

This material is a marketing communication.

A photograph of two women, one Black and one white, looking at a tablet together outdoors. The woman on the left is wearing a red and black patterned top, and the woman on the right is wearing a blue blazer over a white top. They are both smiling and looking at the tablet. The background is a blurred green landscape. The image is framed by a teal border.

ESG Global Study 2021

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01

Executive summary

Executive summary

Global investors strongly prefer an active approach to ESG. Three-quarters use active funds to integrate environmental, social and governance (ESG) issues – more than double the proportion using passive funds and trackers. Rather than investing in funds that merely screen out unethical sectors, investors want managers to identify and manage ESG risks and opportunities through bottom-up security selection and fundamental analysis.

Further underlining the preference for active management, nearly half of investors point to exercising voting rights and having regular meetings with senior executives at companies as key engagement tools. Investors appear to be looking for a holistic approach to ESG that encompasses all stages of the investment process.

The importance attached to qualitative analysis reflects a need for better ESG data and information. Investors point to a lack of robust data as a top barrier to greater ESG adoption. Issues with the quality and consistency of data pose particular problems throughout the investment journey. Investors say the uncertainty around the reliability of ESG scores is the greatest hurdle when incorporating ESG data, ratings and research. And one-fifth of respondents identify lack of consistency among different rating provider scores as the top implementation challenge.

This is precisely why active management is so important. The problems created by a lack of consistent and accessible data can be addressed through an active approach with an emphasis on proprietary research. This approach goes well beyond scoring systems to focus on fundamental analysis and rigorous risk management.

Data can also be the key to unlocking greater opportunities for ESG-focused investing. Asset managers, again, can play a decisive role in this respect. Nearly half of investors say greater transparency in ESG fund reporting frameworks and data availability would most encourage them to increase their ESG focus.

Investors believe the most important element of fund sustainability reporting is a clear explanation of the role that ESG plays in the investment process. The second most important item they look for is information on specific E, S, and G factors – and nearly half their focus is allocated to environmental issues.

More transparent fund reporting is seen as an effective tool in addressing greenwashing, which refers to when companies use superficial or insincere tactics to show concern for the environment. The challenge is sizeable – almost six in 10 global investors think greenwashing is prevalent within the asset management industry. Concerns are more pronounced among ESG sceptics, indicating that worries over greenwashing could be strong barriers to wider ESG adoption.

Investors think regulation can help stem the tide of greenwashing. Nearly one in two say setting minimum regulatory standards for investment products and services would help tackle greenwashing. But global investors are looking for a common set of global rules and standards to replace the current disjointed regulatory framework. Nearly half (45%) of investors think harmonising global standards, taxonomies and metrics should be the top ESG priority for national regulatory frameworks.

02

Methodology and sample breakdown

Methodology

The Capital Group ESG Global Study 2021 gathered the views of 1,040 global investors on ESG investing via an extensive online survey conducted by CoreData Research during June 2021. CoreData Research is a global specialist financial services research and strategy consultancy with operations in Australia, the U.K., the U.S., Brazil, Singapore, South Africa and the Philippines.

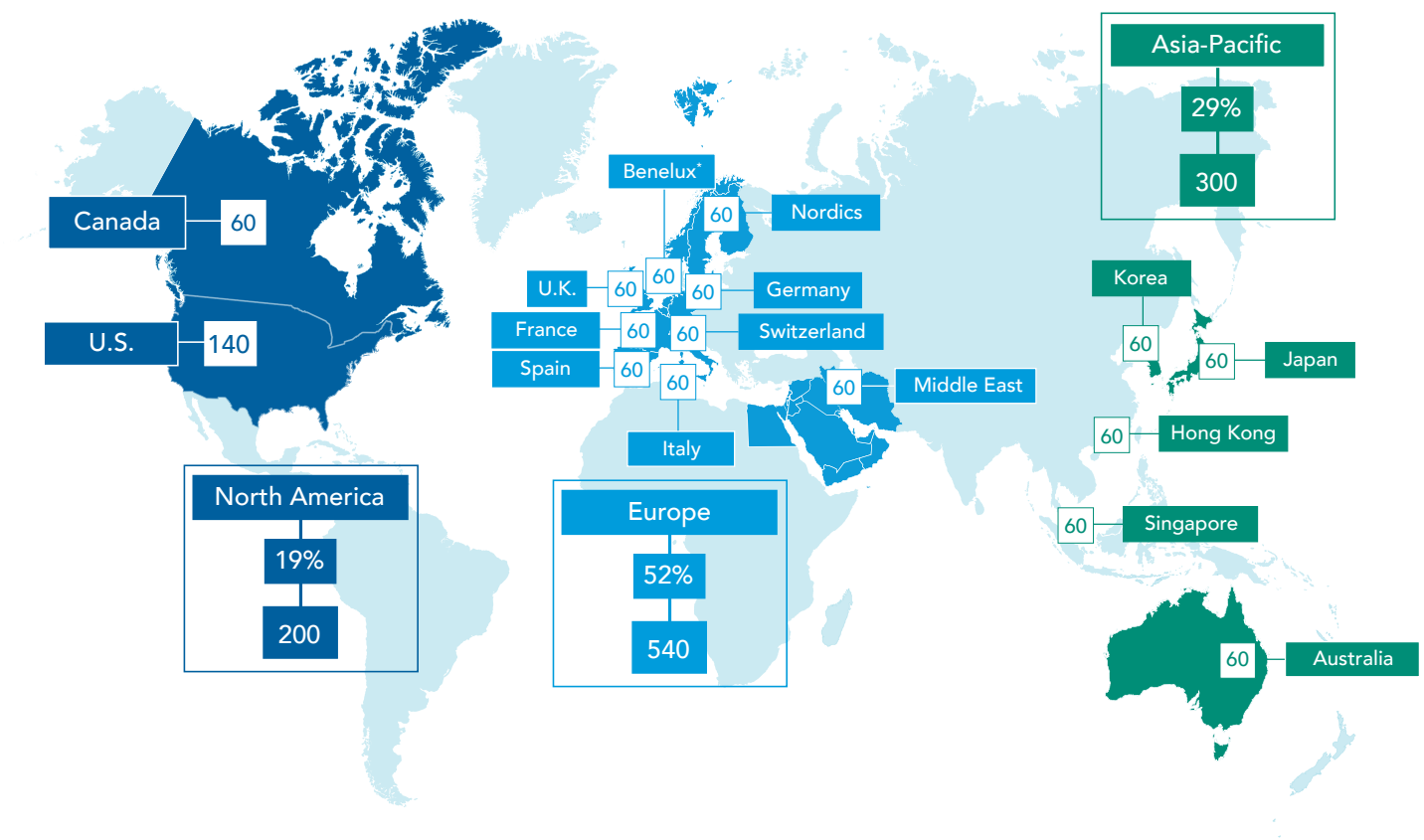
The sample includes 520 global institutional investors (pension funds, family offices, insurance companies, sovereign wealth funds, endowments and foundations) and 520 global wholesale investors (funds of funds, discretionary fund managers, private banks, wirehouse broker/dealers, registered investment advisors, independent advisories and investment divisions of insurance).

Investors were located in Europe (52%), the Asia-Pacific (29%) and North America (19%). The sample includes both ESG users/adopters (84%) and ESG non-users/non-adopters (16%).

Global

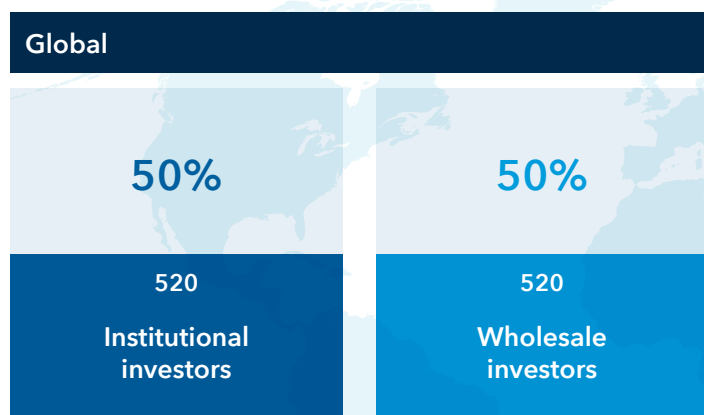
Sample breakdown

Number of respondents in each country



* Belgium, the Netherlands and Luxembourg.

Sample breakdown



Type of organisation	Institutional investors		Wholesale investors		Type of organisation
Pension fund		48%	40%		Independent advisory / Individual wealth manager
Insurance company		25%		15%	Discretionary fund manager/ Turnkey asset management provider
Family office		12%		13%	Private banks / Bank trusts
DC fund		5%		11%	Investment division of insurance
Foundation		4%		10%	Fund of funds
Sovereign wealth fund		3%		5%	Registered investment advisor
Endowment		3%		5%	Wirehouse broker / dealer

Responses may not total 100% because N/A option is not included.

Sample breakdown

Job function	Institutional investors*
Portfolio manager / Investment manager	51%
Chief investment officer	13%
Investment officer	9%
Director	8%
Research analyst	7%
Fund analyst / Fund selector	6%
Asset consultant	4%

Job function	Wholesale investors*
Investment team member (portfolio manager, fund analyst, fund selector, model portfolio manager, etc.)	67%
Chief investment officer	11%
Director / Head of asset class (equity, fixed income, alternatives, ESG, etc.)	17%

Assets under management*	
Less than \$1 billion	11%
\$1 billion to less than \$5 billion	19%
\$5 billion to less than \$10 billion	16%
\$10 billion to less than \$50 billion	18%
\$50 billion to less than \$100 billion	15%
\$100 billion to less than \$250 billion	13%
\$250 billion to less than \$500 billion	6%
\$500 billion to less than \$1 trillion	3%
Total assets under management	\$30.2T

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03

Attitudes and approaches toward ESG

Attitudes and approaches toward ESG

Long-term conviction

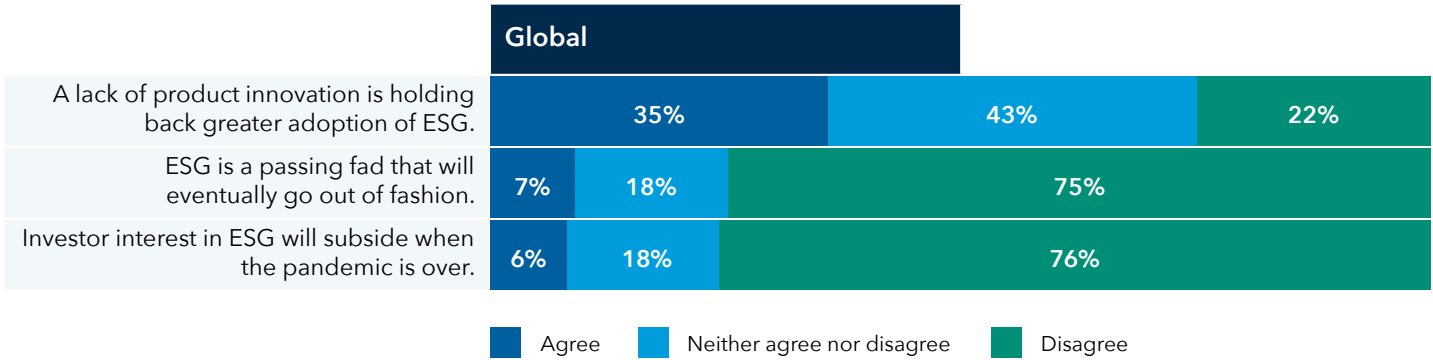
Investors have conviction in ESG, with three-quarters (75%) rejecting the idea that it is a passing fad.

The belief that ESG is here to stay is reinforced in the finding that 76% of investors disagree that interest in ESG will subside when the pandemic is over. While COVID-19 has helped accelerate ESG fund flows, these findings show that investors do not think momentum will slow upon removal of the COVID boost. Investors see ESG as the future and are in it for the long haul.

“We think using ESG is a critical factor to achieve sustainable returns for the long term,” says a portfolio manager at a Singapore sovereign wealth fund. “Companies that don’t have a sustainable business model will not be there for the longer term, and we as long-term investors are very mindful of sustainable issues.”

A portfolio manager at a Canadian pension fund comments, “It comes back to the whole idea that these ESG risks are not, for the most part, short-term. They are long-term, maybe multi-generational risks, and if you can quantify or understand them correctly, you stand a greater chance of generating alpha.”

Views on ESG



This conviction is being driven, in part, by a desire to invest in products that have a positive impact on the planet. Nearly a quarter (24%) of investors say the primary reason their organisation adopts ESG is to do good and make the world a better place.

But the prime driver behind ESG adoption is client demand. Nearly one-third of global investors (31%) say meeting client needs and requests is the number one reason their organisation invests in ESG, well ahead of the numbers who are doing it for regulatory reasons. ESG has moved into the mainstream, fuelled by the demands of ESG-aware pension savers and retail investors.

Main reason for adopting ESG



Responses may not total 100% because N/A option is not included.

Actively seeking sustainable returns

Global investors strongly prefer an active approach to ESG. Three-quarters (75%) use active funds to integrate ESG – more than double the proportion using passive funds and trackers (36%). This suggests that rather than merely screening out unethical sectors, investors want managers to actively identify and manage ESG risks and opportunities as part of their investment process through bottom-up security selection and fundamental analysis.

