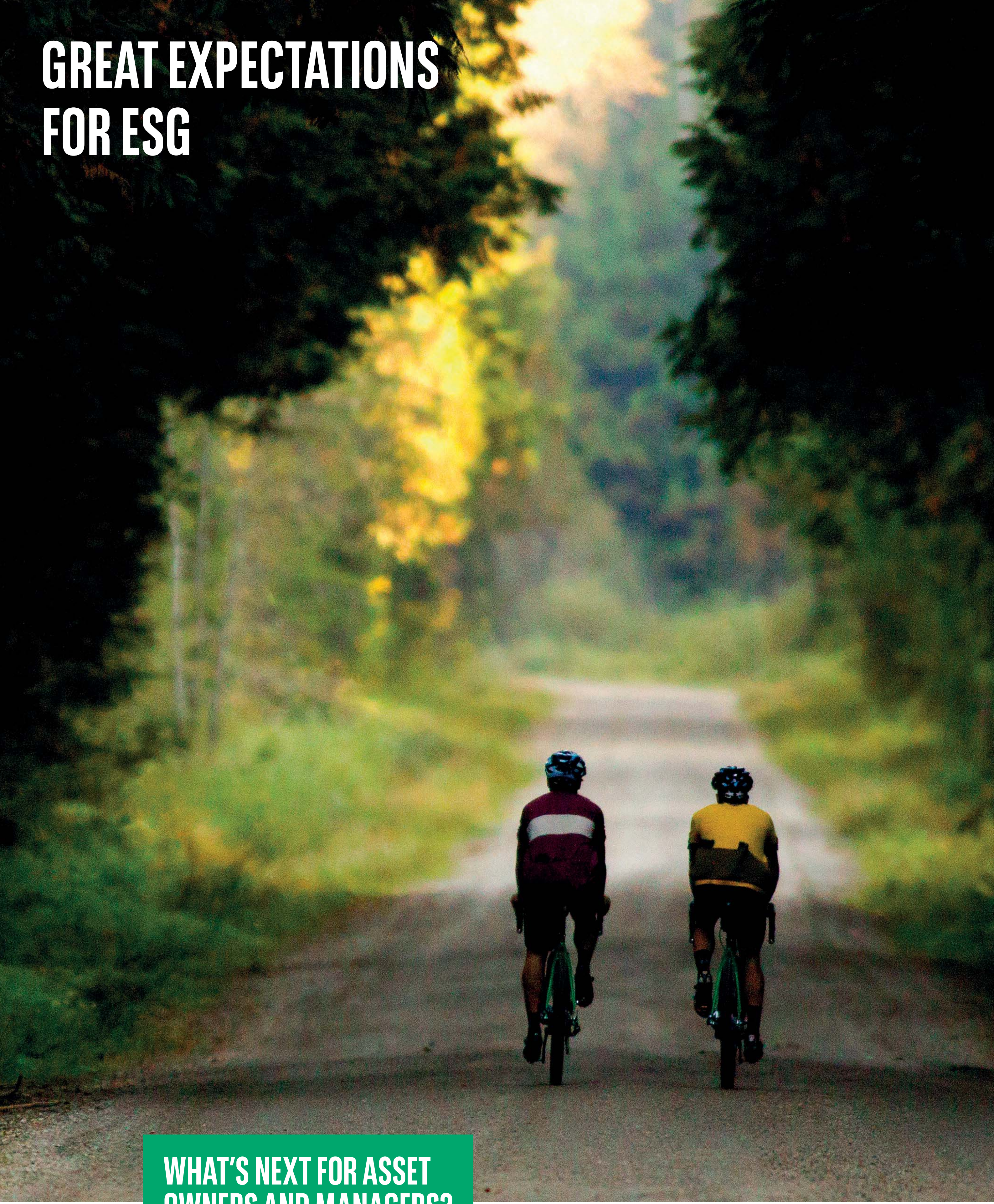
GREAT EXPECTATIONS FOR ESG



WHAT'S NEXT FOR ASSET OWNERS AND MANAGERS?

BNP PARIBAS

The bank
for a changing
world

MANAGING EDITORS
Kate Spencer, Global Marketing Manager, Asset Owners, BNP Paribas Securities Services
Sean Kearns, Managing Editor, Longitude Research

SPECIAL THANKS TO
Trevor Allen, Product Manager, Investment Reporting and Performance (IRP), BNP Paribas Securities Services
Amine Bel Hadj Soulami, Global Head of Research and Sustainable Investments, BNP Paribas Corporate and Institutional Banking (CIB)
Simon Danaher, Media Relations, BNP Paribas Securities Services
Madhu Gayer, Head of Asia Pacific, IRP, BNP Paribas Securities Services
Jean-Philippe Hecquet, Risk and Performance Analyst, IRP, BNP Paribas Securities Services
Stefanie Sfakianos, Head of Sustainable Capital Markets, CIB

PATRICK COLLE
–
General Manager
BNP Paribas Securities Services

FOREWORD

Environmental, Social and corporate Governance (ESG) and Sustainable Investing (SI) is a central topic for policymakers, institutional investors, and corporates. Related stories appear daily in the media, be it human rights, board diversity, or climate change. Major institutions and, increasingly, younger retail investors are keenly focused on these issues and managers are factoring the concepts into their investment strategies. In short, ESG and SI are no longer outliers to the portfolio selection and investment process.

