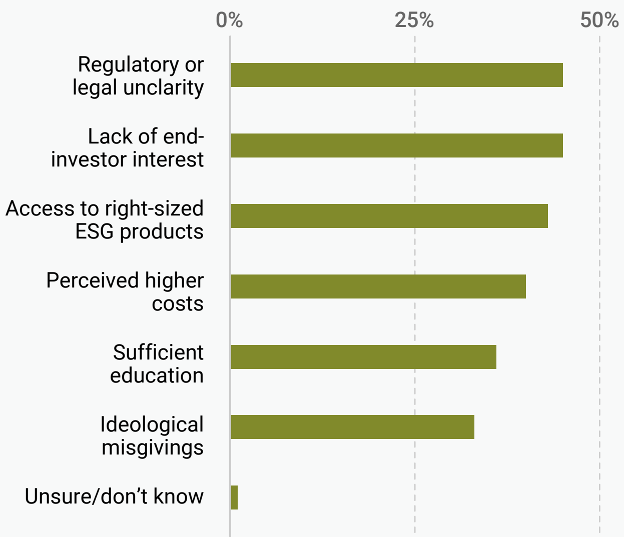


Figure 15

Why does the US appear to be trailing Europe and the UK on ESG investment (US respondents only)?

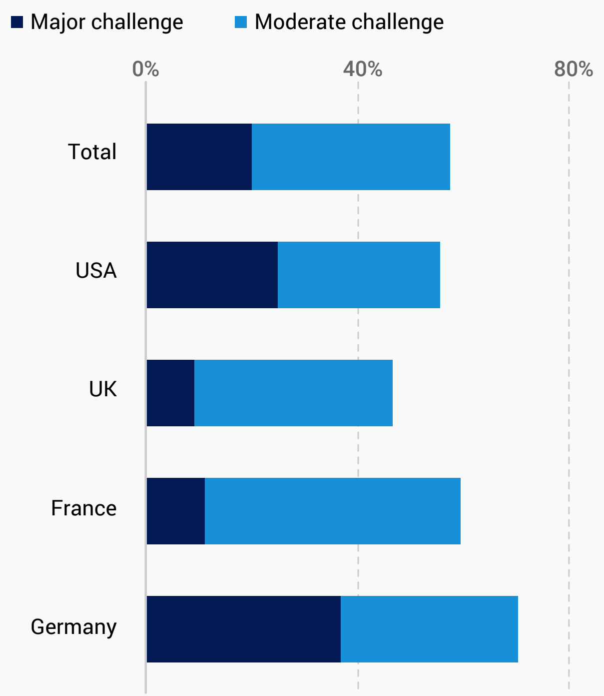


Uneven geographic development of ESG

A third challenge lies in the uneven geographic development of ESG investing. The lion's share of ESG funds (79%) still goes to European portfolios, with the US lagging some way behind with a share of just under 12%.[21] The main factors accounting for this lag, according to US respondents to our survey, were regulatory or legal uncertainty (45%), lack of end-investor interest (45%), access to right-sized ESG products (43%), and perceived higher costs (40%) (see Figure 15).

Figure 16

Extent to which acceptance of ESG in more asset classes is a challenge to ESG implementation



Lack of ESG diversification across asset classes

In terms of asset class, ESG investing is still heavily concentrated in equities. In Europe about 68% of ESG funds went to equities in the last quarter of 2020, with about 18% going to fixed income. For the US, the allocation was even more lopsided, with equities attracting about 90% of sustainable funds flows.[22] According to our survey, 58% of fund managers agree that lack of acceptance of ESG in more asset classes is a challenge to ESG implementation, a proportion that rises to 71% for German fund managers (Figure 16).

[21] Morningstar Manager Research, 28 January 2021, op.cit.

[22] Ibid.

ESG: The role of indexes

To meet the growing demand for increasingly sophisticated ESG investing, asset-management companies need data: Comprehensive, high-quality, up-to date information on a wide variety of ESG characteristics. According to the IIA 2021 survey, the vast majority of asset-management companies, 64%, draw on both quantitative and qualitative sources of data. However, a significant minority, 19%, use only qualitative data; and a similar proportion, 16%, use only quantitative data (See Figure 17)

For qualitative data, companies typically rely on analyst reports (63%), direct engagement with companies (49%), company shareholder reports (45%), external vendors (41%) or regulatory filings (41%). Media coverage is followed to some extent (28%). Just under a quarter of companies reported using non-governmental organizations as a source of data to track ESG strategies (see Figure 18)

Figure 17

Does your company use quantitative or qualitative data to track and monitor ESG strategies?

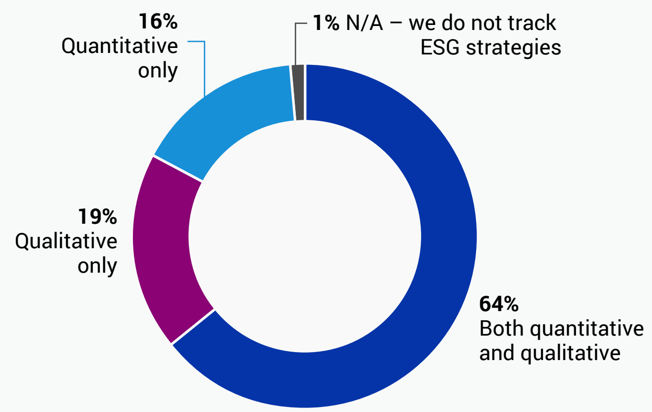
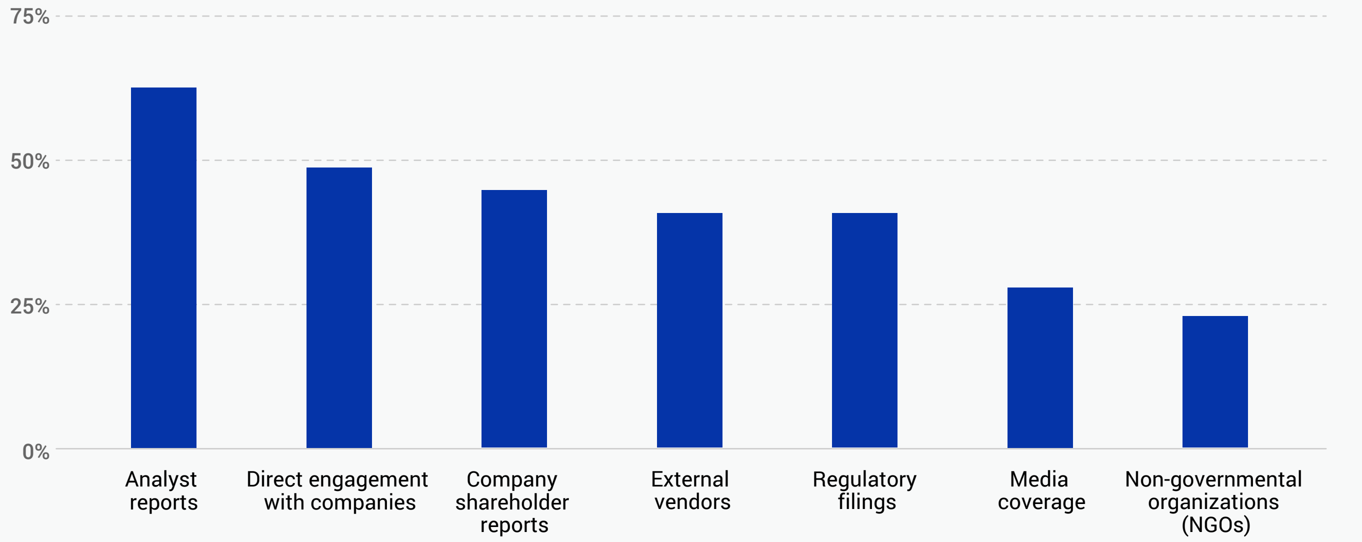