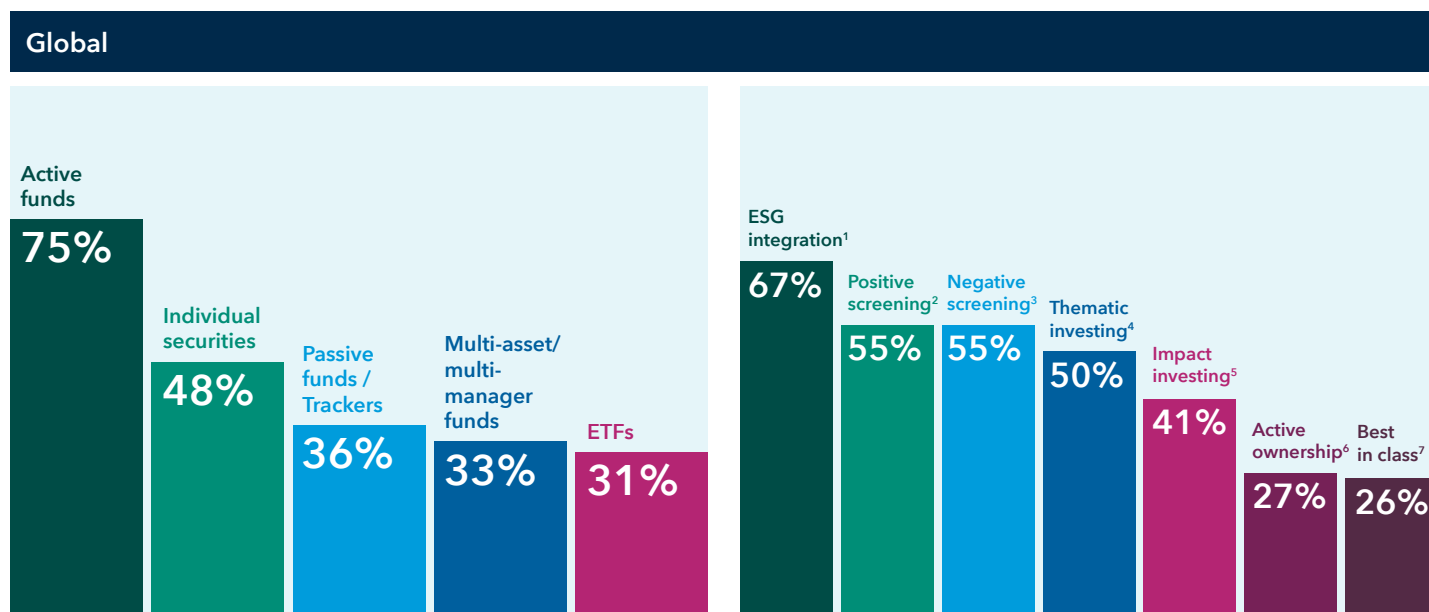
“Active managers can focus on ESG risk mitigation when it comes to specific individual company holdings,” says a portfolio manager at a Canadian pension fund. “Passive managers, on the other hand, will hold the company whether it’s deemed evil or not. So for us, it’s always going to be active managers.”

“Active managers can focus on ESG risk mitigation when it comes to specific individual company holdings,” says a portfolio manager at a Canadian pension fund. “Passive managers, on the other hand, will hold the company whether it’s deemed evil or not. So for us, it’s always going to be active managers.”

A portfolio manager at a U.S. insurance company explains the benefits of an active approach when investing in bonds: “If you are passive investing, then issuers are going to do their own analysis and label a bond green* or not green. And that’s when greenwashing becomes an issue, because the passive managers will buy it based on that one definitive element. Active management allows you to consider exactly what ESG considerations are being incorporated, exactly how accurate that analysis is and exactly how impactful that analysis is.”

*A green bond is designed to support specific climate-related or environmental projects.

Preferred ESG-integration vehicles and implementation strategies



Integration beats exclusion

Investor preference for a rigorous and comprehensive approach to ESG is further reflected in the finding that ESG integration – cited by two-thirds of global investors (67%) – is the preferred ESG implementation strategy. This is followed, by some distance, by positive and negative screening (both 55%) and thematic investing (50%).

“I don’t think thematic investing and impact investing are going to attract many funds,” says an investment team member at a Singapore registered investment advisor.

“I think it’s going to be based on integration, because if you do thematic or impact, you are limiting yourself to a very small universe.”

Interviewees also point out that implementing ESG is a process that evolves and matures as investors become more knowledgeable and familiar with the area.

“When we first started, we had a positive and negative list of industries, but over time we realised it’s not sufficient to have that kind of blanket approach. We have since transitioned to ESG integration into the investment process itself,” says a portfolio manager at a Singapore sovereign wealth fund.

¹ ESG integration: The use of qualitative and quantitative ESG information in investment processes, with the objective of enhancing investment decision-making.

² Positive screening: The inclusion within a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.

³ Negative screening: The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.

⁴ Thematic investing: A form of investing that aims to identify trends and the underlying sectors or companies which stand to benefit from the materialisation of those trends. Funds can be single-themed or multi-themed.

⁵ Impact investing: A form of investing that seeks to generate positive, measurable social and environmental impact alongside financial returns.

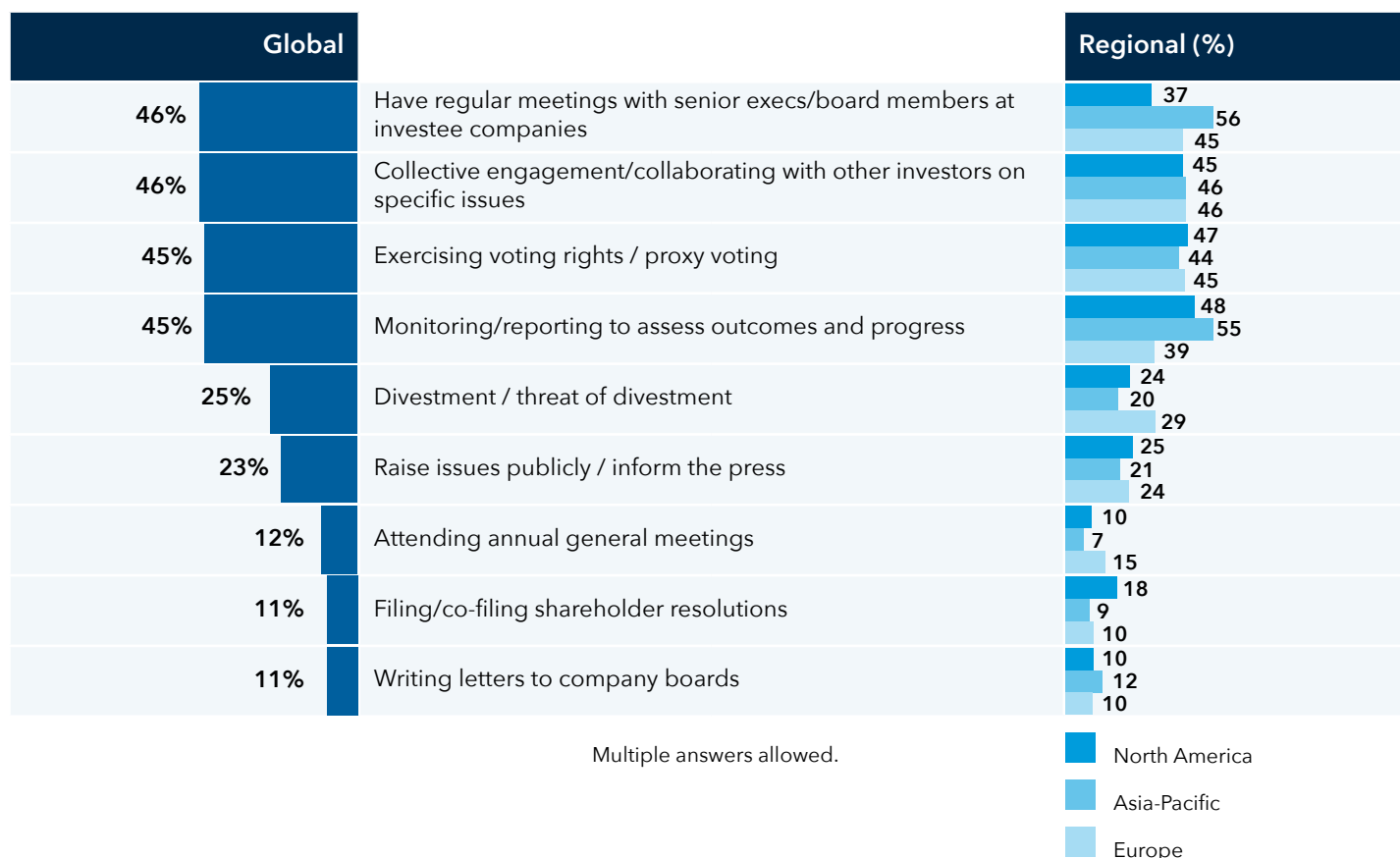
⁶ Active ownership: The use of the rights and position of ownership to influence the behaviour of investee companies.

⁷ Best in class: Investment in sectors, companies or projects selected for their performance relative to industry peers.

Active ownership

The preference for active is again evident when investors are asked how asset managers can most effectively engage investee companies on ESG. Nearly half point to exercising voting rights and monitoring/reporting to assess outcomes (both 45%) as key engagement tools. Slightly more (46%) cite the importance of having regular meetings with senior executives and board members at investee companies. The same proportion (46%) believe in the efficacy of collective engagement.

How asset managers can most effectively engage on ESG



Proxy voting and co-filing resolutions may be the most visible parts of the ESG engagement process, but investors give more weight to active ownership and ongoing dialogue.

"A lot of these asset managers hold significant stakes in companies," comments a portfolio manager at a Canadian pension fund. "If they hold that much of the

company and ESG is a big issue or priority for them, then they need to make that known and engage with these companies."

A credible engagement strategy should also use the power of divestment when companies are not meeting demands or making the necessary improvements, according to a quarter of investors.

Equities reign supreme

In terms of asset class, investors overwhelmingly use equities to gain exposure to ESG (87%). This is followed by bonds (60%) and private markets (41%). While issuances of green bonds and sustainable bonds, which are used to finance environmental or social projects, have recently increased, there are concerns related to complexity and a lack of standards.

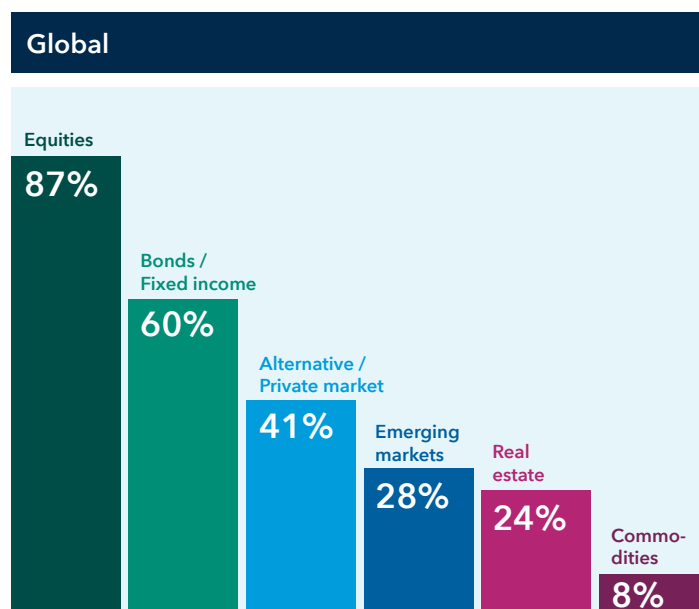
A member of the investment team at a Singapore registered investment advisor says a further problem with bonds is a lack of clarity and transparency on the use of proceeds: "With green bonds, is anybody even tracking what the companies are doing? I think the investor community is lacking on the follow-up."

More keen on green

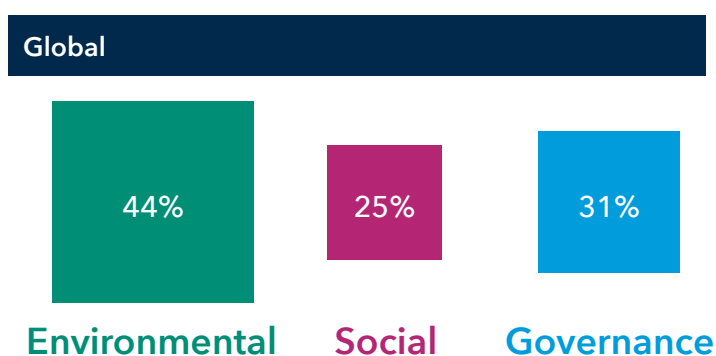
While investors display clear preferences about instruments and integration strategies, they also have a clear preference when it comes to the three individual components of ESG. Global investors have a strong allocation bias toward the E element of ESG. They allocate nearly half (44%) of their ESG focus to environmental factors (E). Less than one-third (31%) is dedicated to governance issues (G) and just a quarter (25%) to social factors (S).

The low allocation to the S element is perhaps surprising and runs counter to the narrative that COVID-19 has seen social factors, such as human capital management, rise to prominence.

Asset classes used to access ESG



The three ESG pillars



What percentage of your ESG focus is, or would be, allocated to these three segments?

Green can be seen

Extreme weather events, like wildfires and floods, have drawn more attention to the impact of climate change and global warming. And more investors are realising that climate change can also pose a systemic investment risk.

“Environmental concerns seem to be a very hot topic these days,” says a portfolio manager at a Canadian pension fund. “We see the natural disasters, we see global warming, we see a lot of this in the news these days. It’s becoming a very provocative topic.”

A portfolio manager at a Singapore sovereign wealth fund says, “I think the focus on E has been driven by the general public’s view on sustainability, and that has filtered down to the investment community, and hence a greater focus on the environmental pillar versus the social and governance ones.”