Our clients believe very strongly that the finance sector has a crucial role to play in enabling the transition to a more sustainable economy.

As one of the world's leading financial institutions, BNP Paribas aims to fulfil those expectations and play a key role in supporting SI practices. The bank is a recognised leader in the green bonds market and a strong supporter of the United Nations Sustainable Development Goals' (SDGs) objectives. BNP Paribas and the World Bank recently partnered together to issue bonds that link returns to the performance of companies advancing global development priorities set out in the SDGs such as gender equality and healthcare infrastructure.

BNP Paribas Securities Services is the first major custodian to be a signatory to the United Nations-backed Principles for Responsible Investment (PRI) and has developed ESG Risk Analytics (ESGRA), an online tool that allows institutional investors to better understand the ESG risks contained within their portfolios and to make decisions on that basis.

BNP Paribas Asset Management is also one of the first asset managers in Europe to adopt a responsible investment policy and to apply ESG requirements to all its open-ended funds. This has been recognised by the PRI and by numerous European awards in the Socially Responsible Investment (SRI) arena.

The leading proponents of ESG recognise the benefits it provides in their investment decision-making process. However this report highlights a series of challenges that the institutional investor must tackle to extract the optimal value from ESG. We hope it provides you with insights into ESG, the challenges faced by your peers and how they intend to overcome these.

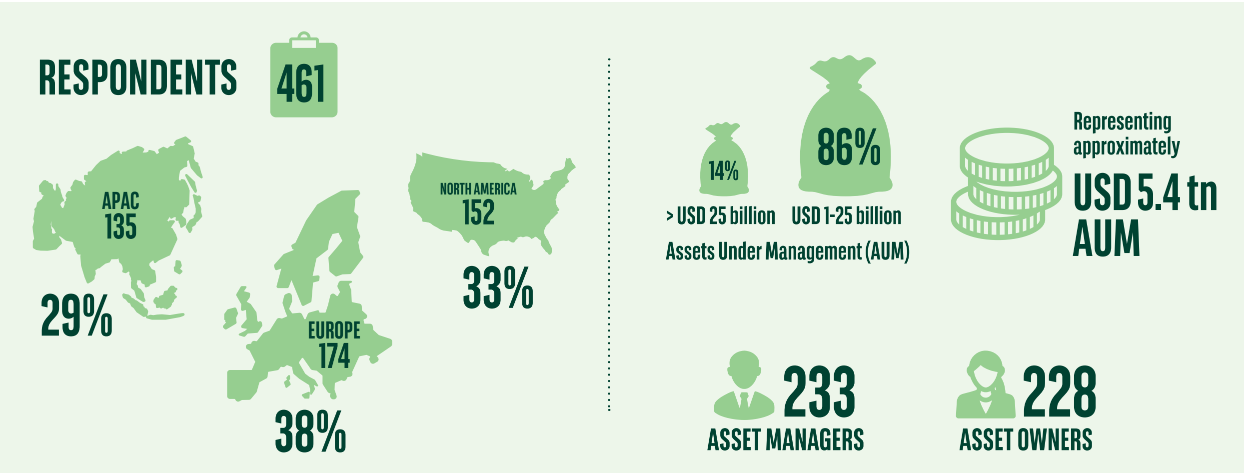
TABLE OF CONTENTS

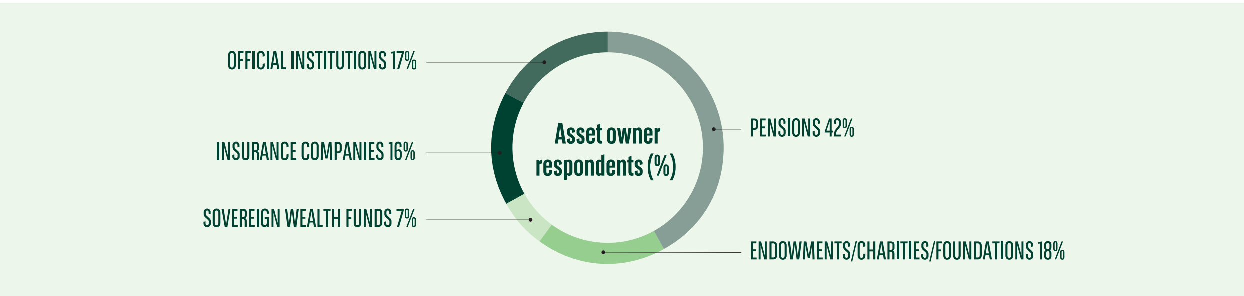
INTRODUCTION

BACKGROUND TO THE SURVEY

ESG integration is the incorporation of ESG factors into financial analysis and investment decision-making in order to enhance investment returns and mitigate risk.

Although many institutional investors have adopted ESG in their investment strategies, this adoption has often been limited to screening out the 'sinful' sectors and/or companies. But many investors are moving to the next level – integration across their entire investment value chains. This report looks at that next wave of integration.





The report is based on a global survey of 461 asset owners and asset managers and is complemented by a series of in-depth interviews. Participants include ESG practitioners and those who ultimately decide on the strategy and vision for the practitioners – the C-suite.

We look at the relationship between asset owners and asset managers, how the obstacles to ESG are shifting, and at the different patterns of activity that are emerging around the world.