Figure 18

Sources of qualitative data used to track and monitor ESG strategies



For those using quantitative data, over half (55%) use market indexes which track ESG factors; the same proportion use their own internal data and market research. 44% draw on third-party providers of raw ESG data. As can be seen from Figures 19 and 20, the significant role of market indexes holds across different investment strategies—active, passive, quant—as well as geographic markets.

Figure 19

Which of the following sources of quantitative data do you use to track and monitor ESG strategies?

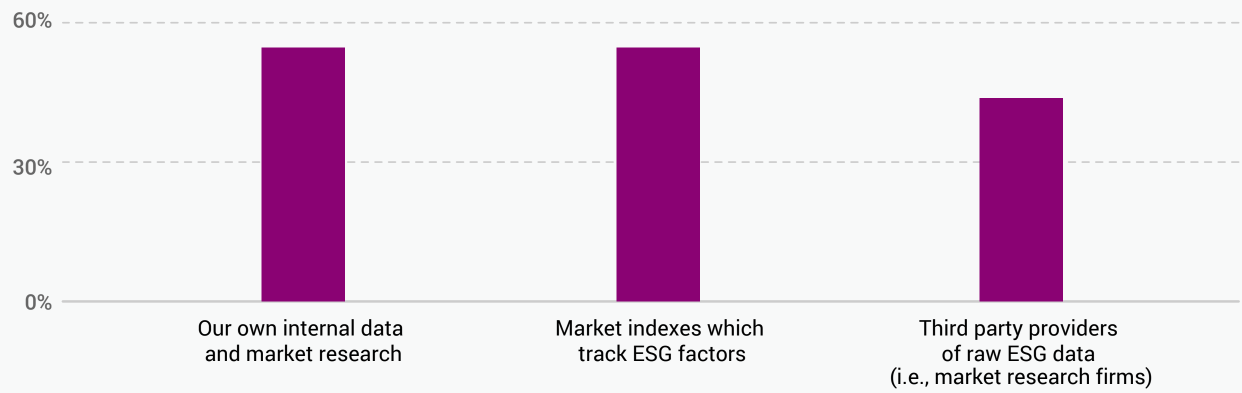
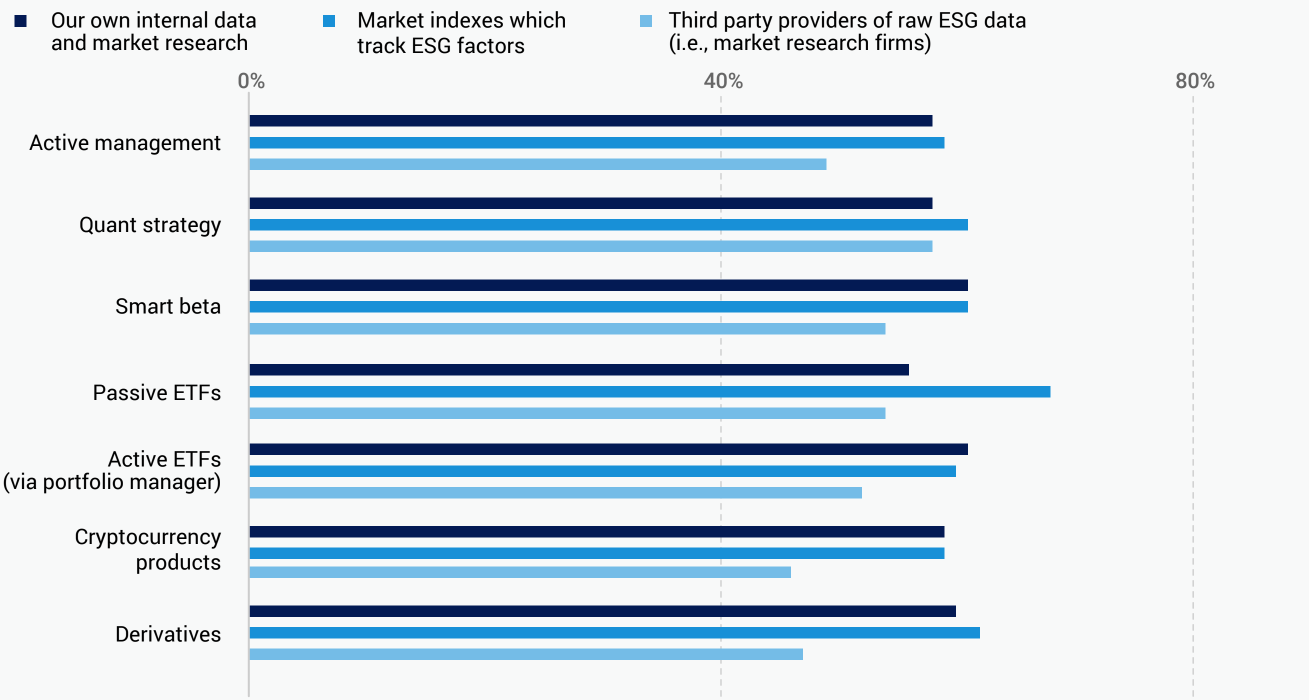