A perception that there is more readily available data on environmental factors compared to social and governance factors may also help explain the dominance of the E element.

“You cannot quantify social and governance the same way that you can quantify environmental factors with a numeric carbon score,” says a portfolio manager at a U.S. insurance company. “And I think that’s why there’s more focus on the environmental side – just because it can be counted and measured. The social and governance factors are a much more difficult thing to quantify. How do you quantify if a company is diverse enough?”

Investors may be further drawn to the E of ESG because of a perception that there are more environmentally focused funds available or that such funds are more heavily marketed.

The predilection for the environmental strand of ESG could also be a function of client demand. In a recent Pew Research Center survey spanning North America, Europe and the Asia-Pacific, 72% of respondents expressed concern that climate change would harm them personally at some point in their lifetime. And 80% said they are willing to make changes in how they live and work to help reduce the effects of global climate change.* If environmental issues are uppermost in the minds of their clients, then institutional and wholesale investors need to consider those concerns.

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The G-force

Many interviewees in our ESG Study also highlight the importance of governance factors in the research realm.

“If you think about ESG in general, governance is probably the one factor where there’s much more information,” says a Canadian pension fund portfolio manager. “If you’re looking at a company and its management through a bottom-up fundamental approach, and you really want to understand whether management is aligned with you and what their track record is, then that’s governance.”

An investment team member at a Singapore registered investment advisor agrees. “Everybody just gets stuck at the E pillar because it’s for the greater good; but from a fundamental analysis and portfolio investing approach, the G is equally if not more important.”

A more blended approach

Capital Group advocates a holistic approach that encompasses E, S and G but also acknowledges that each plays a different role, depending on the company.

Our proprietary sector frameworks allow us to examine how individual elements intertwine and interact with each other. For example, executive pay that is linked to carbon-reduction targets combines both governance and environmental factors. Diversity is important not just as a topic for board composition (governance) but also for all employees (social). ESG should be viewed as a Venn diagram with the three strands overlapping and sharing certain characteristics and relationships.

Funds that combine and integrate two or three ESG pillars should in theory have a wider reach and more powerful impact than those more narrowly focused offerings targeting just one element.

* James Bell, Jacob Poushter, Moira Fagan and Christine Huang. “In Response to Climate Change, Citizens in Advanced Economies Are Willing to Alter How They Live and Work,” Pew Research Center, September 14, 2021.

04

ESG regional trends

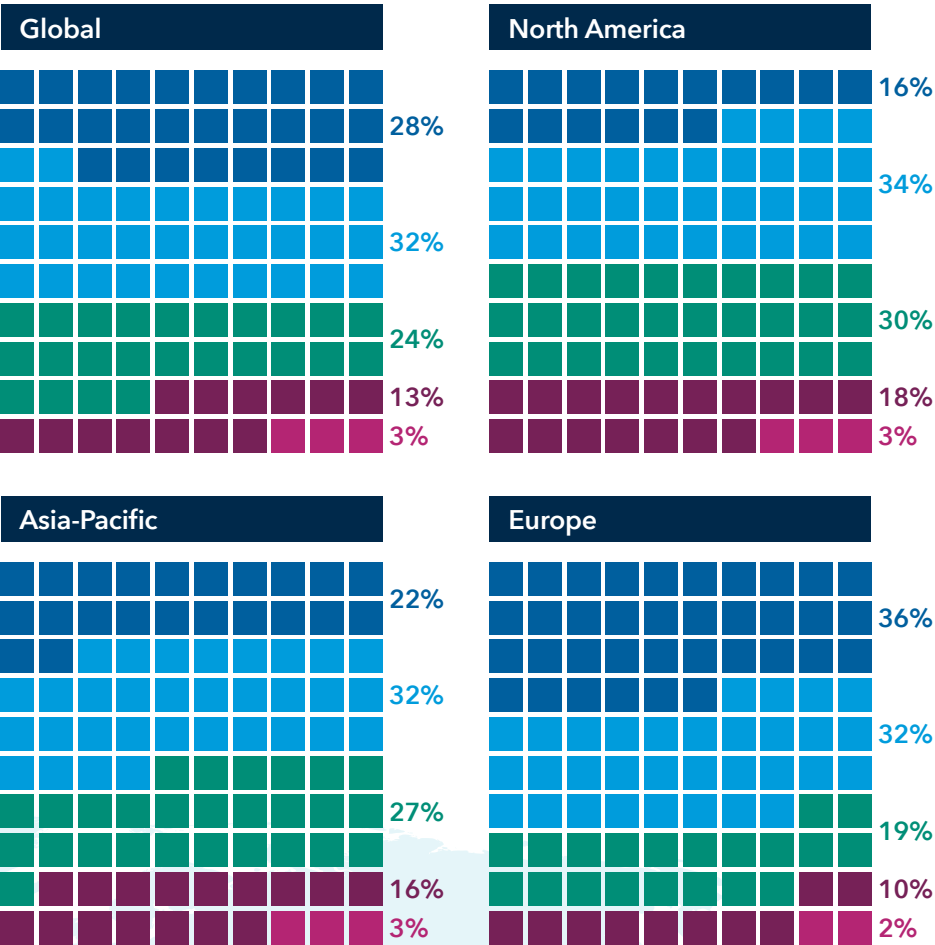
ESG regional trends

Europe in pole position

European investors are leading the sustainability charge. Far more Europeans say ESG is central to their investment approach (36% vs. 16% North America and 22% Asia-Pacific). European respondents therefore represent a more ESG-committed cohort. The stronger conviction among European investors likely reflects the region's more mature ESG market and regulatory framework.

- Conviction:** ESG investing is central to our approach.
- Acceptance:** We apply ESG investing in our approach.
- Compliance:** We consider ESG issues in our approach.
- On the sidelines:** We are yet to be convinced about ESG.
- Non-adoption**

ESG adoption levels, by region

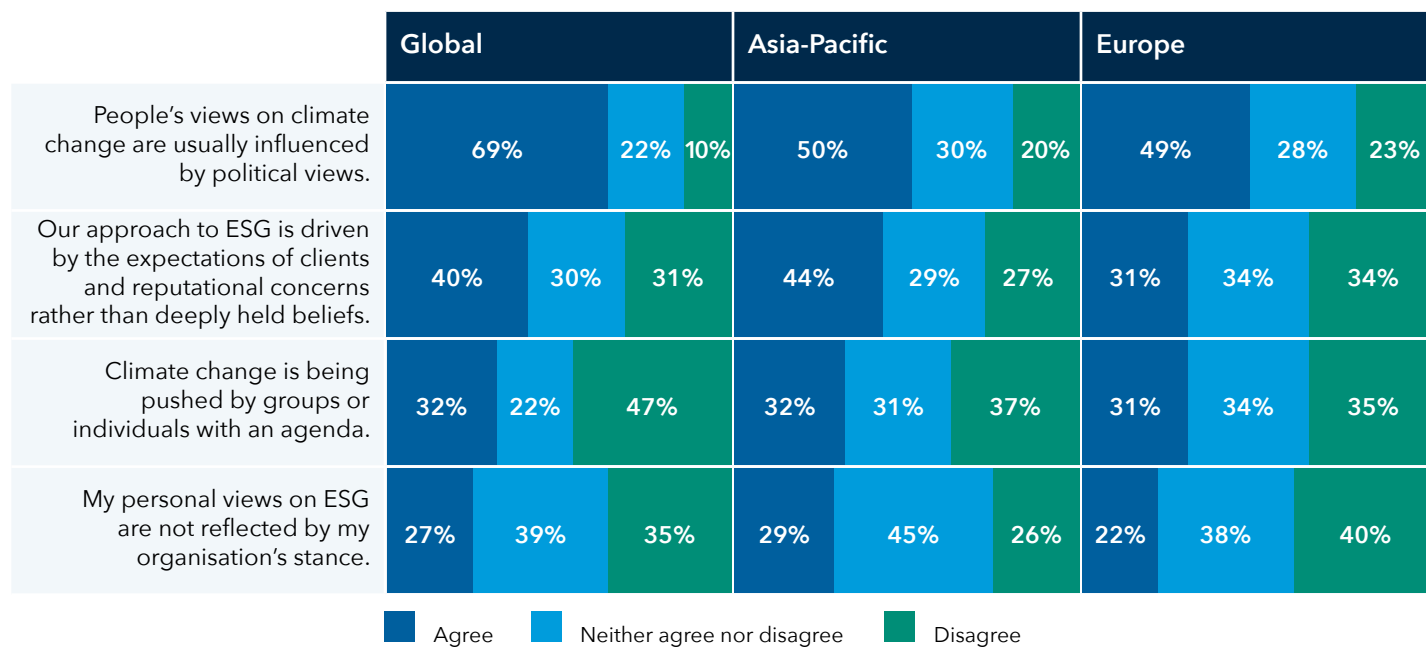


Percentages may not add up to 100% due to rounding.

Stronger set of beliefs

This deeper sense of commitment is further highlighted in the finding that European investors appear more driven by principles and values than by client expectations. For example, 31% of Europeans say their approach to ESG is driven by client expectations and reputational concerns rather than deeply held beliefs. This compares to 44% in Asia-Pacific and 40% in North America.

Views on ESG, by region



Percentages may not add up to 100% due to rounding.

A member of the investment team at a Swiss private bank says Switzerland has experienced a cultural and societal shift when it comes to sustainability and looking after the planet.

"Switzerland is well known to be very clean, very green, very pro-environment, very pro-preserving nature," he says. "And you can really see how new ways of life are developing – new ways to sort out your waste, new ways to reduce consumption by using public transportation. And there is a very strong consciousness when it comes to preserving nature."

While European investors have a stronger set of beliefs, they are also at a more advanced stage when it comes to embedding ESG into the investment process. Nearly half (47%) say ESG investment integration is the most developed capability within their organisation – compared to 28% in Asia-Pacific and 37% in North America.

Rating ESG capabilities



Please rate each of the following aspects of your organisation's ESG capabilities.

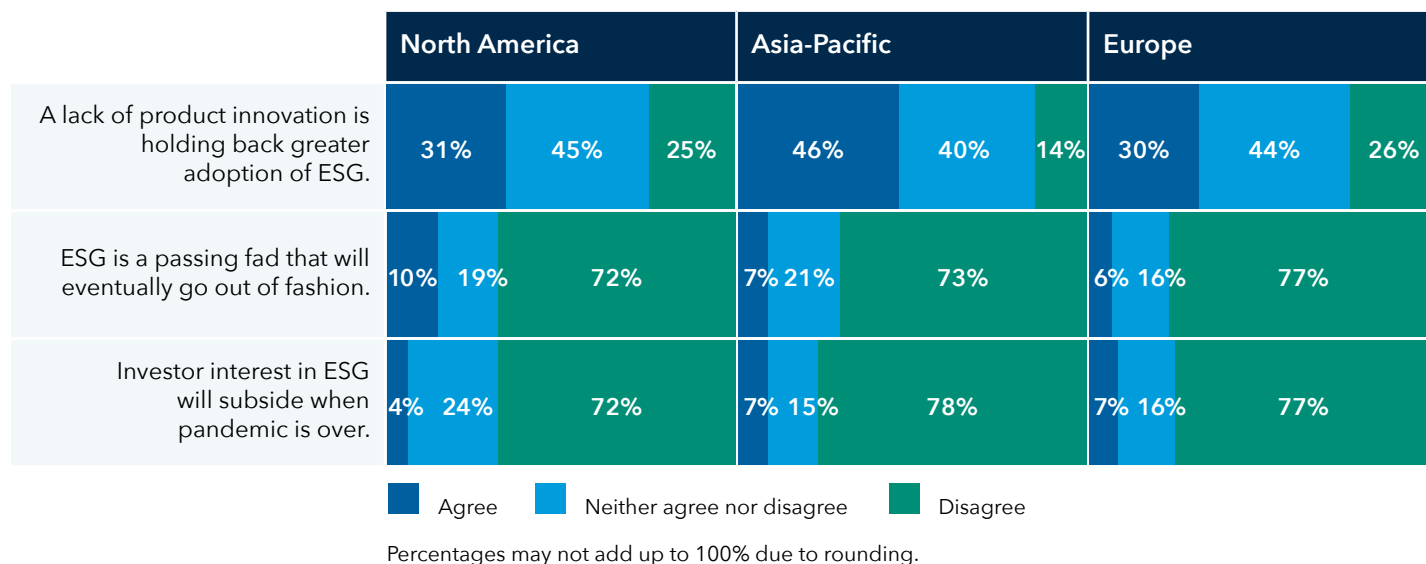
Rate on a scale of 0-10.

A global megatrend

Europe is in pole position in terms of integration (87% of respondents are ESG users), but the other regions are not far behind. The overwhelming majority of respondents are adopting ESG (North America 80% and Asia-Pacific 81%).

This more uniform global picture can also be seen when investors are asked about the sustainability of ESG itself. Investors from all regions strongly agree ESG is here to stay and will not go out of fashion (77% Europe, 73% Asia-Pacific and 72% North America), not even when the pandemic is over (77% Europe, 78% Asia-Pacific and 72% North America).

Views on ESG, by region



Ultimately, ESG is a megatrend that is reshaping the global investment landscape. We would therefore expect the higher level of conviction in Europe to diffuse into other areas of the world. There are already signs that the U.S. is now catching up amid an increased policymaking and regulatory focus.

North American firms more client-centric

Looking at North American investors, we can see that a desire to respond to client demand plays a particularly important role when investing in ESG. More than four in 10 (41%) North American investors say meeting client needs and requests is the number one reason their organisation invests in ESG. This compares to just 26% of Asia-Pacific investors and 31% of European investors.