KEY FINDINGS

ESG continues to grow
There is a pronounced shift to funds that incorporate ESG. By 2019, 46% of asset owners plan to have 50% or more of their investments in funds that incorporate ESG/RI, and 54% of asset managers plan to market 50% or more of their funds as ESG/RI funds. 47% of respondents who integrate ESG, apply ESG analysis to developed markets equities. ESG analysis however is set to grow in multiple asset classes in particular for fixed income, emerging markets and private equity.

The E in ESG takes centre stage
When asked which component (E, S or G) has the greatest potential influence on returns, 42% of respondents cite E – environmental factors. We would have expected more respondents to cite the influence of governance factors. We think this result shows that organisations are planning ahead to future legislation and the transition to a low-carbon economy. However, they find both the E and the S components to be the most difficult to analyse.

Green and sustainable bonds are a key part of the strategy
Our survey found that of those integrating ESG, more than 50% are also carrying out sustainable investing such as green and sustainable bonds (being bonds whose proceeds are specifically allocated to environmental and social projects).

Overcoming the data challenge – analytics and technology will be the enabler of ESG
Our survey suggests that today's data challenge will be less of a barrier in two years' time but instead analytics will be a major barrier. When they are fully exploited, advanced analytics (such as scenario analysis) and other new technologies will be future enablers of ESG.

Asset managers are struggling to develop the right products
Asset owners expect asset managers to have the skills and resources to provide ESG-related products and reporting. However, nearly a third of asset managers in our survey are concerned about rising costs and a quarter about whether they have the right products to meet the needs of asset owners. Good communication between the two groups is going to be increasingly critical to align the right products with the right organisations.

Practitioners are the realists
Heads of RI and ESG/RI analysts are far less confident in their organisations' ESG capabilities than respondents whose daily roles do not centre on ESG. This begs the question: are references to ESG in organisations' investment beliefs/mission statements filtering through to action at the working level?

The sceptics are confounded by the definition of ESG
A fifth of respondents do not incorporate ESG. There are numerous reasons for this, but the main one (at 38% of these respondents) is an inability to define ESG. Furthermore, 43% are unlikely to reconsider their position, which leads us to believe that the sceptics will be hard to convert.

APAC firms show the strongest potential for growth
Our survey highlights significant regional differences in strategy, adoption and attitudes towards ESG, with investors in the APAC region being the most positive in terms of ESG integration.


2
SP 23

GREAT EXPECTATIONS

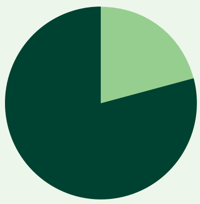
ESG CONTINUES TO GROW

“Our members are highly educated and engaged in their pension fund. And they have high expectations about what we do in this area.”

Sybil Dixon, Senior Investment Analyst, UniSuper

Does your organisation incorporate ESG in its investment decision-making process?

79% YES
(362)



21% NO
(99)

Our survey finds that nearly four fifths of asset managers and asset owners incorporate ESG factors into their decision-making.

What proportion of your funds are invested in/marketed as ESG/RI funds?

TODAY
< 25% of funds invested in ESG/RI

45% ASSET OWNERS

40% ASSET MANAGERS

TODAY
< 25% of marketed as ESG/RI

TWO YEARS' TIME
> 50% of funds invested in ESG/RI

46% ASSET OWNERS

54% ASSET MANAGERS

TWO YEARS' TIME
> 50% of funds marketed as ESG/RI

Of those asset owners incorporating ESG, 46% plan to invest at least half of their assets into funds that incorporate ESG by 2019, and 54% of asset managers plan to market at least half of their funds as ESG/RI funds by 2019. This represents a significant shift from today where for 45% of asset owners and for 40% of asset managers, 25% or less of their funds is either invested in or marketed as ESG/RI funds.

What is driving this growth? Both institutional and retail investors are demanding greater consideration of and disclosure around ESG issues and climate change in particular is a very high profile topic and one that directly affects millions of people around the world. In parts of Asia, for example, concerns about pollution and air quality are daily news items – this may explain why respondents from the APAC region were the most likely (84%) to incorporate ESG into their investment decision-making. APAC investors are also more likely than those in Europe or North America to say that environmental factors have the biggest influence on returns. Another key reason is institutional investors' views on fiduciary duty, with ESG now seen as highly relevant or indeed critical in satisfying fiduciary duties.