Figure 20

Which of the following sources of quantitative data do you use to track and monitor ESG strategies? (by asset class)



Market indexes are often poorly understood in popular discussion of financial markets. Their core purpose is to reduce the informational haze and complexity in financial markets by measuring and tracking the performance of different asset types over time—equities, bonds, commodities etc. A particular index will track the performance of a basket of assets that share some common characteristic—for example, the FTSE100 or S&P500 which track the largest stocks by market capitalization in the London Stock Exchange or US stock exchanges. When commentators talk about 'how the markets are doing', they are always implicitly referring to the performance shown by one or more indexes. At the most recent estimate in 2020, there were 3.05 million indexes globally, of which 76.6% were equity indexes.[23] Indexes are therefore distinct from the actual funds or asset portfolios managed by investment companies, pension funds and other financial institutions. However, by making decisions around which assets to include as part of a particular basket, market indexes provide important signals to investors around the allocation of capital, and many passive funds will aim to track a particular index such as the S&P500.

ESG-based indexes play a crucial role in ESG investing, as they provide comprehensive data on the ESG characteristics of particular stocks or other assets that may be otherwise hard to obtain or measure. Figure 20 shows that asset-management companies use indexes almost equally for measurement / benchmarking purposes (40%) and for investment strategies (39%). The use of indexes for investment is especially prevalent among funds where ESG is a core part of all of their activities (56%—see Figure 22).

Figure 21

Do you currently use ESG indexes as the basis for investment strategies or for measurement?

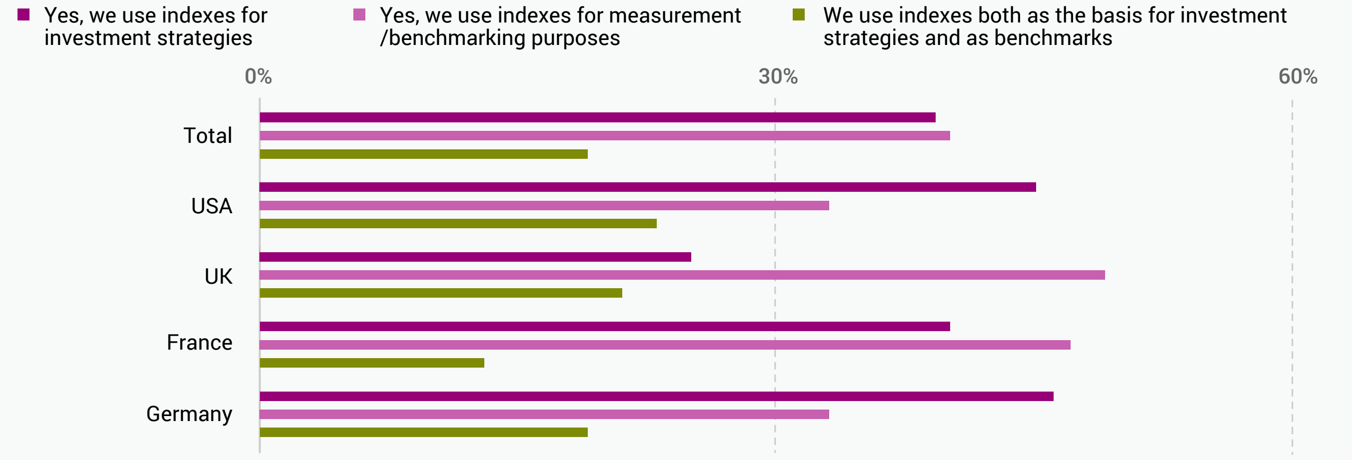
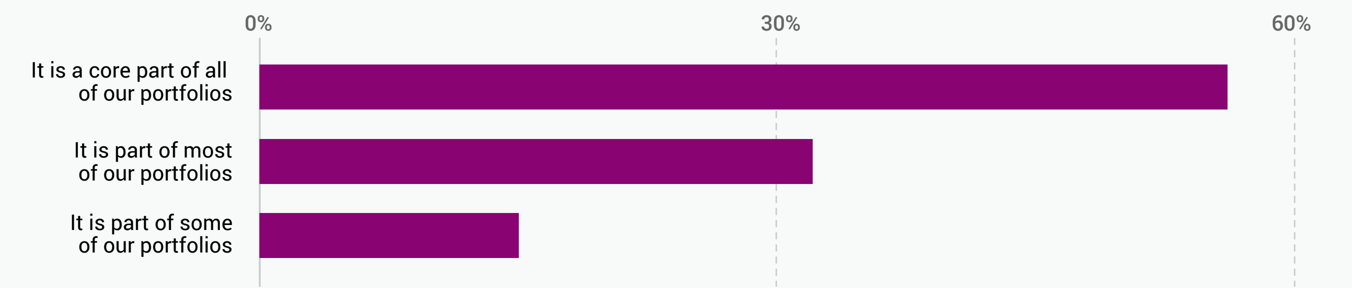


Figure 22

How do you currently use ESG indexes as the basis for investment strategies or for measurement by importance of ESG?



[23] Businesswire, 2017, "Index Industry Association surveys the index universe".

The evidence shows that market indexes are generally highly trusted by asset-managers within the four countries we surveyed: 84% say they trust index providers a lot (33%) or somewhat (51%) to push financial services ESG innovation and standards, just slightly behind the asset-management industry itself (88%) (see Figure 23).

Market indexes play a key role in helping to address these challenges, as can be seen from the data in Figure 24. Eighty percent of respondents agreed that indexes help them direct investment quickly to companies and sectors with strong ESG performance, a key consideration given the ESG investment gap notes above. Seventy-three percent agreed that indexes improve comparability in ESG performance, and 78% agreed that indexes give them greater confidence in the reliability of ESG data. Importantly, given the fast-evolving nature of ESG issues noted above, three quarters agreed that indexes help them respond quickly to new ESG concerns and issues.

Figure 23

To what extent do you trust the following to push financial services ESG innovation and standards?