The U.S. may not have the same volume of ESG-specific regulation as the EU, but regulation does shape how ESG is adopted there.

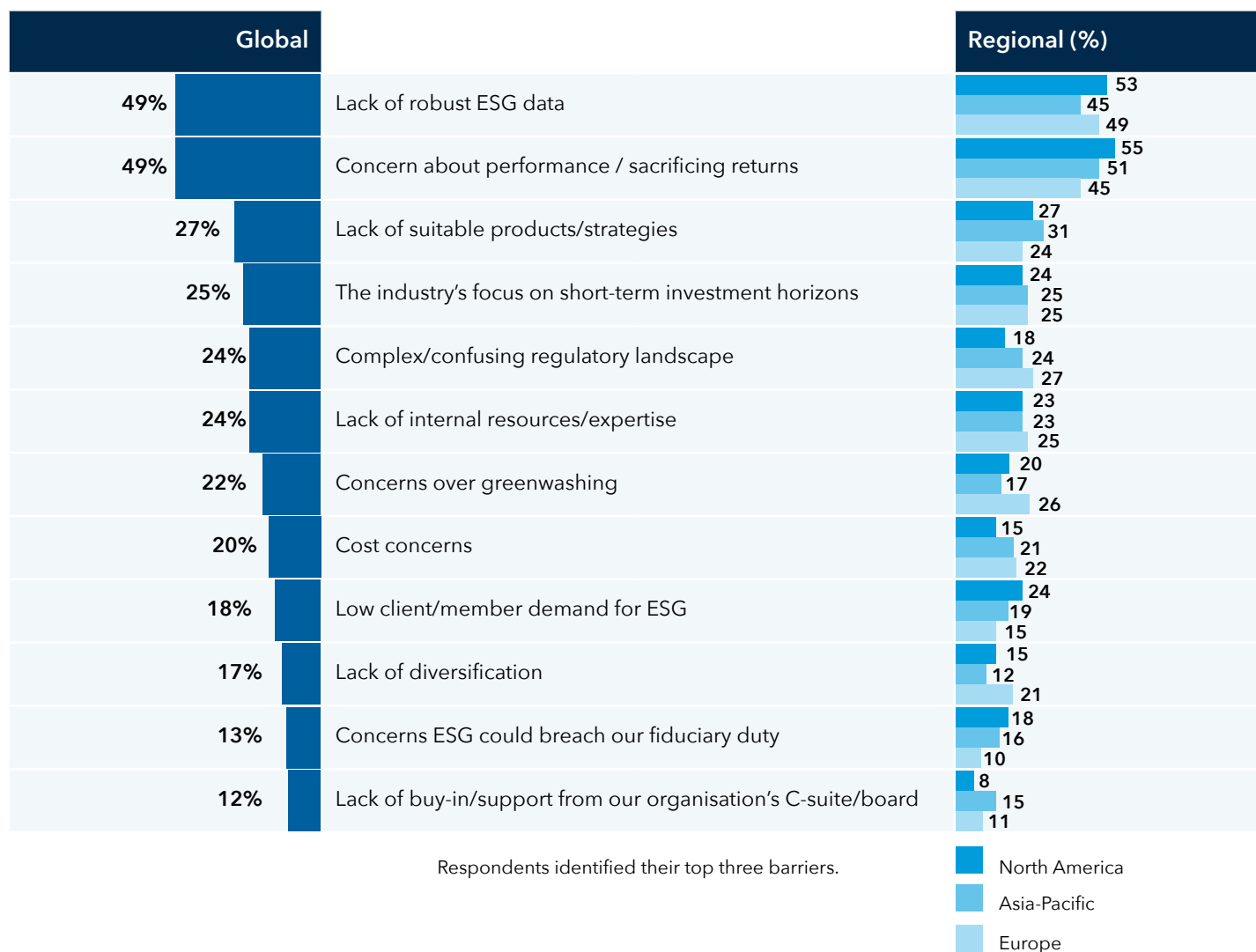
A portfolio manager at a U.S. insurance company explains, "Institutional investors may consider climate-change types of investments in order to either get ahead of regulation or because they feel a particular way. But ultimately, their hands are tied by their fiduciary needs to their clients, which are financial in nature."

Main reason for adopting ESG, by region

	North America	Asia-Pacific	Europe
A desire to meet client needs and requests	41%	26%	31%
A desire to do good / make an impact / make the world a better place	24%	23%	25%
A desire to improve our reputation / Fear of reputational harm	6%	11%	11%
A desire to improve performance	12%	12%	7%
Peer pressure / Industry standards	5%	15%	7%
A desire to enhance risk management	9%	5%	10%
Regulatory pressure / Fear of falling foul of regulations	2%	7%	8%

Responses may not total 100% because N/A option is not included.

Biggest barriers to ESG adoption, by region



North American respondents are most concerned about sacrificing returns when investing in ESG. More than half (55%) say concern about sacrificing returns presents the biggest barrier to ESG adoption – compared to 45% of European investors and 51% of Asia-Pacific investors.

E for Europe

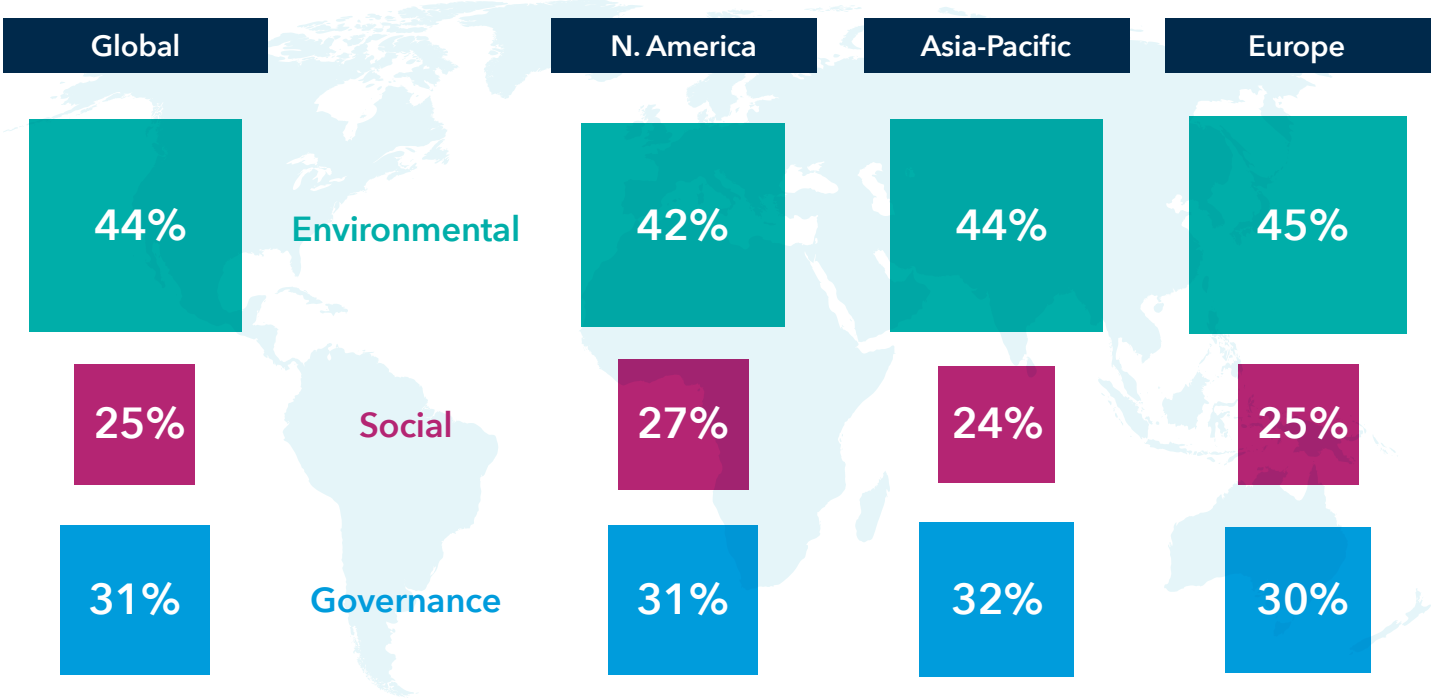
There is very little difference between the relative importance of the E, S and G pillars when broken down on a regional basis.

European respondents allocate 45% of their ESG focus to environmental factors compared to 42% for North America and 44% for Asia-Pacific.

North American investors attach marginally more importance to the S element – they allocate 27% of their ESG focus to social factors, compared to 24% for Asia-Pacific and 25% for European investors. Asia-Pacific investors allocate slightly more to governance issues (32% vs. 30% Europe and 31% North America). This may indicate higher levels of concern over corporate governance issues in the region.

“In Asia there’s always been a lot of focus on G even before ESG became so important, because of the history of private corporates or family-owned businesses,” says an investment team member at a Singapore registered investment advisor.

The three ESG pillars, by region



% Mean

Q What percentage of your ESG focus is, or would be, allocated to these three segments?

05

ESG attitudes by investor type

ESG attitudes by investor type

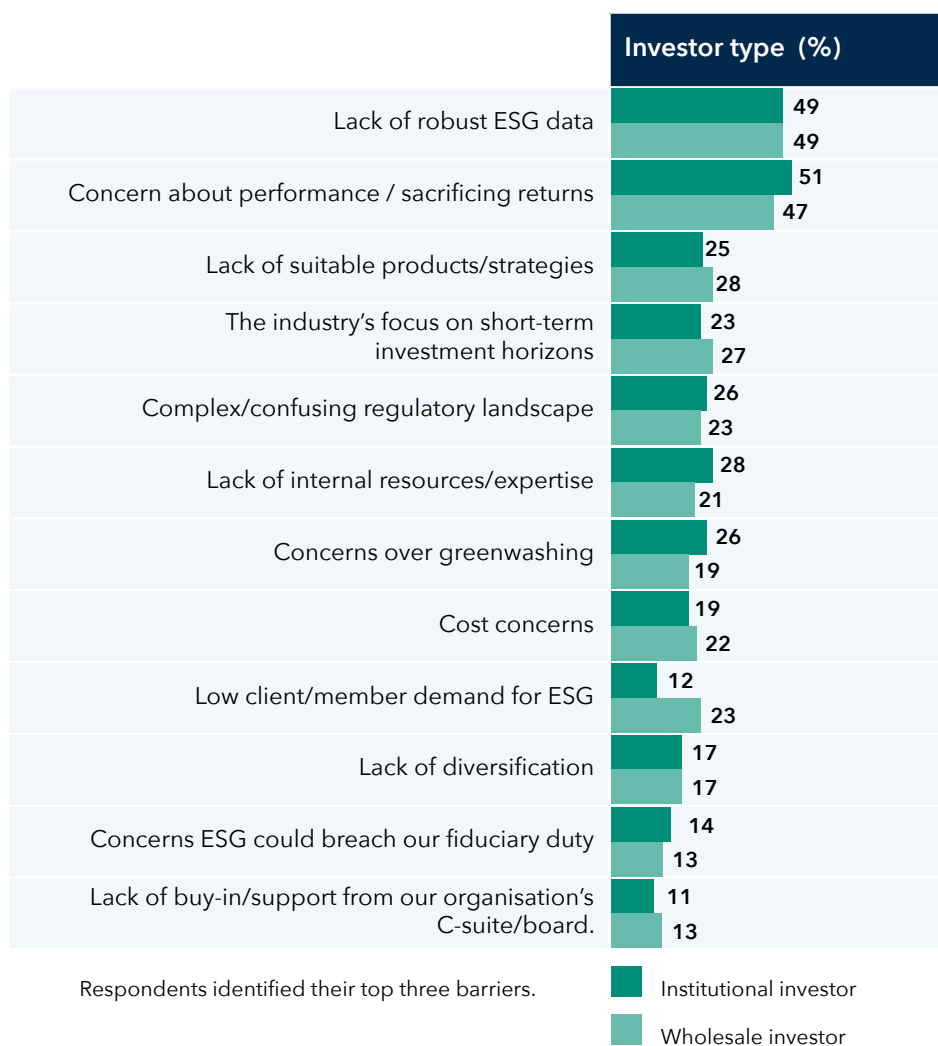
The alpha barrier

Concerns about investment results are uppermost in the minds of investors when it comes to ESG. In fact, the two largest barriers to ESG adoption are lack of robust data and concern about performance.

And with nearly three in 10 (28%) global investors believing ESG factors do not directly improve investment results, the industry faces a difficult task overcoming these concerns.

Worries over investment results present a higher hurdle for institutional investors. More than half (51% vs. 47% wholesale investors) say concern about sacrificing returns presents the biggest barrier to greater ESG adoption. Institutional investors will therefore need more convincing that ESG can deliver superior investment results.

Biggest barriers to ESG adoption, by investor type



Global view



28% Believe ESG factors do not directly improve financial performance

Proving investment results

While institutional investors harbour stronger concerns about investment results, they are also more inclined to put such concerns aside if presented with research demonstrating a clear link between ESG and returns.

Nearly half of institutional investors (46% vs. 38% wholesale) say that more convincing academic evidence showing a positive relationship between ESG and returns would encourage their organisation to raise its ESG focus.

These findings show that investors set a high bar of proof when it comes to demonstrating investment results. This underlines the importance of providing investors with concrete, data-led evidence. Investors will not be swayed by vague assertions or abstract predictions. They want proof rather than promises that ESG will generate alpha.