THE E IN ESG TAKES CENTRE STAGE

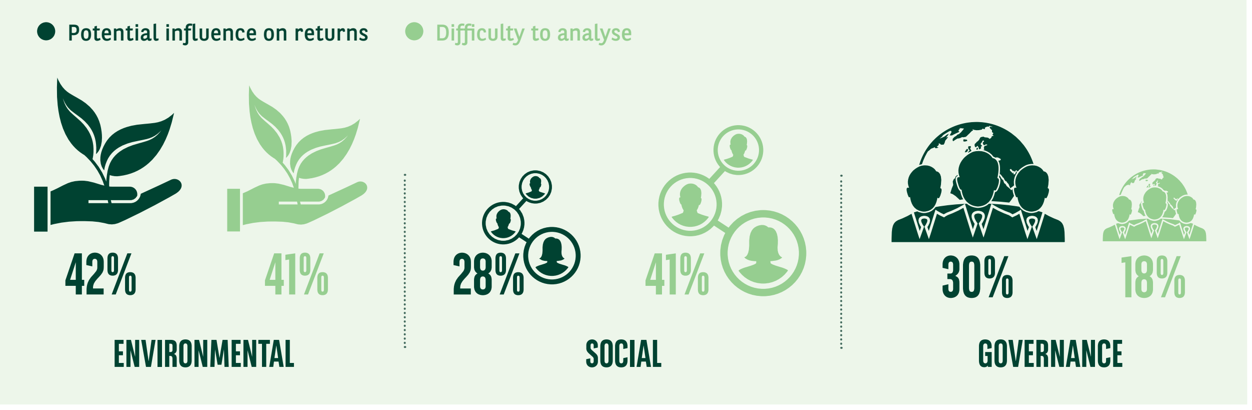
> "There is a lot of data on environment and governance, but on social factors it is so varied. It's the aspect where you really need the guidance of the asset owner, because social issues vary so much by market."

Charles Yang, Managing Director, Tokio Marine Asset Management

Nearly three quarters (72%) of respondents believe that ESG enhances investment returns over the long term.

But of the three pillars, which do they believe has the greatest potential impact? The E, S and G are perceived as having their own trade-offs in terms of their effects on returns and ease of incorporation, with G traditionally viewed as the most attractive.[1]

Which component of ESG (E, S or G) currently has the greatest potential influence on levels of return? And which component is currently the most difficult to assess and incorporate into investment analysis?



Of our survey respondents, 42% believe that environmental factors have the greatest potential impact on returns – a response that is not surprising. The media is reporting about climate change. Simultaneously there are well known initiatives such as COP21 and the Task Force on Climate-Related Financial Disclosures. As a result investors are starting to look at the transition to a low-carbon economy and its potential impact on portfolios, so institutional investors, with their long-term fiduciary duties, are increasingly concerned about the financial risks of 'stranded assets' – notably fossil fuel reserves – in a low-carbon economic future.

Environmental factors are ranked, along with social factors, as the most difficult to assess and incorporate into investment analysis. The perceived difficulty of analysing social factors may even be affecting perceptions of the S component's potential influence on returns. We believe that the potential benefits of this pillar are greatly underestimated.

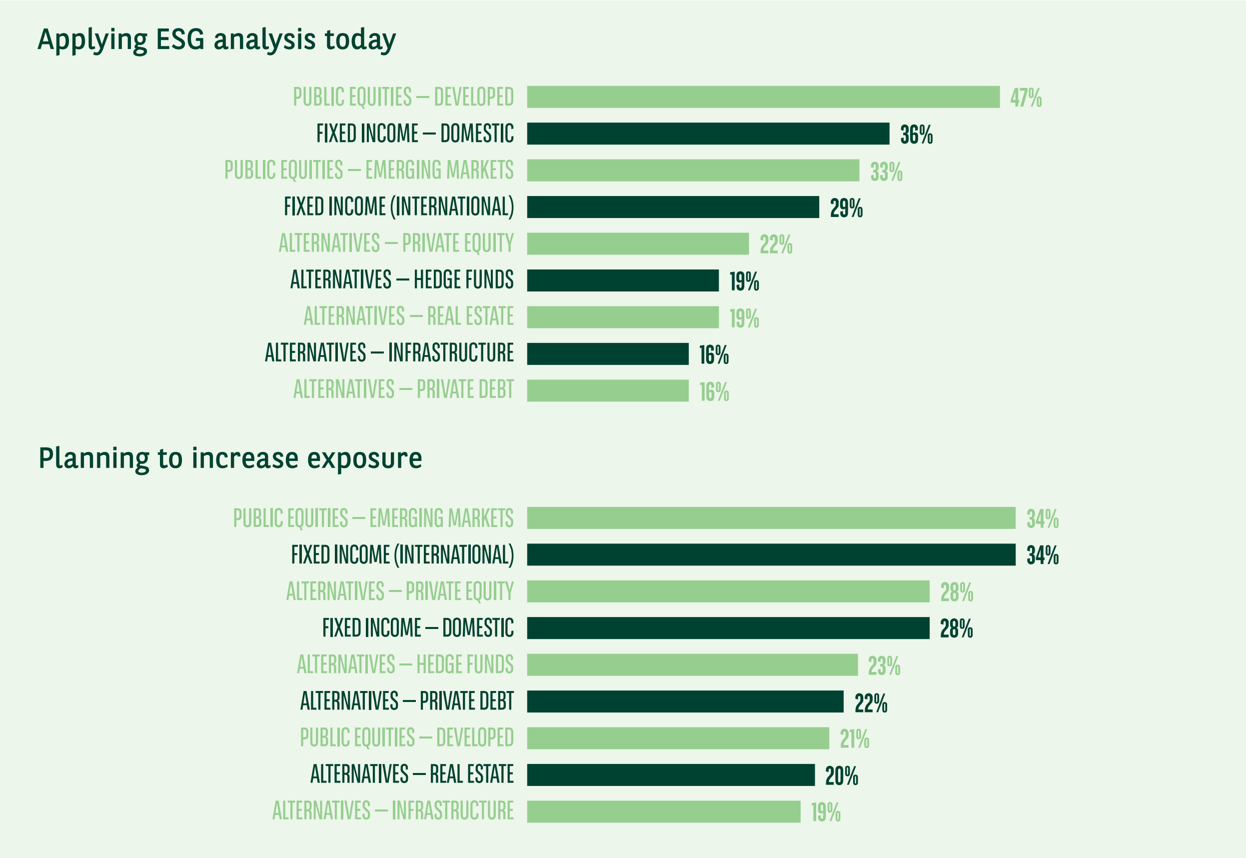
[1] Friede, Busch & Bassen – *ESG and financial performance: evidence from more than 2000 empirical studies*. Journal of Sustainable Finance & Investment. 15 December 2015.

