Responsible investing around the world

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It seems everyone in the asset management industry is talking about responsible investing and the importance of ESG (environmental, social and governance) issues.

Over the years, ESG has come a long way in terms of capturing investor attention. From something that was considered marginal, it has become a central tenet of modern active management.

However, ESG can look very different around the world. Different regions have embraced ESG principles in varying ways, while ESG terminology may be open to interpretation.

Nonetheless, each market has something to contribute. This makes it all the more valuable for investors everywhere to have an overview of how ESG is evolving from a global perspective. Here, we focus on three areas – Europe, global emerging markets and Asia.

Europe

Europe has had a long, deep and uneven relationship with ESG analysis over the past three decades.

Scandinavia has, for some time, been considered the most advanced region in the world for ESG integration. This is due, in part, to the fact that many ESG-related norms permeate Scandinavian culture and society. These include strong state support for higher education, equality and universal health coverage.

One of the most influential managers in Europe is Norges Bank Investment Management, Norway's sovereign wealth fund. It excludes companies that don't meet guidelines set by Norway's Government Pension Fund Global. Divestment recommendations are made by a Council of Ethics, which is appointed by Norway's Ministry of Finance. Its decisions are often followed by other Scandinavian and European public pension funds.

There's no doubt that screening – the inclusion or exclusion of assets based on specific criteria – remains an important process for Scandinavian investors, as well as for European investors in general. However, this shouldn't draw attention away from more recent developments. Responsible investing, as we understand it today, should include an understanding of all the ESG factors that can affect the financial fortunes of a business. Some countries have been better than others at embracing this more modern definition.

Over in France, ISR (l'Investissement Socialement Responsable), has been dominated by social issues. This reflects the country's concerns for labour and the environment. For example, Duty of Vigilance 2017 requires companies to have good oversight of their operations and supply chains. Companies must comply with health, safety, environmental and human rights obligations.

By contrast, other parts of Europe such as Germany, Italy and Switzerland, have been slower to embrace ESG integration. There are regional bodies, such as Swiss Sustainable Finance, which promote the role of ESG in investing. But, on the whole, while these jurisdictions have retained screening, we haven't seen much investor interest in integrating ESG into investment processes, or in issues such as climate change.

Global Emerging Markets

ESG integration within the global emerging markets has mostly been a tale of catch-up over the past 20 years.

The reasons for slower ESG developments are fairly straight-forward but multi-faceted. They vary on a country-by-country basis.

In general, the biggest barrier for foreign institutional investors has been language. Many companies do not translate what ESG-related information they do provide into English. A second hindrance has been an inadequate supervisory structure or organisation within these markets.

A lack of appropriate infrastructure has also taken its toll in terms of government control and regulation.

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Better ESG standards require continued evolution in the minds of investors which will, in turn, shape their expectations of the corporates in which they invest. We see evidence of that taking place as governments and leading companies see the light.

Carbon footprint, human rights and diversity are emerging as big themes that will encourage a basic box-ticking exercise to meet minimum standards. However, this should evolve into deeper, more granular analysis as the conversation between companies and investors progresses.

Asia

Asian companies have been slower than their counterparts in other parts of the world to integrate ESG concepts into their business strategies. But there are signs that this is changing for the better.

Asset owners and asset managers are showing more interest and putting pressure on companies. For example, Japan's Government Pension Investment Fund (GPIF) announced its intention to increase allocations in ESG-related investments to 10% from 3%. This amount is worth some US$29 billion, sufficient to influence corporate behaviour. Meanwhile, fund managers have been signing up to internationally recognised agreements.

Final thoughts…

In general, ESG analysis has evolved beyond screening, even though screening remains at the heart of ESG in many jurisdictions.

The market has moved towards looking at the broader medium-term and long-term ESG risks and opportunities associated with assets. At its heart, ESG analysis is about understanding all aspects of an investment and being an active owner once invested.

Irrespective of the country, we have found that asset owners and managers are critical agents of change. Fund managers around the world have been keen to demonstrate their commitment to ESG tenets. However, responsible investing cannot be a simple box-ticking exercise. A superficial nod towards compliance helps nobody in the long run.

These are just a few countries that highlight the differences seen in Responsible Investing around the world. If you'd like to read our full white paper, then please let us know.

For more information go to www.aberdeenstandard.ie