But proving that ESG alone is driving returns is difficult due to the many factors – such as geography, market capitalisation, quality or value – that can affect returns, and how they may correlate with ESG issues. For example, large corporations and regions with elevated disclosure requirements tend to have better ESG scores. The inability to split correlation from causality is an ongoing debate and challenge.

Long time frames associated with some of the ESG themes, such as transition from fossil fuels, also make it difficult to prove investment results.

Outsourcing expertise

A larger proportion of institutional investors compared to wholesale investors cite a lack of internal resources/expertise as a major barrier to greater ESG adoption (28% vs. 21% wholesale). In addition, slightly more institutional investors say a better-equipped and larger internal ESG team would help their organisation analyse and implement ESG factors (32% vs. 30% wholesale).

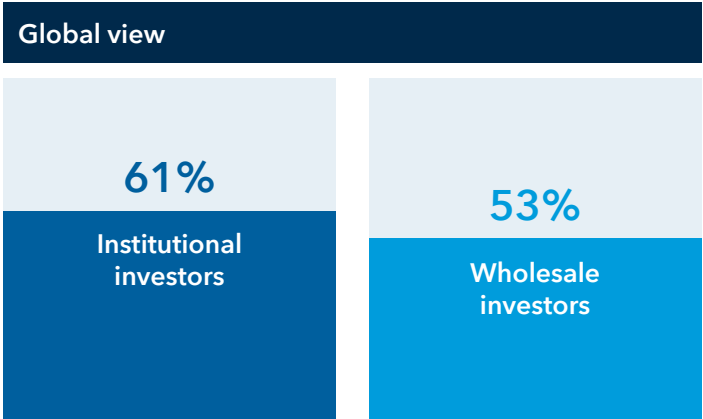
Such concerns underline the case for outsourcing ESG to third-party asset managers with ESG expertise. Institutional investors derive a sense of confidence and reassurance from letting dedicated external experts handle the ESG investment function. Indeed, when asked which asset manager characteristics most inspire trust and confidence when investing in ESG, more institutional investors point to ESG specialists with dedicated capabilities (42% vs. 37% wholesale).

Greenwashing

While institutional investors need more convincing that ESG can improve investment results, they also need more convincing that ESG funds are legitimately green. Institutional respondents display more concern about ESG funds not living up to their green credentials than wholesale investors. Six in 10 (61%) think greenwashing is prevalent within the asset management industry compared to 53% of wholesale investors.

How prevalent do you think greenwashing is within the asset management industry?

Rate on a scale of 0-10.



Percentage of respondents who rated prevalence 7-10.

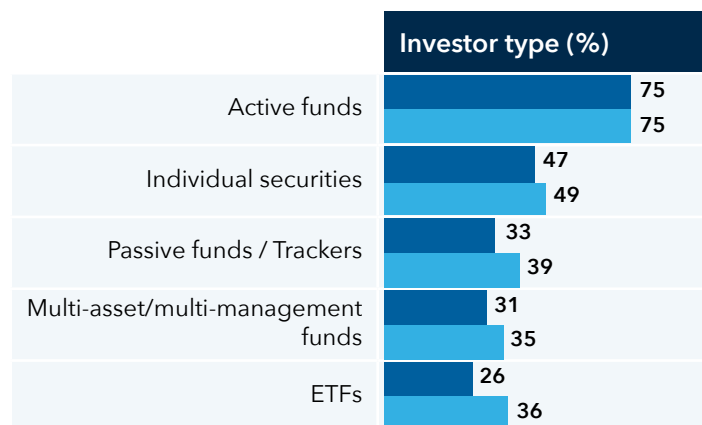
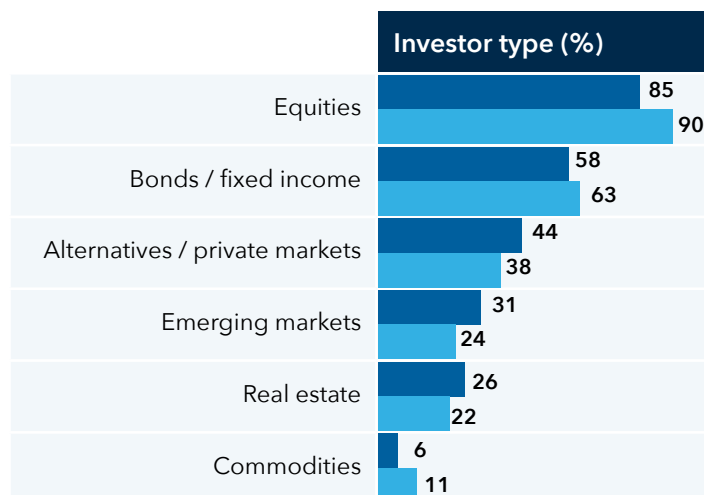
A wholesale desire for diversity

Wholesale investors, meanwhile, are looking for a more diverse set of ESG investment options. A larger proportion say a wider range and availability of investments/vehicles, including bespoke ESG approaches, would encourage them to enhance their ESG focus (41% vs. 33% institutional). This finding indicates that a perceived lack of product innovation and diversity could be holding back wholesale investors from investing more sustainably.

Wholesale investors also tend to use a broader range of asset classes, investment vehicles and strategies to access and implement ESG. A higher proportion use both equities (90% vs. 85% institutional) and bonds (63% vs. 58%) to gain exposure to ESG. They also make greater use of passive funds (39% vs. 33%), multi-asset funds (35% vs. 31%) and exchange-traded funds (36% vs. 26%).

Preferred asset classes/vehicles to integrate ESG, by investor type

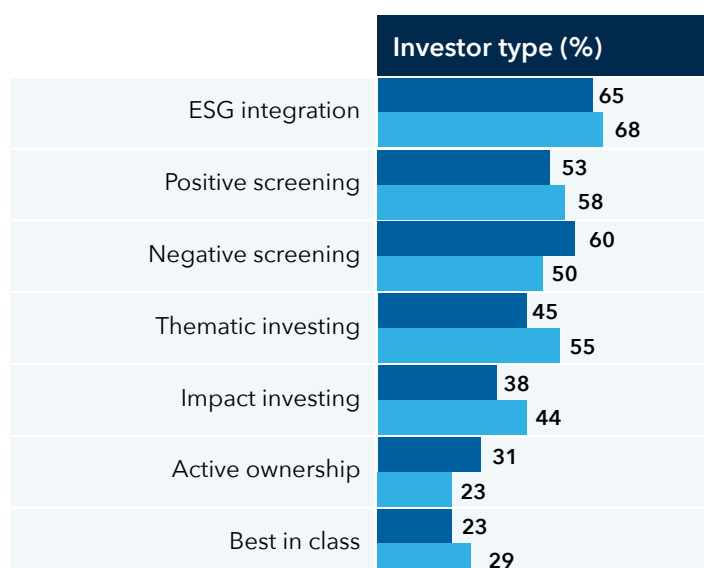
Institutional investor **Wholesale investor**



This group of investors also employs a wider set of implementation strategies – more use thematic investing (55% vs. 45% institutional), positive screening (58% vs. 53%) and impact investing (44% vs. 38%). Slightly more wholesale investors use ESG integration (68% vs. 65%), which is the most prevalent implementation strategy for both groups.

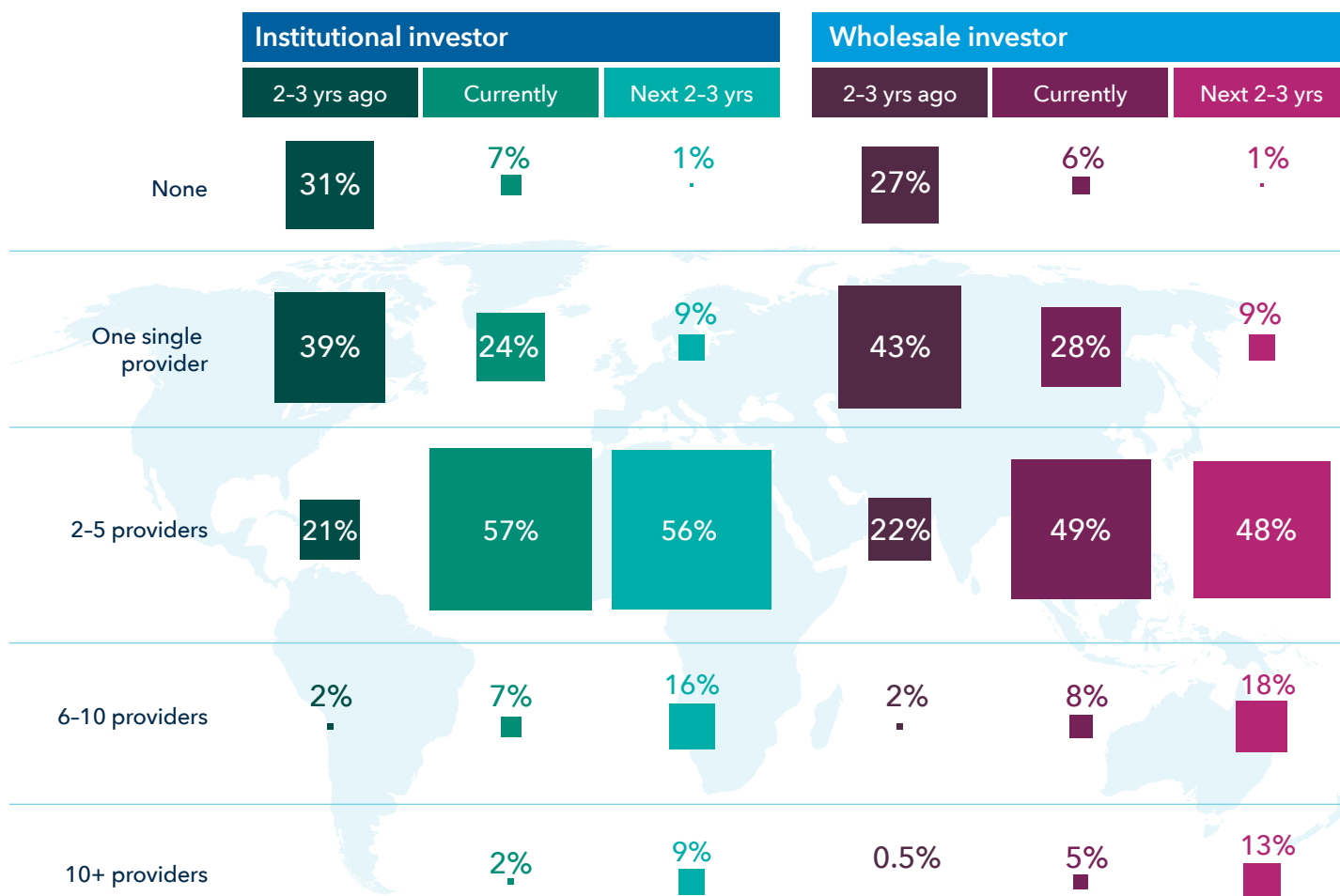
Preferred implementation strategies, by investor type

Institutional investor **Wholesale investor**



The appetite for more choice and a wider range of options also plays out when we look at use of ESG data and research providers. Wholesale investors are increasingly relying on multiple providers. A larger proportion currently uses more than six providers (13% vs. 9% institutional), with this figure set to rise to 31% (vs. 25% institutional) over the next two to three years.

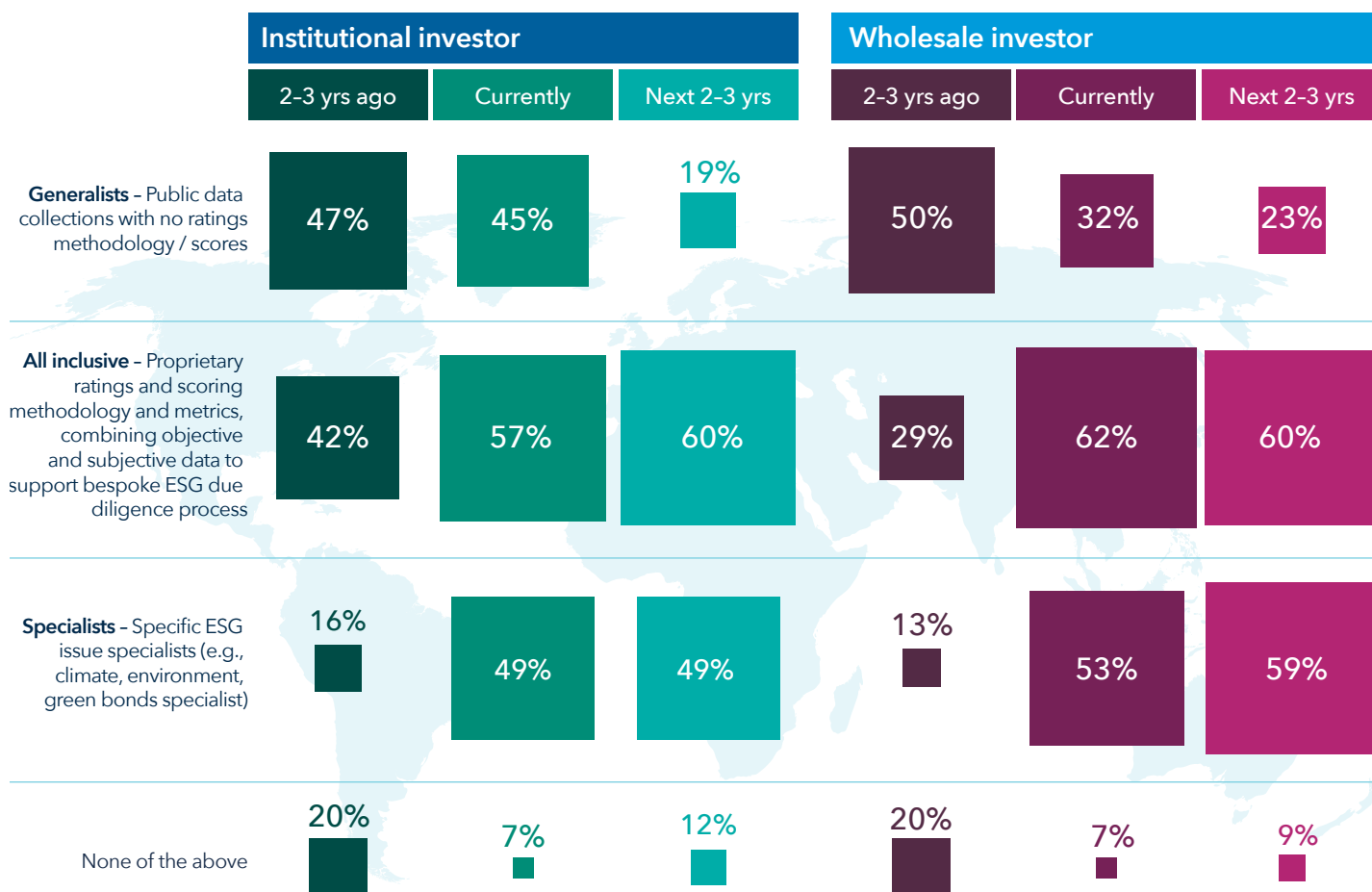
Number of ESG data and research providers used, by investor type



Multiple answers allowed.