APPLYING ESG TO A BROADER RANGE OF ASSET CLASSES

> “I worked with our alternatives team in the process of hiring their own ESG resources. For any organisation looking to embed ESG due diligence deeply into their investment process, it’s sometimes helpful to have a catalysing change agent to lead the charge.”

Jon Duncan, Head of Responsible Investment, Old Mutual Investment

Looking at the construction of your portfolios, which asset classes currently incorporate ESG analysis?
Of those asset classes that incorporate ESG, which do you plan to increase your exposure to over the next two years?



Our survey shows that asset owners and managers are primarily applying ESG analysis to developed market equities and less so to alternatives. However, respondents are ambitious about increasing allocations to a broader set of asset classes (fixed income, emerging market equities, private equity) and so we are likely to see a significant expansion of ESG analysis across asset classes.

Success depends, however, on definitions, standards and disclosure on the long-term business models of investee companies, and the picture is moving here. Global initiatives such as the Sustainable Stock Exchanges, the Global and Real Estate Sustainability benchmark, and the PRI’s Responsible Investment Due Diligence Questionnaire for Hedge Funds, are all pushing for disclosure. Meanwhile, companies will be motivated to improve how they perform from an ESG perspective in the knowledge that they will be more desirable to investors.

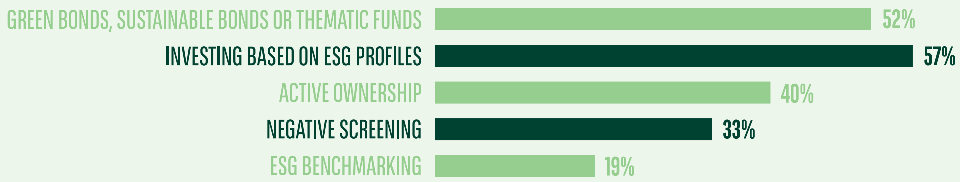
“We’ve got approximately 15 managers, working across a variety of portfolios and asset classes. We have a different set of ESG criteria for corporate bonds, for real estate, and for private equity, for example. And we’ve got an extensive list of criteria which we use to judge our managers.”

Jeroen van der Put, Managing Director, MPD

GREEN AND SUSTAINABLE BONDS ARE A KEY PART OF THE ESG TOOLKIT

According to the Global Sustainable Investment Alliance, globally there are USD 22.89 trillion of assets being professionally managed under responsible investment strategies, an increase of 25 percent since 2014.[2]

ESG strategies



Our survey found that Investing based on ESG profiles (ESG company research) and Investing in green bonds, sustainable bonds and thematic funds are the top two ESG approaches that respondents are taking.

BNP Paribas has lead managed over USD 8.9bn (~EUR 7.9bn) in Green Bonds since 2012. BNP Paribas and the World Bank recently partnered together to issue bonds that link returns to the performance of companies advancing global development priorities set out in the SDGs such as gender equality and healthcare infrastructure.

[2] *2016 Global Sustainable Investment Review*. Global Sustainable Investment Alliance.

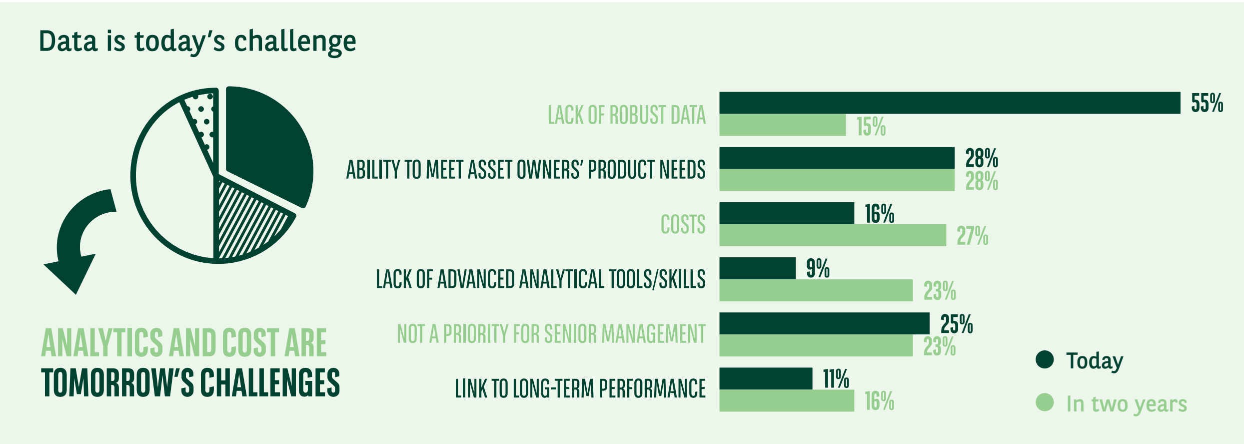
SHIFTING BARRIERS TO DEEPER INTEGRATION

THE MARKET PERCEIVES THAT THE DATA CHALLENGE WILL BE MET

“There is a blizzard of information out there, but it’s not so much quantity that is the problem, but quality, consistency and relevance.”