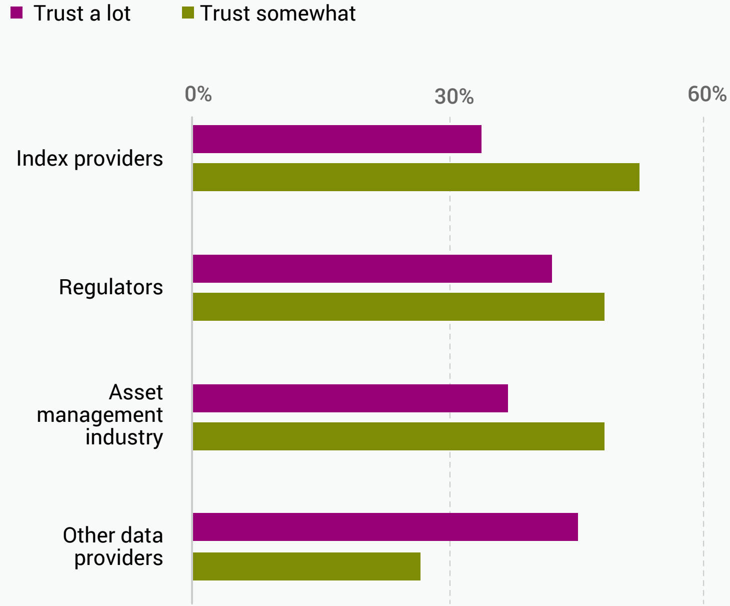
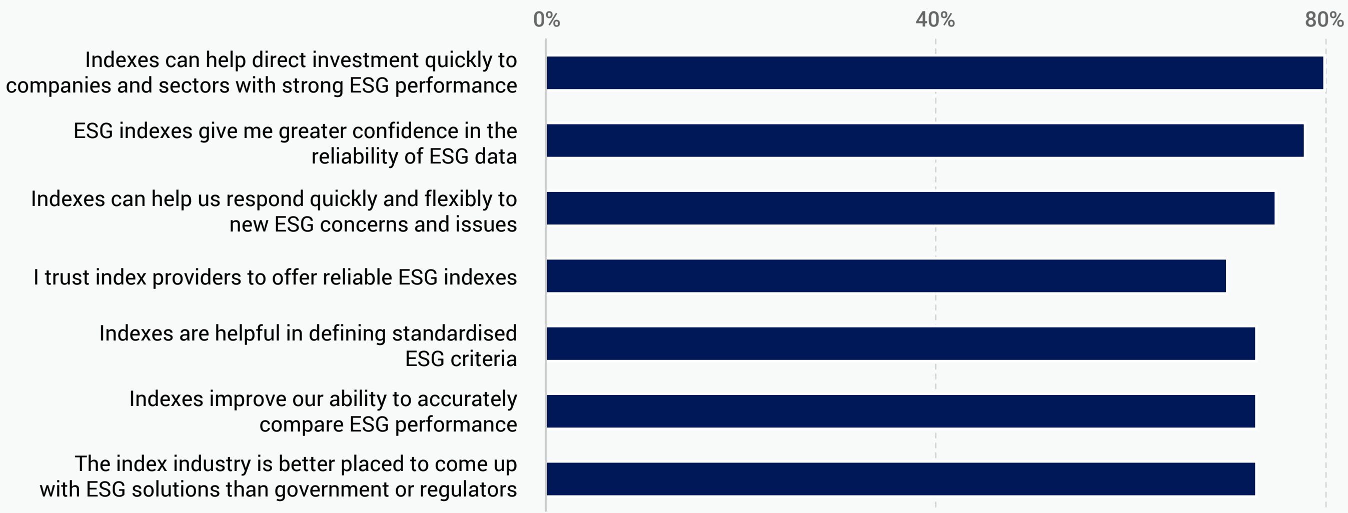


Figure 24

Thinking specifically about ESG indexes, do you agree with the following statements?



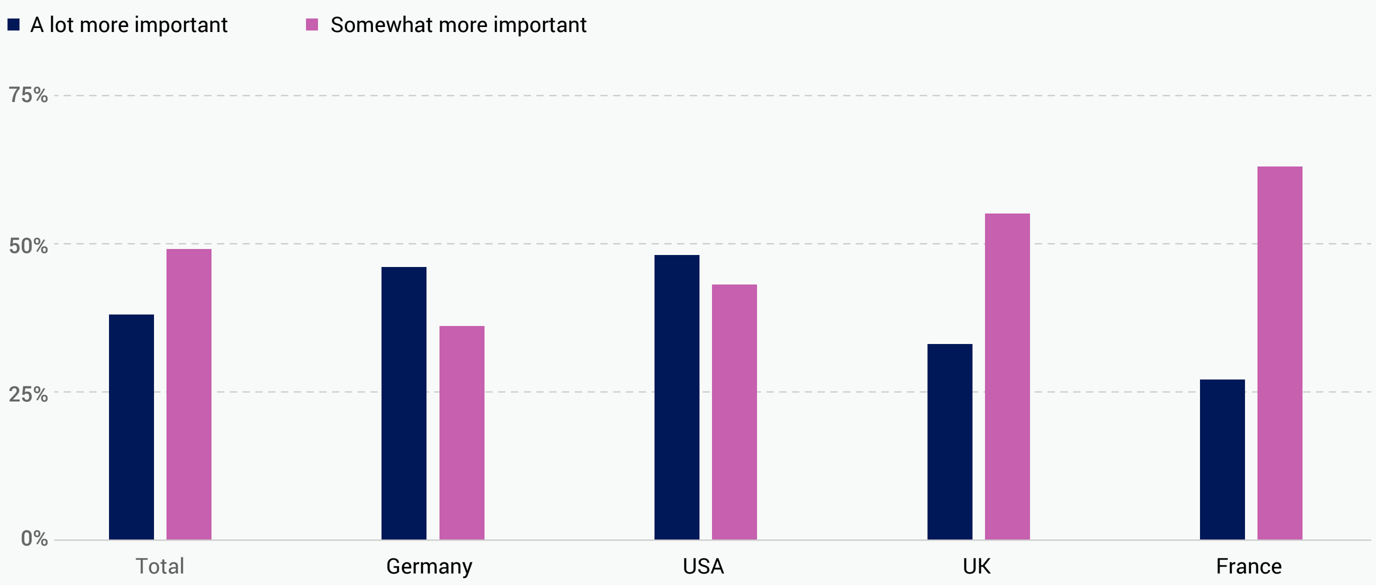
Future development of ESG standards and best practices

How do asset-management companies see the ESG landscape developing over the coming years? Our 2021 survey helps pinpoint some of the key directions of change in ESG investing.