Wholesale investors are also keener users of specialist data and research providers. A higher proportion currently uses specialist providers focusing on specific ESG issues (53% vs. 49% institutional). And more wholesale investors expect to use these specialist providers over the next two to three years (59% vs. 49% institutional).

Types of ESG data and research providers used, by investor type



Multiple answers allowed.

06

Data and ESG data providers

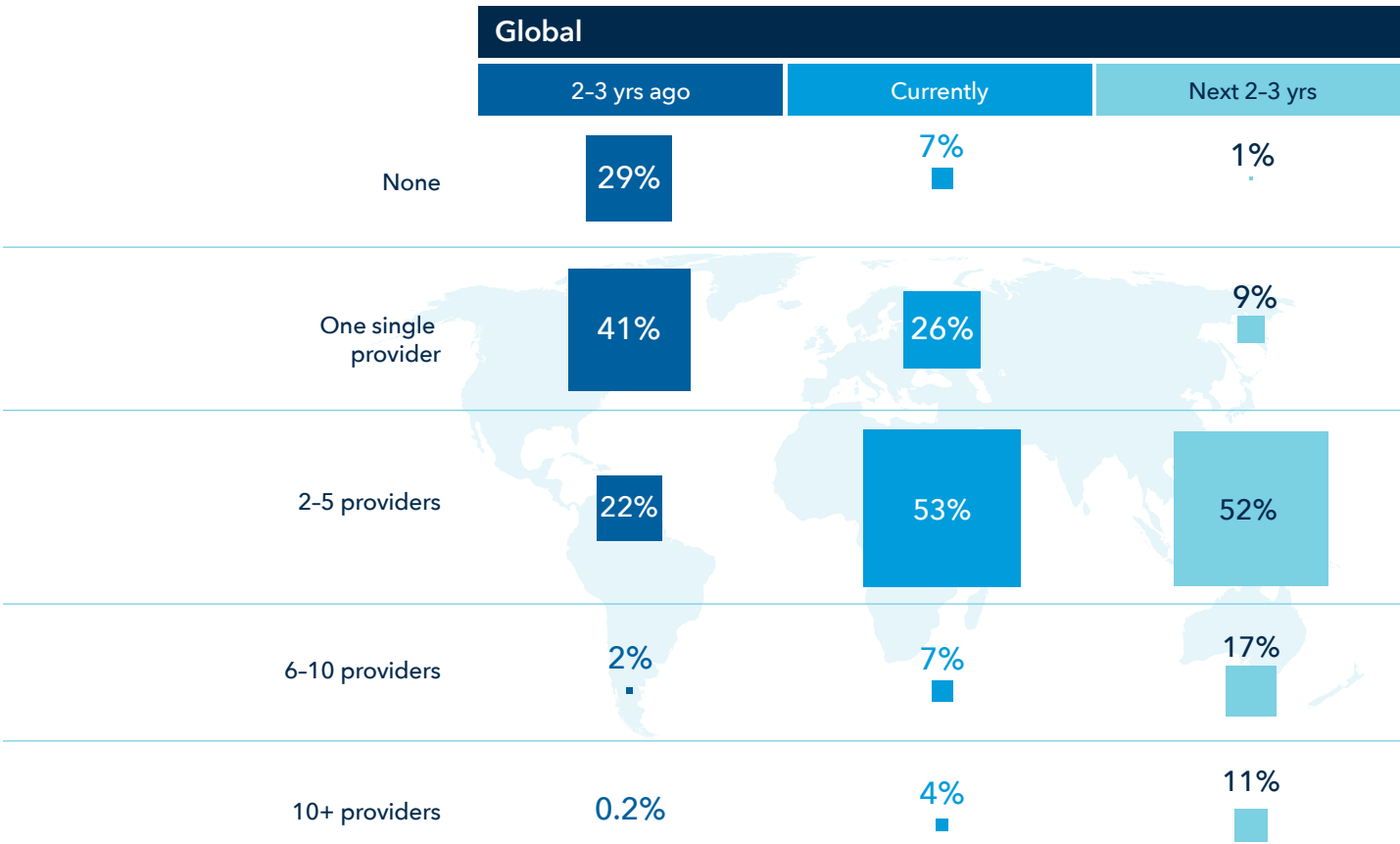
Data and ESG data providers

A thirst for data

As investors seek out more information about the sustainable credentials of companies, ESG data and research providers are playing a greater role. Just 7% of global investors say they don't use any data and research providers – compared to three in 10 (29%) two to three years ago.

The thirst for knowledge and information is also seeing investors increasingly rely on multiple providers. More than half (53%) of investors now use two to five providers compared to less than a quarter (22%) of investors two to three years ago. This multiple-provider strategy is set to become more entrenched, with the proportion who use at least six providers expected to more than double over the next two to three years, from 11% to 28%.

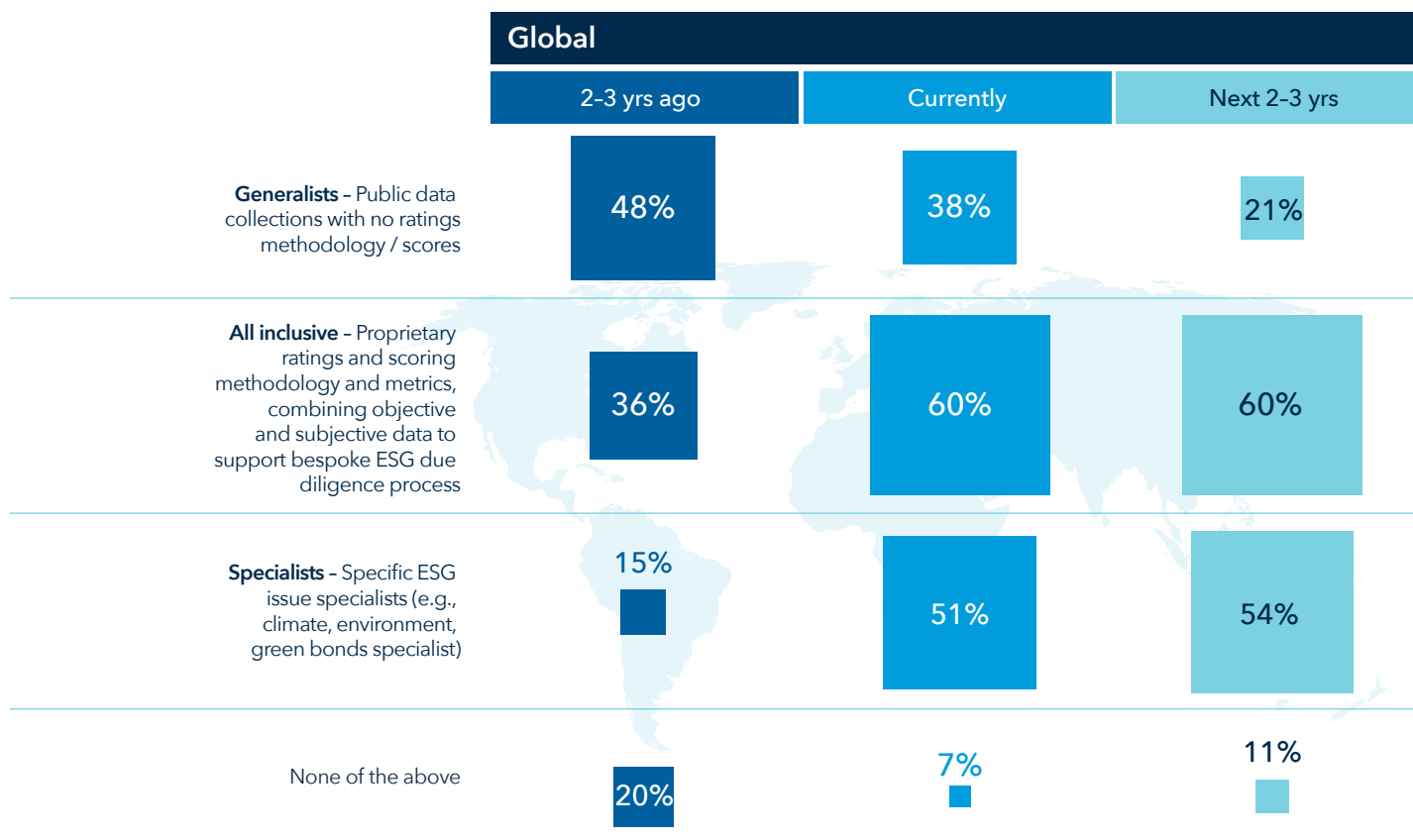
Number of ESG data and research providers used



A shift to specialist providers

Investor appetite for more detailed ESG data and information can also be observed with the move away from generalist providers to specialist outfits. Two to three years ago, almost half of investors globally (48%) relied on public data collectors with no ratings methodologies/scores (generalist providers). But today, six in 10 (60%) use providers with proprietary ratings and scoring methodologies (all-inclusive) and more than half (51%) use specific ESG issue specialists.

Types of ESG data and research providers used

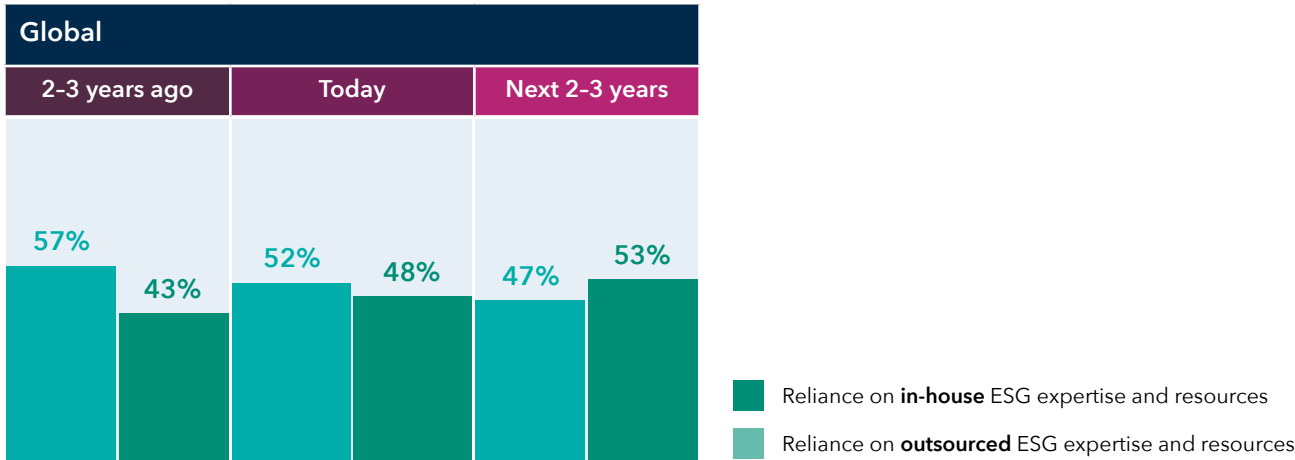


In-housing expertise

But as investors look for more specialist sources of information, they are also shifting away from a reliance on outsourced ESG resources and toward in-house expertise. Two to three years ago, the reliance on outsourced ESG expertise and resources stood at 57%, but this has declined to 52% today. And this is expected to further drop to 47% over the next two to three years, by which time investors will mainly rely on in-house ESG resources (53%).

These findings suggest investors want to develop and customise their own ESG resources so their investments can have a more targeted impact.

In-house versus outsourced expertise



“At my firm, I’ve seen in-house capabilities being built up over the last couple of years, and I’m also aware of other institutional investment firms adding people with ESG expertise,” says a portfolio manager at a Singapore sovereign wealth fund.

An investment team member at a Singapore registered investment advisor says his company has integrated ESG analysis at the firm level: “When we work in-house, we are actually creating a framework that can be followed and replicated over years to come, because ESG is not going to go away. We all need to have experience and expertise in ESG in some form or other.”