Anne Simpson, Investment Director, Sustainability, at the California Public Employees’ Retirement System (CalPERS)

What are the significant barriers to greater adoption of ESG across your investment portfolio currently, and what do you expect they will be in two years’ time?



It is difficult to draw definitive conclusions or answer the ‘so what?’ question without robust data. This is by far the biggest barrier today and is a particular concern for asset owners (64%). But it is not the challenge of tomorrow: data quality is set to substantially improve. As asset owner requirements become more sophisticated, the lack of analytical tools and skills is expected to become a more significant barrier.

> “Data is the easy bit. Analysis is the relatively easy bit. It’s the ‘so what’ in each asset class that is the challenge. But answering the ‘so what’ question is different in a credit portfolio than it is in an equities portfolio. Those analysts think in very different ways.”

Ian Woods, Head of ESG Research, AMP Capital

The BNP Paribas view on the ‘so what?’ and analytics

Today the main challenge cited in our survey is a lack of robust data. So why is this?

ESG risk assessments require metrics that capture and describe ESG factors and apply these across asset classes and investment vehicles. These metrics – based on quantitative and publicly available data – allow for a comprehensive scoring mechanism and rating of companies and jurisdictions. However, there is still a lack of consensus as to all the relevant ESG factors. Analysis typically involves third party input and data scrubbing, as not all stocks, bond issuers or funds report in the same way. Data can be patchy and require triangulation.

However, the industry is helping to solve this issue with new standards and definitions.

Tomorrow’s challenge is the seamless integration of ESG into the mainstream across the investment value chain – in company and portfolio valuation, portfolio optimisation, performance measurement, investment compliance monitoring, and risk analysis – so that the practitioner is able to gain the maximum value and provide the C-suite with decision-ready data and analytics. Placing ESG within a comprehensive risk management framework allows the investor to see the links and interaction between credit, market and liquidity risks, and then incorporate these explicitly into their scenario analysis.

THE TRAVAILS OF THE ASSET MANAGER: PRODUCTS AND COSTS

> “I think the question on skills and capabilities can be overcome, but cost is another issue. Who is going to foot that cost? Is it going to be yet another expenditure for asset managers, who will not be able to reclaim that incremental fee from asset owners?”

Charles Yang, Managing Director, Tokio Marine Asset Management

More than a quarter (28%) of asset managers are concerned about their ability to create the right ESG-themed products for their clients. That figure rises to 38% for the smallest firms (those with AUM of between USD 1 billion and USD 5 billion). Nearly a third (31%) of asset managers expect rising costs to be a significant barrier in two years’ time.

As more and better ESG data become available, it is concern over increased costs – of data, process and investment talent – that will come to the fore. This kind of uncertainty around the business model is giving industry participants pause for thought, and is acting as a brake on more widespread and rapid adoption.

This is something that only the senior team can address. Senior management buy-in is crucial to overcoming the 'traditional' mindset and caution that are hindering more widespread ESG adoption and integration.

> “Senior management want to be leaders in sustainable investment. The easy way to solve that problem is to employ people like me, or buy products from external researchers or recognised suppliers that are delivering applicable solutions in a packaged way, to create a platform from which managers can work. But if they're not really incentivised to do it, that will continue to be a barrier.”

Anita Lindberg, Senior ESG Analyst, Alfred Berg

PRACTITIONERS ARE THE REALISTS

> “You speak to the guys who do sustainability or ESG work at some of the bigger houses and they're passionate, but they do seem to struggle to put the pedal to the metal. They have to overcome so many barriers from an institutional perspective.”

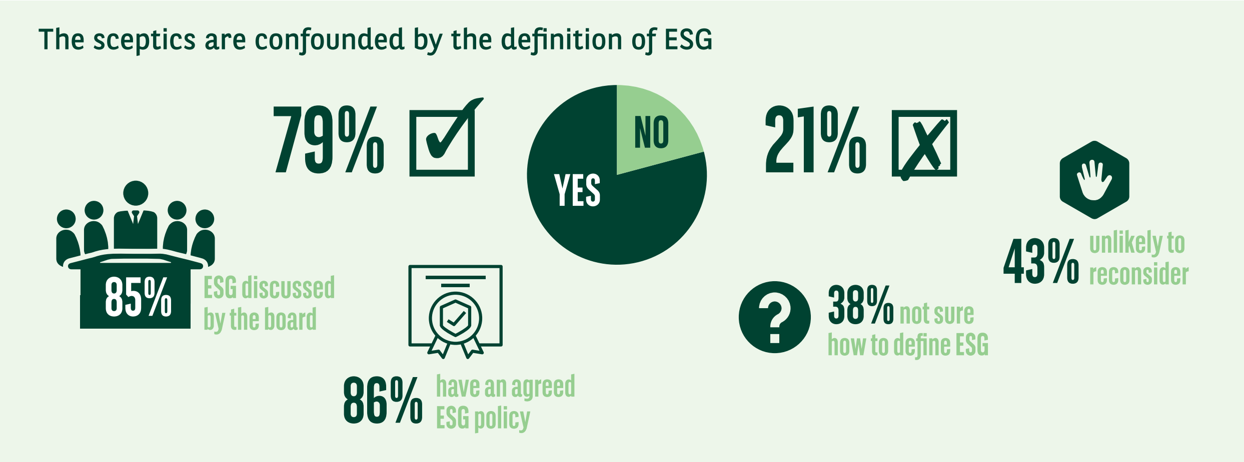
Andreas Feiner, Founding Partner, Arabesque Asset Management