First, ESG seems set to become even more central to the asset-management sector. The overwhelming majority of respondents, 87%, indicated that ESG was going to become a lot more important (38%) or somewhat more important (49%) over the next three years (Figure 25). US respondents (48%) and German respondents (46%) were more likely to say that ESG will become a lot more important in the next three years. This growing importance is mirrored in investment intentions. The asset-management companies we surveyed expect the proportion of ESG elements in their portfolios to climb from an average of 26.7% 12 months from now to 43.6% in 5 years' time. By the end of the decade, the average proportion of ESG elements in fund portfolios is expected to be over half (52.3%).

Figure 25

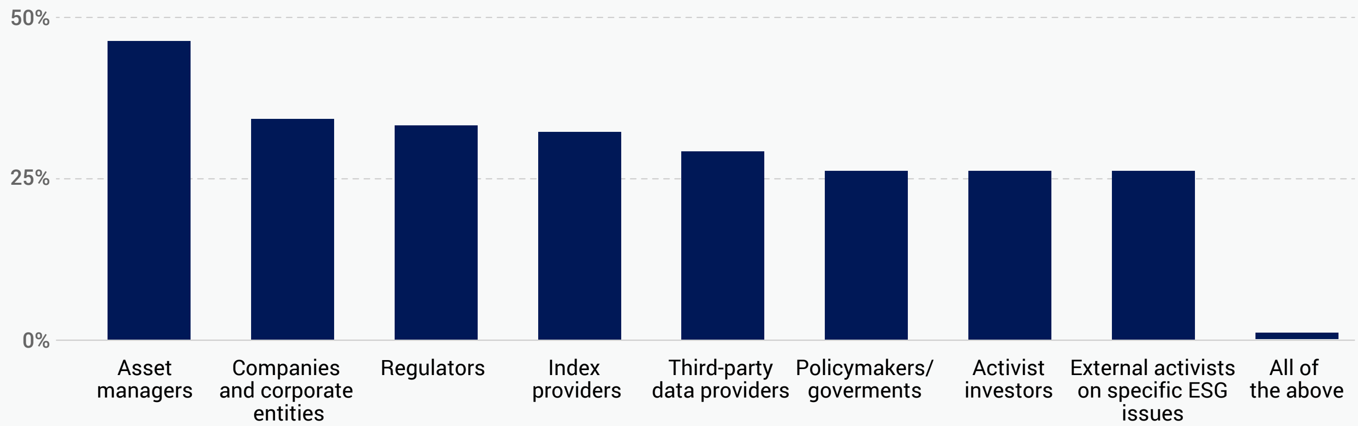
Overall, do you expect ESG to become more or less important to your company over the next three years? (by country)



Second, in terms of the mix between regulation and market-driven approaches to ESG development, asset managers generally favor a market or industry-driven approach (Figure 26). Asked who should have the greatest responsibility for developing ESG standards for the industry, 46% say asset managers, 34% companies, 33% regulators, and 32% index providers. In Germany respondents were more likely to choose index providers (40%) as having the greatest responsibility.

Figure 26

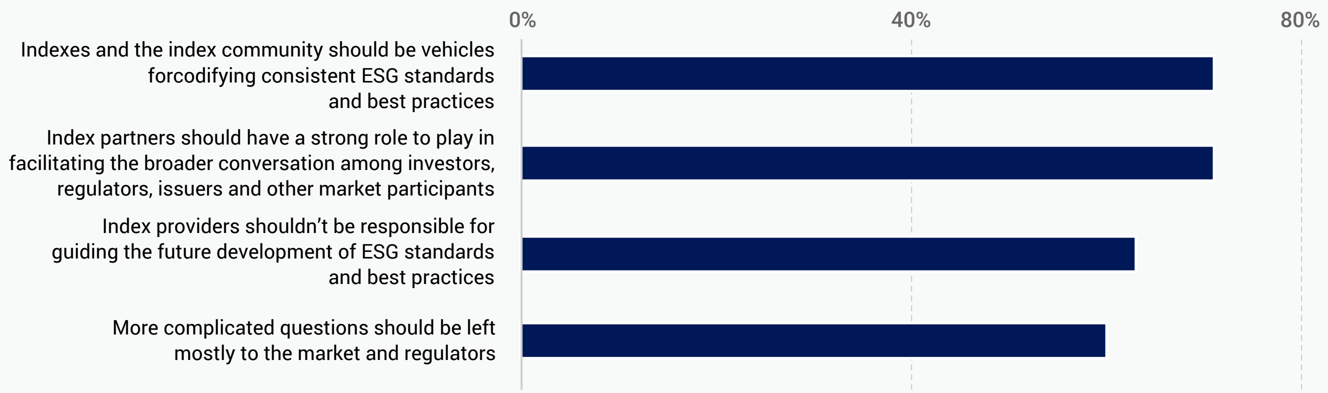
Which of the following do you believe has the greatest responsibility for developing and improving ESG criteria and strategy for the fund management industry? Please choose up to three options.



Third, in line with their generally market-led approach, asset managers see indexes playing an important supportive role codifying standards and best practices, and generally facilitating the broader debate around ESG in the investment community: 71% say indexes and the index industry should be vehicles for codifying consistent ESG standards and best practices; 71% agree that index partners should have a strong role to play in facilitating the broader conversation among investors, regulators, issuers and other market participants (Figure 27). However, they did not see the role of indexes extending to include the development of ESG standards themselves, and 60% agreed that more complicated questions should be left to the market and to regulators to address.

Figure 27

Thinking about the future development of ESG standards and best practices, do you agree with the following statements?



Survey Snapshots: Future developments

The open-ended questions in our survey offer some glimpses of the future from the asset-manager perspective on ESG. Among the comments: ESG will continue to change in response to client demand and government policy; source data will become much more granular; there will be a shift to measuring ESG outputs rather than inputs; the experience of the covid pandemic will bring a new urgency to ESG issues. Technology is seen as playing a pivotal role, both in terms of creating new ways to automate and measure ESG (e.g., through AI and machine learning) and in terms of its wider societal impacts.

"However, the next wave of ESG investing will go much further than relying on the much-simplified ratings, which currently dominate the landscape. In the future, investors will access source data with much greater granularity. Corporate reporting – these are currently the different and often highly simplified overall scores of the rating agencies.