However, a member of the investment team at a Swiss private bank says his company is not developing its in-house expertise for now: “My bank is following a wait-and-see approach when it comes to ESG investing. They don’t want to reinvent the wheel, so we partnered with an asset manager to create a fund, as they are much more advanced than us on ESG investing. We do the marketing and sales speech, but they do the fund management side. We therefore prefer to have a partnership type of approach. The good part is that we rely on experts; the bad part is this tends to be slow moving.”

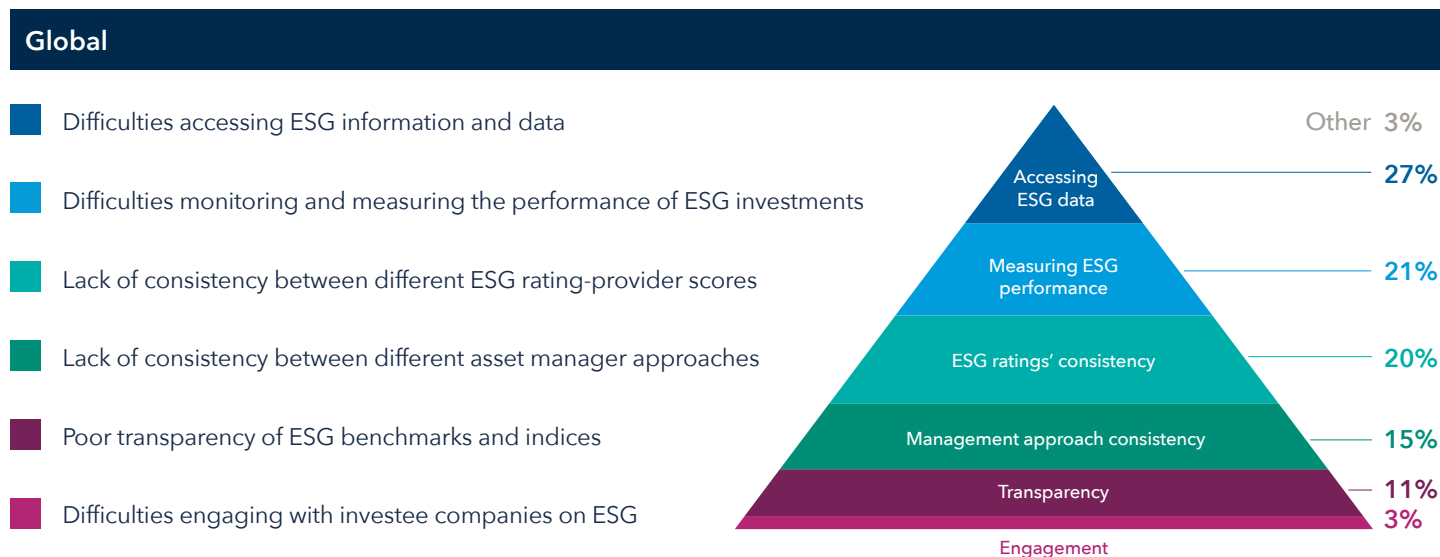
Data difficulties

As investors gather increasing amounts of information to inform their ESG decision-making, they are encountering difficulties with the reliability of data. Problems with the quality, consistency and accessibility of ESG data present themselves throughout the investment journey.

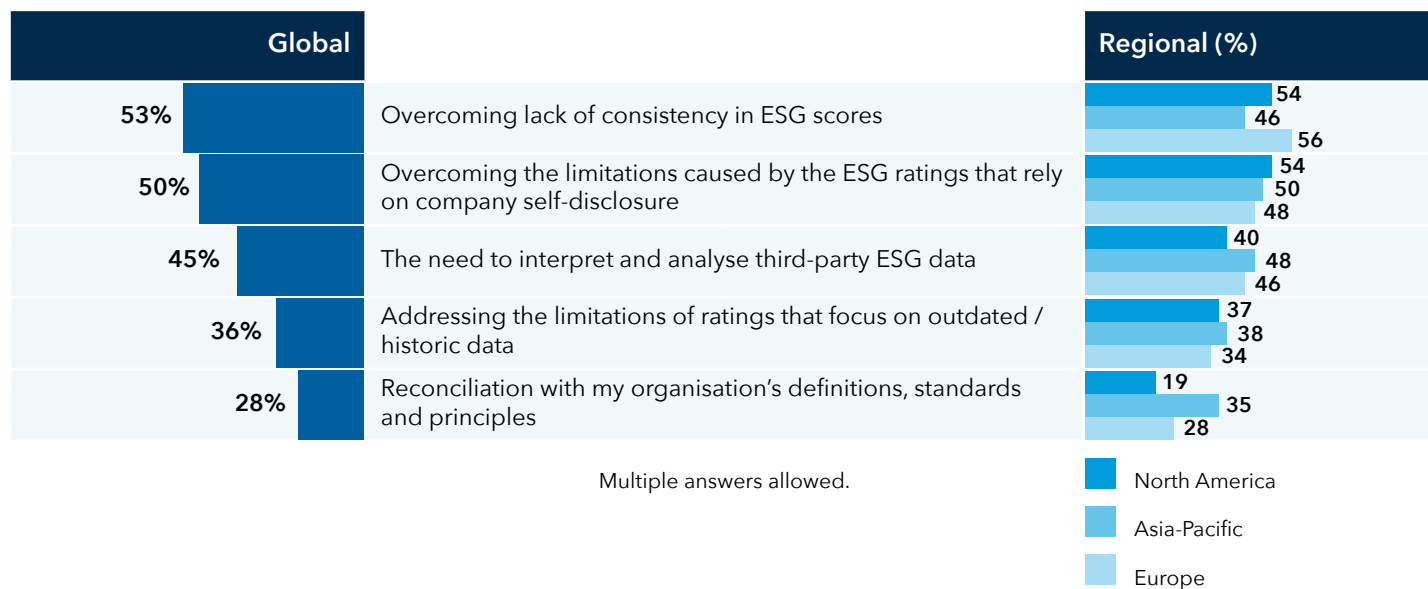
Global investors point to a lack of robust data (49%), along with concerns about investment results, as the number one barrier to greater adoption of ESG.

Data is again the top hurdle when it comes to implementation. More than a quarter (27%) of global investors say difficulties accessing reliable information and data are the number one challenge when implementing ESG investments. And one-fifth (20%) point to the lack of consistency between different ESG rating-provider scores as the top implementation challenge.

Top challenges when implementing ESG



Greatest challenges when incorporating ESG data, ratings and research



Difficulties with ESG scores also present a major barrier when incorporating ESG data. More than half (53%) of global investors say overcoming the lack of consistency in ESG scores is the greatest challenge when incorporating ESG data, ratings and research. And just under half (45%) say the predominant challenge is the need to interpret and analyse third-party ESG data.

“When it comes to the major ESG rating providers, there is a large inconsistency,” says a member of the investment team at a Singapore registered investment advisor. “And the real problem with these providers is they don’t adopt a forward basis but look at it on a backward basis. As an investor, when you look at a company, you are trying to figure out what it will look like going forward. This does not happen in the ESG world.”

A portfolio manager at a Singapore sovereign wealth fund also highlights problems caused by data inconsistencies. He thinks the answer lies in ESG data providers collaborating to develop a more coherent framework: “Data providers could potentially work together to try and harmonise the different standards and frameworks that they have; and I think that would be very helpful to institutional investors like us.”

He adds that there also needs to be a more sector-specific approach to ESG scores: “It would be good to have an industry and sector lens for the ESG factors, because different factors affect different industries.”

“Data providers could potentially work together to try and harmonise the different standards and frameworks that they have; and I think that would be very helpful to institutional investors like us.”

Fundamental research

Investors are currently swamped by large volumes of ESG data and information. Difficulties stemming from a lack of consistency in ratings and scores are adding to the data overload. Different scoring methodologies and conflicting definitions of what is good practice mean the same company can be rated highly by one provider and poorly by another. Divergent data is creating confusion for investors and ultimately creating more questions than answers.

Add to this a reliance on self-disclosure, and it’s not surprising that there are accusations of greenwashing.

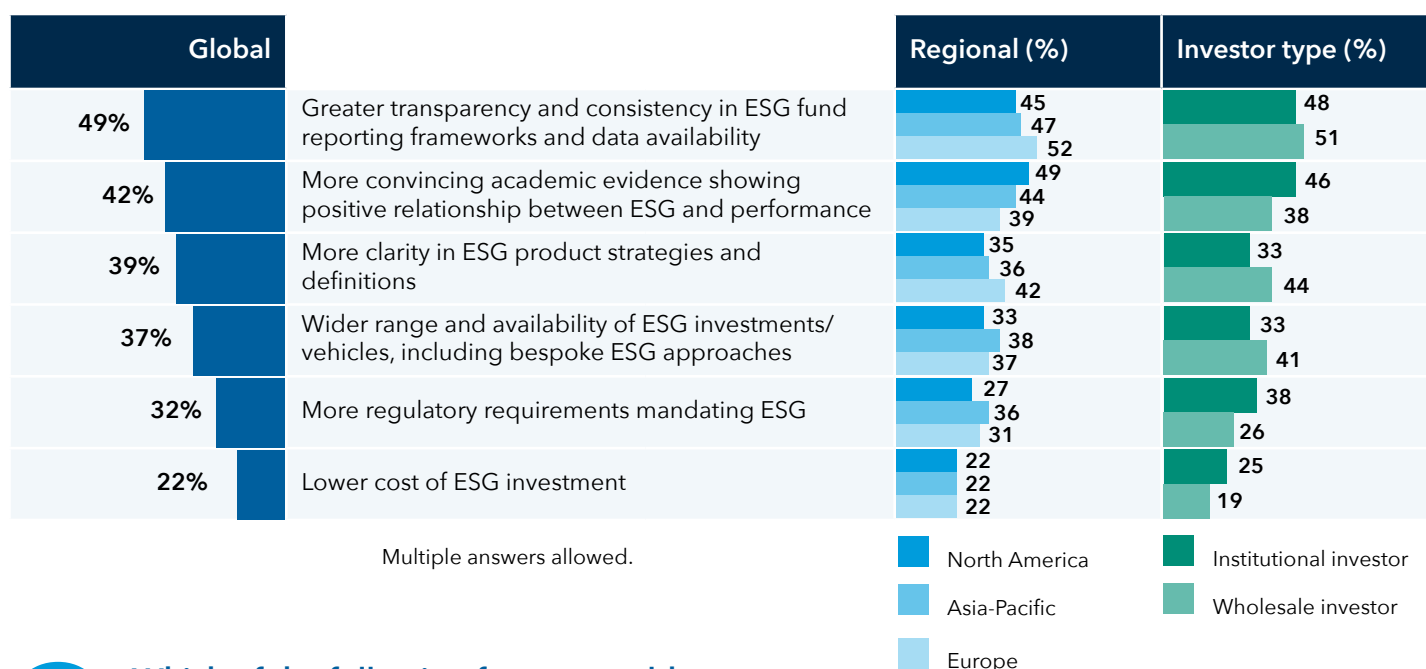
This is precisely why active management is so important. The problems created by a lack of consistent, reliable and accessible data can be addressed through an active approach with an emphasis on fundamental research and a rigorous process. Such an approach goes well beyond ESG scoring mechanisms to identify and understand specific ESG risks and opportunities through fundamental security analysis. This can be especially useful when analysing smaller companies where there is less external research coverage. Fundamental proprietary research digs deep to find information that provides actionable insights.

The problem and the panacea

Data is the main challenge when investing in ESG but can also be the key to unlocking greater ESG investment. And asset managers play a pivotal role in deploying data to drive better outcomes.

Indeed, nearly half (49%) of global investors say greater transparency and consistency in ESG fund-reporting frameworks and data availability would most encourage their organisation to increase its ESG focus.

Factors driving ESG focus



Which of the following factors would encourage your organisation to increase its ESG focus?

Furthermore, 43% of global investors say consistent data from asset managers would help them most when it comes to better analysing and implementing ESG factors.

Meanwhile, 42% of investors say more convincing academic evidence showing a positive relationship between ESG and returns would encourage them to increase their ESG focus. This, again, underlines the centrality of reliable data and information and their ability to influence investor behaviour.

What investors need to better analyse and implement ESG



Multiple answers allowed.



What would help your organisation better analyse and implement ESG factors?

(Select up to five answers.)

Data the dominant driver

This study demonstrates the driving and dominant role of data when it comes to ESG. A lack of robust data is the biggest barrier to greater ESG adoption. But the provision of reliable and insightful data and research is the greatest aid when it comes to adopting and implementing ESG. It can also ensure that funds are directed to those causes that could have the most impact and that investors care about most. This will ultimately improve investor trust and confidence amid escalating concerns over greenwashing.

07

Regulation, reporting and greenwashing

Regulation, reporting and greenwashing

The green sheen

The inexorable rise of ESG has been accompanied by growing concerns over greenwashing – where companies embellish their green credentials to enhance their reputation or gain more business.