Our survey reveals a significant divergence in opinion between frontline ESG practitioners and their colleagues, with ESG analysts and Heads of RI typically less confident about their organisations' overall ESG capabilities than a CEO[3] or CIO or head of risk. For example:

- 39% of practitioners are confident about their ability to keep pace with ESG reporting requirements compared with 78% of CEOs
- 29% of practitioners believe their ESG policies are adequate compared with 60% of CIOs and 67% of CEOs
- 55% of practitioners state that they have resources dedicated to ESG, compared with 78% of CEOs
- 37% of practitioners state that they have adequate resources dedicated to ESG compared with 56% of CEOs and 62% of CIOs

Does this therefore mean that references to ESG in organisations' investment beliefs/mission statements are not filtering through to action at the working level?

[3] Note the small sample size (18) for CEO survey respondents.



Some asset owners and managers still need to be convinced of ESG's importance, and increasing ESG adoption will depend on overcoming this residual scepticism.

According to our survey, the biggest reason why ESG is not part of investment decision making today is a lack of clarity over how to define it – an obstacle for 38% of those respondents that do not currently incorporate ESG into their investment decisions. ESG is broadly defined and has many interpretations, so terminology and language are clearly an issue. A perceived lack of relevance to their investment strategy, meanwhile is a major reason for about a fifth (19%) of respondents.

And there is a high degree of intransigence. Among the sceptics, 51% of asset owners and 35% of asset managers are either unlikely or very unlikely to reconsider their decision not to incorporate ESG over the next two years. Only 13% of asset owners are likely to reconsider.

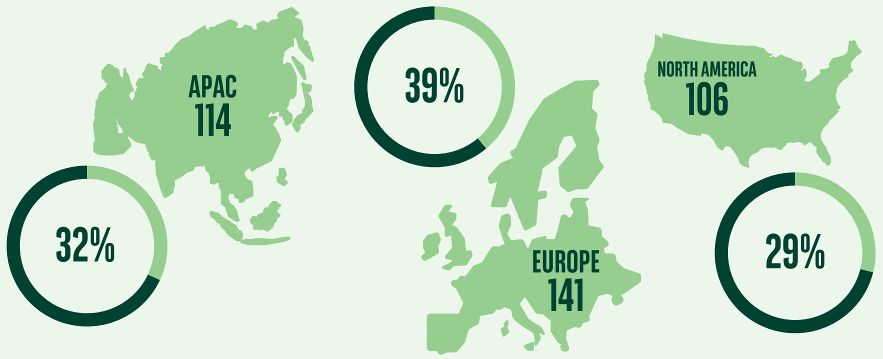
Defining ESG and demonstrating its link to performance are therefore critical.

> “It's vital that we can provide evidence of returns. By measuring and monitoring and reporting that we are doing well, we will increase ESG impact based on our investments. It's absolutely crucial that we move from beliefs to facts.”

Gert Dijkstra, Chief Strategy & Communication, APG Asset Management

03 REGIONAL DIFFERENCES

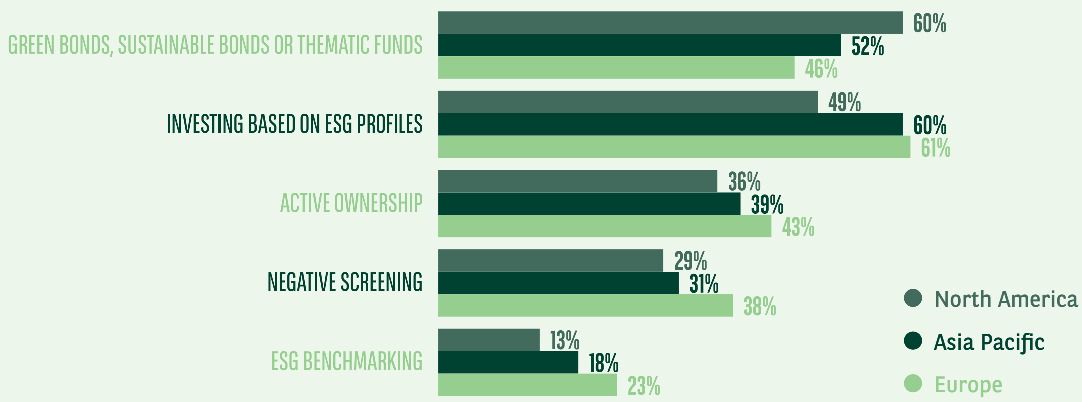
Respondents by region (those integrating ESG)