"The biggest task of ESG in five years is to integrate new and more accurate data and information sources."

"Technologically advanced tools will provide the opportunity for every portfolio to hold ESGs."

"ESG will be heavily influenced by regulations for AI/automation technologies"

"(ESG evaluation) will be more automated."

"ESG will continue to rise on the public and corporate agenda. If there was a silver lining in the coronavirus pandemic, it is that it has forced many people and companies to think about sustainability issues and climate change in particular."

"I see ESG changing significantly in the next five years as a result of government policy and more importantly due to the rapid technology advance evident in the business sector currently."

"ESG investing will keep changing according to client demand and technological developments."

Annex: Country Profiles

The UK

ESG developments in the UK

The UK government has been clear that its efforts to rebuild the global economy should focus on a 'green recovery'. Upon withdrawal from the EU, the UK government chose not to implement the EU's SFDR or the Taxonomy Regulation into its domestic legislation, and instead opted to establish its own measures. Some key measures include:

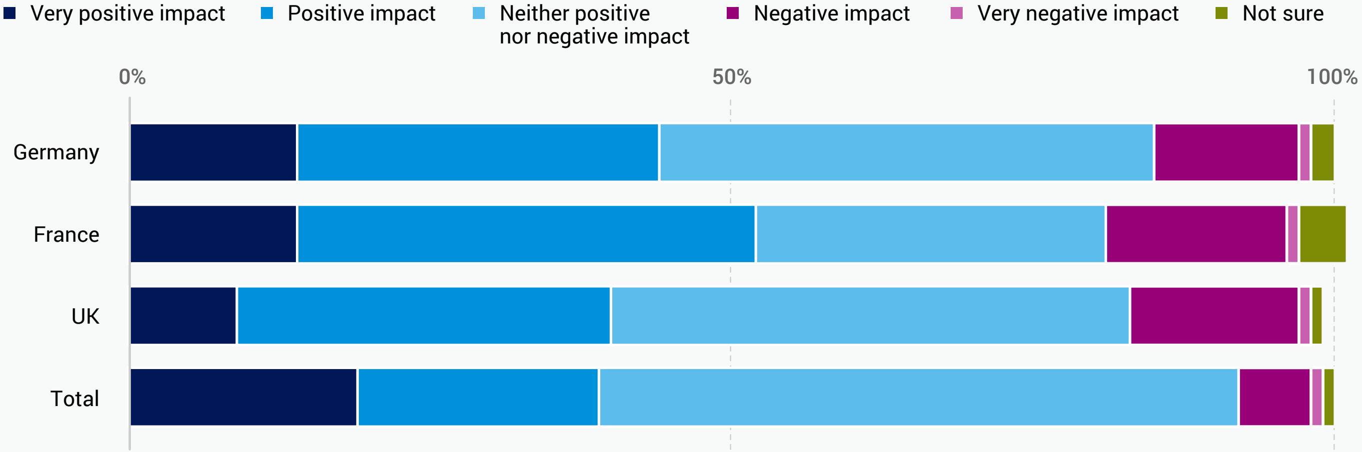
- In November 2020, Chancellor Rishi Sunak announced plans to make the UK the first country in the world to make Task Force on Climate-Related Disclosures (TCFD) aligned disclosures fully mandatory across the economy by 2025. The joint Government Regulator TCFD taskforce published its interim report and 'roadmap' setting out the roll out of TCFD-aligned disclosures.
- Also in November 2020, prime minister Boris Johnson announced the 'Ten Point Plan for a Green Industrial Revolution' mobilizing £12 billion for green initiatives such as clean energy production and public transport investment.
- In March 2021, the 'Build Back Better' report stated that the government "intends to fully implement a 'Green Taxonomy' to provide a common standard for measuring firms' environmental impact".
- There is currently an ongoing call for evidence on the "S" of ESG investing in pension schemes, with the hope that the evidence will better inform both government and industry on the risks and opportunities.

Impact of 'Brexit' on ESG investing

Overall, respondents in the UK believed that the UK's departure from the EU would lead to a net positive impact on advancing ESG (51% compared to 16% negative). A similar view was shared in France and Germany, with 40% and 39% predicting a positive impact compared to 16% and 7%, respectively.

Figure A1

Do you think regulatory changes following the UK's departure from the EU will have a positive or negative impact on advancing ESG investing overall?



Sample base: 220 respondents in UK, France and Germany

The UK respondents' open-ended survey responses highlighted several reasons for their positive predictions, including:

- The ability to "tailor specifically to the British market", bringing a competitive advantage to companies investing in ESG;
- The opportunity for fund managers to "get more of a say with regulators than before" since it had previously been difficult to contest EU regulation;
- The potential freedom for the UK to "invest in ESG in emerging markets away from the EU".

However, some respondents were less positive, stating that:

- The market would become less attractive to foreign financial capital since capital flows freely between EU Member States in the single market;
- 'Brexit' brought "unnecessary chaos to [their] market".

In France and Germany, respondents equally pointed to positive impacts for both the UK and EU, including:

- A potentially "more competitive and flexible" global market;
- The opportunity for the UK to become a global leader in green finance;
- The possibility for a new basis for negotiations between the EU and the UK.

The respondents in France and Germany also noted several concerns and negative impacts, including:

- The concern that the UK "has become quite unpredictable with its continuous announcements that it will simply ignore bilateral treaties with the EU", limiting interest in the UK as a market for ESG;
- The negative consequences of the extra administrative burden on the UK to make new regulations;
- The lack of clarity in the EU regarding "benchmarks [which were] established by the English financial community and could be called into question".

When asked about how ESG may change over the next 5 years, respondents in UK stated that:

- ESG would "change massively" due to technological developments;
- There will be an increase in regulations and policy due to Brexit;
- There would be a change around the world, including China who will "pay attention to sustainable and environmentally friendly infrastructure";
- A considerable shift in client demand is to be expected.

EU Developments

- The EU has been at the forefront for ESG reforms in recent years. One of the most significant recent development was the EU's Action Plan on Sustainable Finance, which included:
- The introduction of the Sustainable Finance Disclosure Regulation (SFDR), requiring all asset managers to publish information on their sustainability processes.
- The Taxonomy Regulation, which sets out a classification system on which economic activities are "sustainable" and comes into force on 1 January 2022 at the earliest.
- The Benchmark Regulation, setting out the ESG disclosure requirements in relation to benchmark statements and the minimum standards required for the new "Climate Transition Benchmarks" and "Paris-aligned Benchmarks".