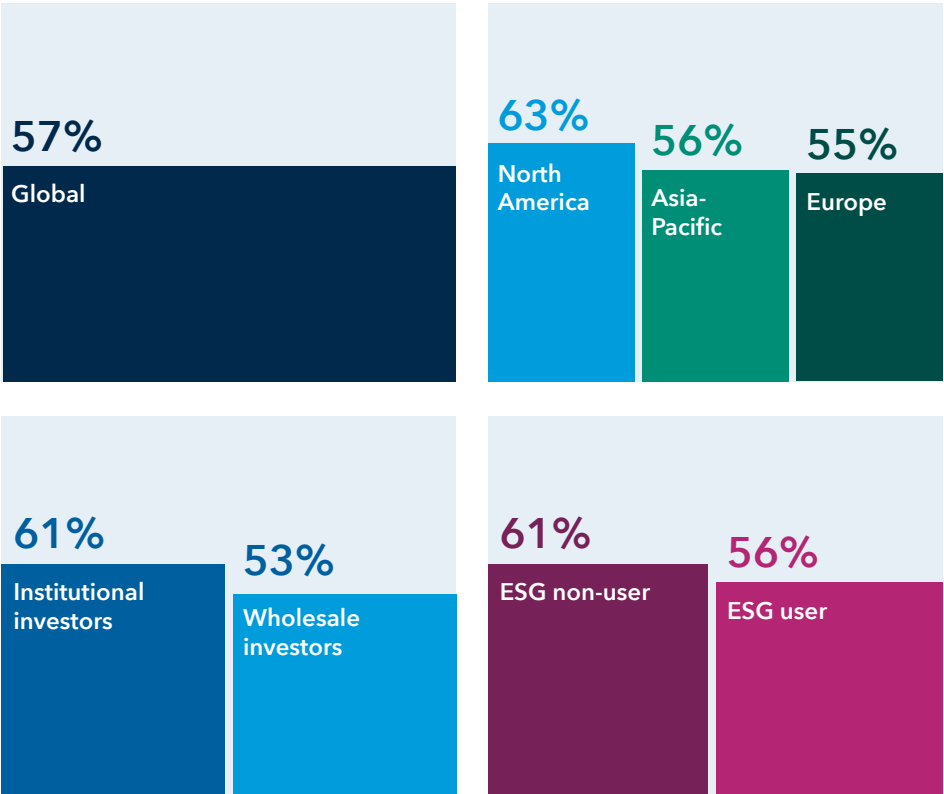
Almost six in 10 global investors (57%) think greenwashing is prevalent within the asset management industry. This issue holds particular concern to investors in North America, where almost two-thirds (63%) say greenwashing has become widespread. Such misgivings perhaps explain why the U.S. has lagged somewhat on the ESG front.

It's important to note that concerns around greenwashing are more pronounced among non-ESG users. More than six in 10 (61%) non-users think greenwashing is prevalent compared to 56% of ESG users. This indicates worries over greenwashing could be a strong barrier to ESG adoption among non-users. Marketing and media campaigns that educate and inform investors about ESG could help overcome these barriers and ultimately increase ESG uptake.



How prevalent do you think greenwashing is within the asset management industry?
Rate on a scale of 0-10.

Prevalence of greenwashing



Percentage of respondents who rated prevalence 7-10 .

"Reputational risk is a big barrier to institutional investors getting into ESG," says a U.K. endowment director. "Because of unethical stakeholders who greenwash, some pension funds and sovereign wealth funds just can't afford the reputational risk, so they just don't invest."

Despite the perceived prevalence of greenwashing, investors say it has not made them more cynical about ESG investing.

"I don't think greenwashing deters us from continuing to commit to ESG," says a portfolio manager at a Singapore sovereign wealth fund. "We think that, while there might be some companies that are greenwashing, we focus on using the right frameworks and the right approach to really discern between the misleading ones versus the ones that are truly providing an ESG impact."

A portfolio manager at a Canadian pension fund questions the extent of greenwashing. "We don't see ESG as a fad, and we don't see an ulterior motive behind it," he says. "We see it as a legitimate way to further assess or evaluate your portfolio."

Tackling greenwashing

More transparent fund reporting is seen as the most potent weapon in the fight against greenwashing. Over half of global investors (55%) say increasing the quality and transparency of fund reporting/fund literature is the best way to tackle it. This proportion rises to nearly two-thirds of Asia-Pacific investors (64%).

These findings highlight the need to alleviate investor concern over greenwashing through comprehensive fund literature that details particular ESG investments and spells out how they will be monitored.

A portfolio manager at a Canadian pension fund questions the extent of greenwashing. "We don't see ESG as a fad, and we don't see an ulterior motive behind it," he says. "We see it as a legitimate way to further assess or evaluate your portfolio."

Best ways to tackle greenwashing



Multiple answers allowed.



Clear explanation of ESG role

Investors say providing a clear explanation of the role ESG plays in the investment process is the most important element of fund sustainability reporting (50%). The second-most important element, according to 43% of investors, is reporting on specific E, S and G factors. With investors allocating nearly half of their ESG focus to environmental factors, in-depth reporting on the E element will be paramount.

Clear and comprehensive fund reporting is seen as key not only to tackling greenwashing but also increasing investors' willingness to integrate ESG.

Most important elements of fund sustainability reporting



Percentage ranked in the top 3.

Clear definitions

A U.K. endowment director thinks the greenwashing issue stems from a lack of definition: “If you asked 100 people what they see as ESG, you’re going to get 100 different answers. There’s a lot of misunderstanding about what it means and how it can be monitored, and there are so many ESG index providers. If there were an agreed strong definition of ESG, that should stop greenwashing in its tracks.”

A portfolio manager at a U.S. insurance company agrees. “The lack of a clear definition as to what is a good ESG name versus a bad ESG name is holding back greater adoption of ESG,” he says. “When I attended a recent conference discussing ESG in the insurance industry, 90% of it was trying to get to definitions. How do we define a credit that is good from an ESG perspective versus bad from an ESG perspective?”

The role of regulation

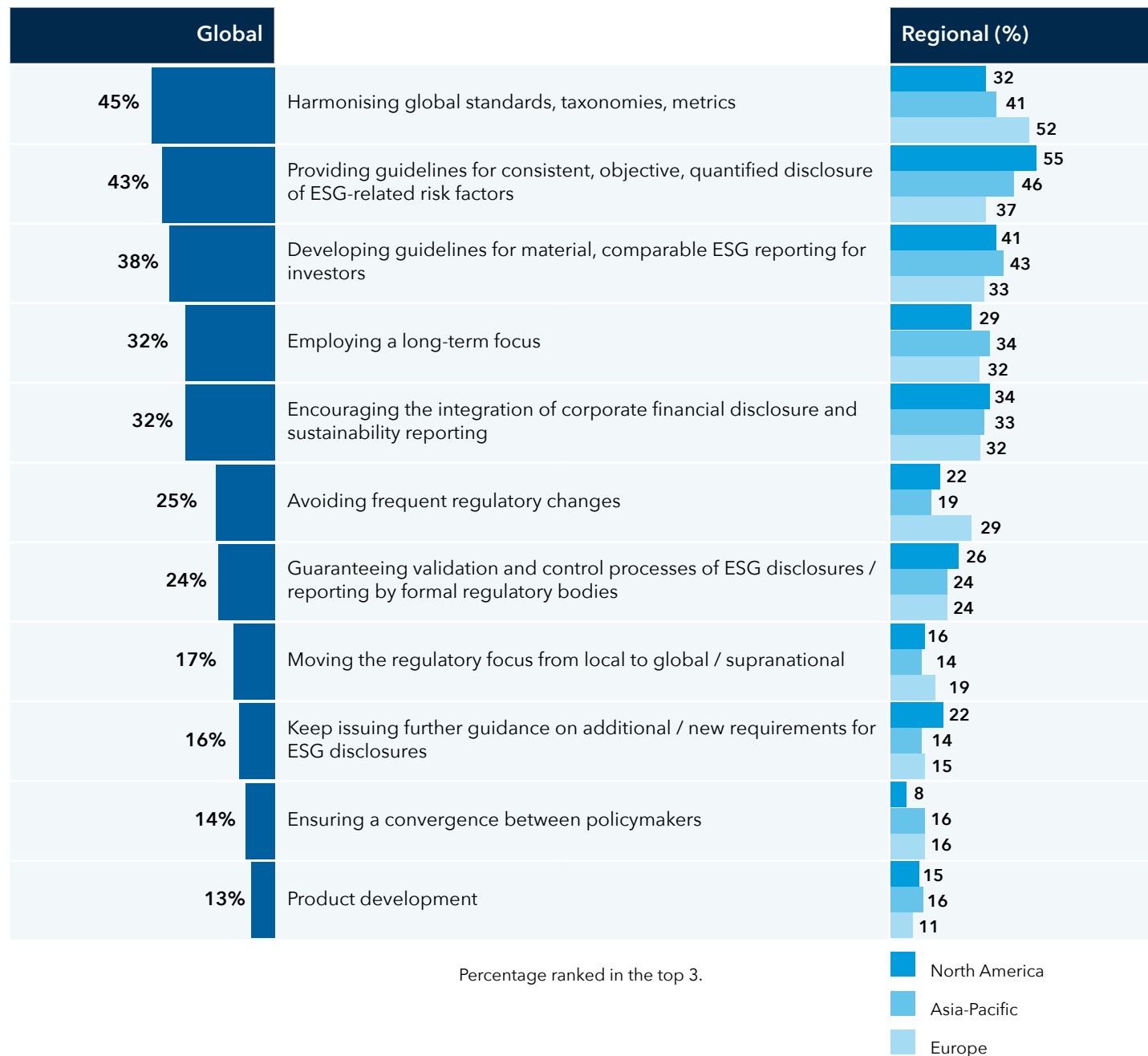
Regulation is also seen as key to solving the greenwashing issue. Nearly half (47%) of investors say setting minimum regulatory standards for investment products and services to qualify as sustainable would help tackle greenwashing.

But the current global ESG regulatory framework represents a disjointed and chaotic patchwork of different rules overseen by different bodies and a range of both hard and soft regulation.

Despite more ESG regulation and ESG data than ever before, all designed to prevent greenwashing, investor concern remains very high. Nearly half (45%) of global investors say harmonising global ESG standards, taxonomies and metrics should be the top ESG priority for national regulatory frameworks in their respective countries.

“If you asked 100 people what they see as ESG, you’re going to get 100 different answers.”

What should the ESG regulatory framework prioritise?

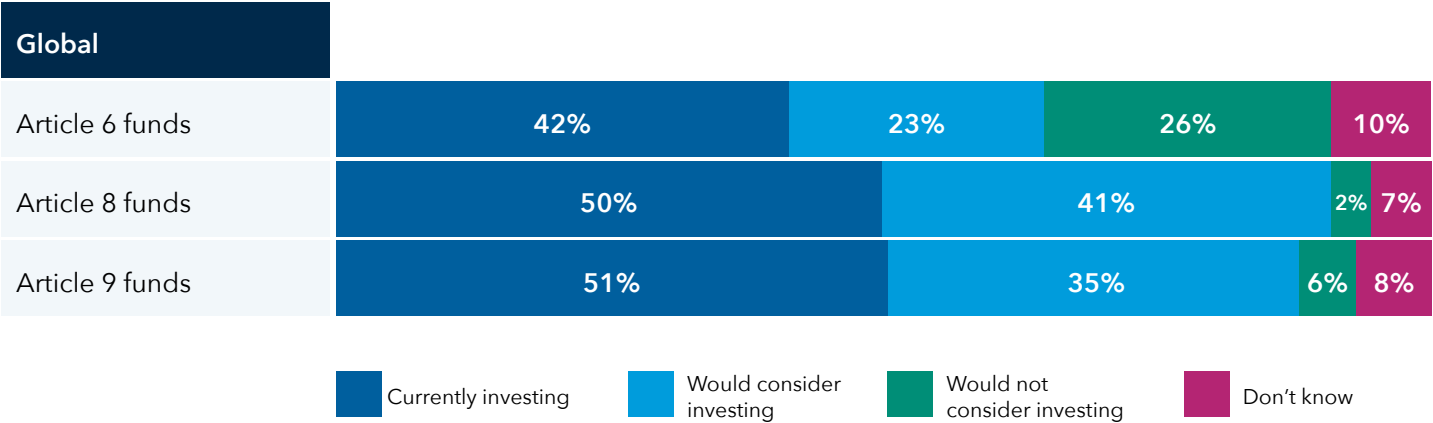


Q What should the ESG regulatory framework in your country prioritise?
 (Rank five priorities in order of importance.)

European investors are the loudest advocates of a global regulatory framework, with 52% demanding regulators harmonise global standards, taxonomies and metrics. Europe, which introduced the Sustainable Finance Disclosure Regulation (SFDR) in March 2021, is arguably setting the pace on the regulatory front. European respondents show strong commitment to SFDR-classified vehicles, with half currently invested

in Article 8 and 9 funds. We expect this proportion to further grow. The concerns we see in our survey mirror some of the industry comments over the rather vague definition of Article 8 funds. We expect more focus on transparency and disclosure, which are in the regulatory roadmap to receive intense scrutiny, given the concerns on greenwashing and lack of harmony on standards.

Commitment to SFDR funds



Article 6: Funds with no mandated ESG considerations.
Article 8: Funds that promote Environmental or Social characteristics.
Article 9: Funds that have a sustainable investment objective.

The importance of disclosure and transparency

Achieving a strong framework on company disclosure is a central part of Capital Group’s ongoing consultation with policymakers. If we get the right corporate disclosure, it will create the right building blocks for asset managers to report clearly on ESG to end investors. Better disclosure will both increase investor confidence and help tackle greenwashing. Interestingly, the results from our survey support this: Consistent disclosure is ranked higher than pure policymaker convergence.

But a global guidance on ESG disclosure needs to be the right set of rules. They need to clarify and simplify the current complex and fragmented system. This is why we support existing frameworks like the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD), which have been built with investor and company input, as well as a focus on materiality, which is also important to investors.

Industry-wide consensus

Concerns about greenwashing need to be recognised and addressed. Our discussions with clients show that they want a constructive and transparent conversation about the role that ESG plays in investments. They value a focus on consistency and materiality. It’s a dialogue the industry as a whole needs to tackle collectively. Crucially, we must not let fear of greenwashing disrupt the progress the industry has made on ESG integration.

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