France

- Alongside the EU regulations, there have been several domestic developments in France on ESG, including the 'AMF (Autorité des Marchés Financiers) doctrine', announced in March 2020, aiming to prevent the risk of greenwashing by requiring that non-financial information provided to investors is proportionate to their actual consideration of a list of factors.

When asked about how ESG may change over the next five years, respondents in France stated that:

- It would "evolve positively thanks to technological developments";
- "Companies adopting a sustainable approach" would be able to "emerge even stronger from the crisis";
- It would be "very problematic given the economic situation";
- There will be "obvious reasons to take an interest in socially responsible funds" and that they would be able to generate strong returns;
- There would be a sharp rise due to "demand for assets, better regulation and client demand for better control of portfolios".

Germany

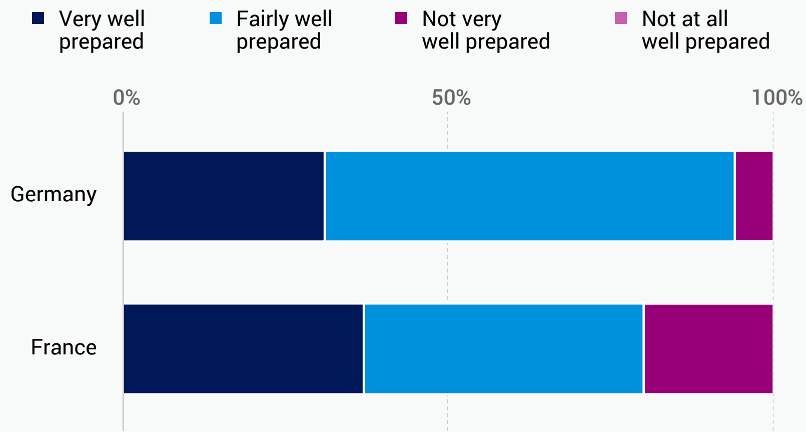
- In November 2016, Germany announced its Climate Action Program 2050. The long-term goals include being largely gas-neutral by 2050 and complete carbon neutrality in the second half of the century, in line with the Paris Agreement. By 2030, the country aims to reduce its emissions by at least 55% by 2030, compared to 1990 levels.

When asked about how ESG may change over the next five years, respondents in France stated that:

- There would be a "harmonious/collaborative development of increasing customer requests" coupled with "readjustments by companies" that would lead to it surpassing the regulatory minimum requirements;
- There would be a positive technological development, but that there was a "tendency to overregulate".
- There would be 'more attention paid to the environment', particularly renewable energies.
- Acceleration would be driven by "social and consumer attention, as well as investors and executives".

Figure A2

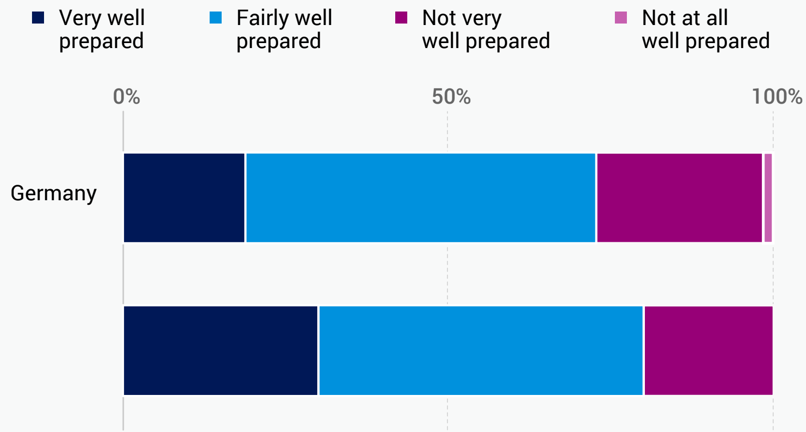
How well prepared is your company to deal with additional ESG disclosure requirements mandated by the European Union's new Sustainable Finance Disclosure Regulation (SFDR)?



Sample base: 140 respondents in France and Germany

Figure A3

How well prepared is the asset management industry as a whole to deal with additional ESG disclosure requirements mandated by the European Union's new Sustainable Finance Disclosure Regulation (SFDR)?



Sample base: 140 respondents in France and Germany

France and Germany

Overall, respondents from both France and Germany largely indicated that they were either very or fairly well prepared for the new EU regulations.

There were similar responses when asked about the preparedness of the asset management industry as a whole.

However, the respondents also note challenges to ESG implementation. Respondents from France (66%) and Germany (71%) were most likely to identify lack of data standardization as a major or moderate challenge, compared to 49% of US and 51% of UK respondents.

The U.S.

The Biden Administration has made significant commitments to sustainable investment in its first 100 days, including:

- In January, establishing a new White House Office of Climate Policy, within the Executive Office of the President.
- In January, a White House Executive order set out various policies, including reconvening the Major Economies Forum on Energy and Climate, the creation of a Special Presidential Envoy for Climate, and development of a climate finance plan.
- On 19 February, the US formally re-joined the Paris Climate Agreement, which aims to create a climate-neutral world by the middle of the century.
- In March, President Biden introduced a $2 trillion plan, dubbed the “American Jobs Plan” to rebuild infrastructure and address climate change and racial inequality. The plan includes removing lead pipes, electrifying 20% of school buses, $174 billion to encourage the manufacture and purchase of electric vehicles, and the construction of half a million electric vehicle charging stations.

There continues to be a significant geographical imbalance of ESG flows, with the majority going to European funds. However, US asset managers report being confident in their knowledge of ESG, with 59% being very confident in their personal knowledge of ESG investing, and 50% very confident in their clients’ knowledge and understanding of these issues. Additionally, they assign a high priority to ESG in their portfolios, perhaps reflecting an element of catch up given the historical lag to Europe. Ninety-four percent of US respondents indicated that ESG investment had a high or very high priority in their company’s overall investment offering or strategy, compared to the UK (79%), France (77%), and Germany (89%).

US investors were also most likely (48%) to state that ESG would become ‘a lot more important’ in the next three years. They also predicted the most rapid growth of ESG elements in their funds in the next 10 years.

Figure A4

Overall, do you expect ESG to become more or less important to your company over the next three years? (US respondents)

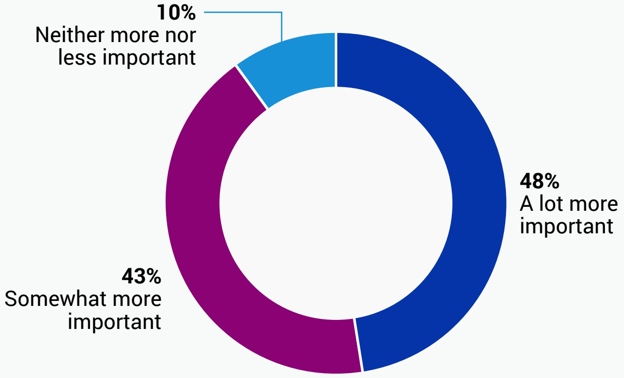
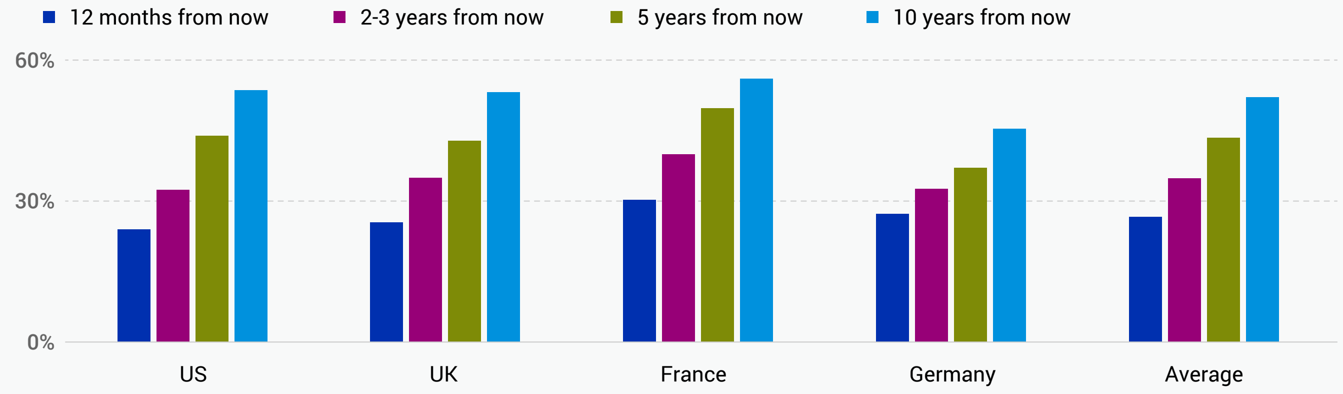


Figure A5

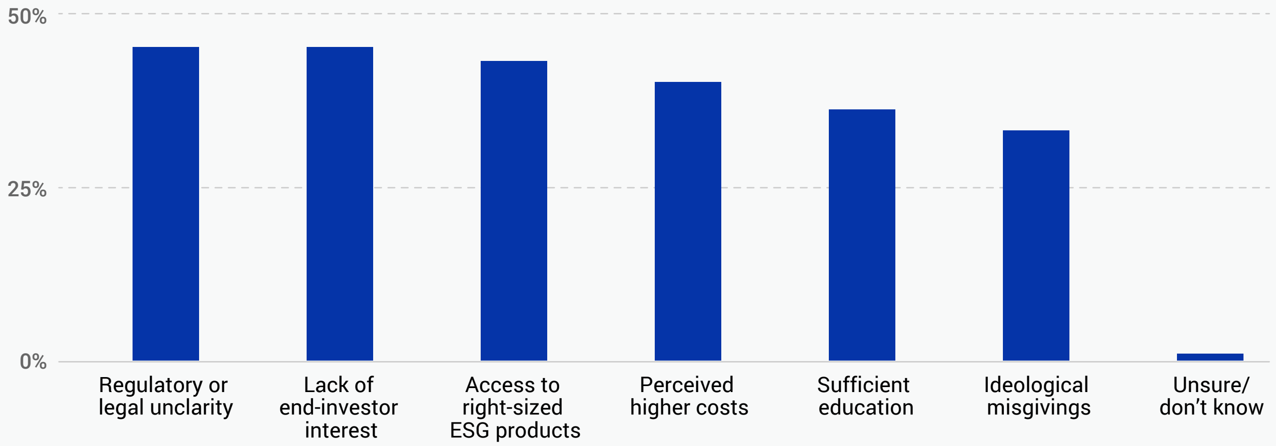
Approximately, what percentage of your asset management portfolios in your firm do you expect will contain ESG elements ...? (Avg % response)



Despite the overall positive response to ESG, US asset managers also see obstacles ESG investment, as seen in the graph below.

Figure A6

Why does the US appear to be trailing Europe and the UK on ESG investment (US respondents only)?



Sample base: 80 US respondents

US respondents, when asked why ESG investment trailed compared to the UK and Europe, indicated a lack of regulatory or legal clarity and lack of end-user interest as a key reasons.

On the matter of indexes, US respondents were most likely to strongly agree (38%) that indexes were helpful in defining standardized ESG criteria and 33% strongly agreed that indexes improved their ability to accurately compare ESG performance. Thirty-four percent of US respondents strongly agree that the index industry is better placed to come up with ESG solutions than government or regulators, compared to the UK (23%), France (19%) and Germany (21%).

When asked about how ESG may change over the next 5 years, respondents in US stated that:

- The demand from clients will "continue to trend upward due to a new generation coming into the age of investing";
- The development of technology could help investors bring greater benefits to their investments;
- There will be a significant change driven by government policy and technological developments;
- In the future, ESG will be "a much bigger investment model" and will be "a much more marketable one".

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About the IIA

The Index Industry Association (IIA) is the global trade association for the index industry. A not-for-profit organization serving the fast-growing global community of index providers, IIA membership is open to independent index businesses worldwide. For more information about membership, please contact CEO Rick Redding.

Our Purpose

The purpose of the Index Industry Association (IIA) is to represent the global index industry by working with market participants, regulators, and other representative bodies to promote sound practices in the index industry that strengthen markets and serve the needs of investors.

About the Author

Mark Purdy is managing director of Purdy & Associates, an independent advisory and thought leadership firm focused on issues at the intersection of economics, technology and business. He has over 25 years' experience as an economist in business and government.

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https://purdyassociates.com/

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