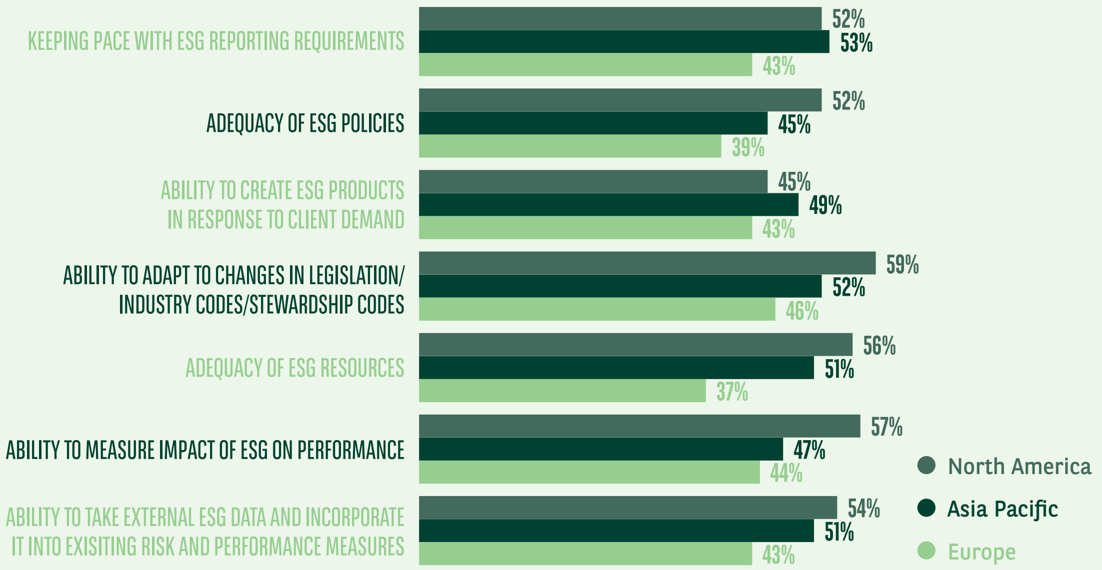
Global snapshot

- In North America, 60% of respondents are investing in sustainable investment opportunities such as green bonds, sustainable bonds and thematic funds (compared with 52% in APAC and 46% in Europe).
- APAC investors are most worried about the lack of robust data today (61%), but are confident that they will overcome this challenge (9% see data as a challenge in two years' time, compared with 24% in Europe).
- In Europe, 38% of respondents believe that governance is most important for returns (almost twice as many as in North America, where the figure is 20%).
- North American investors are most confident about the adequacy of their resources, their ability to measure ESG impact, and their potential to adapt to legislative changes.

ESG strategies by region



Regional perspectives on competencies



For each of the following internal factors, please rate your organisation on a scale of 1 to 10, where 1 = significant weakness and 10 = significant strength for your organisation in pursuit of its ESG strategy.

Percentages above represent significant strength (responses ranked 8-10).

APAC – GAINING MOMENTUM

> “Introduction of the ‘two-strikes’ rule in 2011 has helped to drive much higher levels of engagement with company boards in Australia. We meet with a lot of companies. So as our company engagement has become broader and more international, then so has our ESG coverage.”

Sybil Dixon, UniSuper

Over half (52%) of APAC respondents in our survey report that they are investing in green bonds, sustainable bonds or thematic funds. According to a recent report by the Principles for Responsible Investing (PRI), the Paris Agreement has been hugely important in focusing attention in Asia on green and low-carbon growth, and in spurring environmental and social investing. “In many Asian countries, it is no longer regarded as something that is ‘nice to have’, but instead regulation and policy development is placing the region on a trajectory that will see it soon overtake other parts of the world.” [4]

At present, the largest markets for sustainable investing in Asia, excluding Japan, are Malaysia (30%), Hong Kong (26%), South Korea (14%) and China (14%).[5] China has emerged as a global leader on green finance, and from 2014 to 2016 was the fastest-growing market in the region for sustainable investing. Furthermore, says the PRI report, “China’s leadership is having a ripple effect throughout the region’s key financial centres, such as Singapore, Hong Kong and Malaysia.”

APAC respondents in our survey are particularly positive about ESG. They are more likely to have an ESG policy as part of their strategy (92%) and incorporate ESG factors into decision-making (84%).

Nearly two thirds (64%) believe their ESG tools are industry leading – likely a critical factor in bolstering enthusiasm towards ESG. In addition, they boast the highest level of asset owner satisfaction with the level of ESG reporting they receive from their asset managers (69%).

[4] *Responsible Investment Market Update: A Snapshot of Signatory Action*, Principles for Responsible Investment, 20 March 2017 https://www.unpri.org/news/pri-report-on-progress-signatories-more-committed-than-ever-to-responsible-investment.

[5] GSIR http://www.gsi-alliance.org/members-resources/trends-report-2016/

EUROPE: RELATIVELY DISSATISFIED

> “ESG is no longer a question for us. If you want to be a leading player in Europe, you need to focus on ESG. The questions that now need to be answered relate to data standardisation and robustness, sound analytics, measuring impact and scaling up. The honeymoon period is over. The real work has started.”

Helena Viñes Fiestas, Head of Sustainability Research, BNP Paribas Asset Management

In Europe, 82% of respondents say they incorporate ESG into their investment decision-making process.

However, European respondents are the least satisfied with the tools and capabilities with which they can analyse and understand ESG's impact on their portfolios. The region has the highest percentage (16%) of respondents saying they lack the requisite tools, and the lowest number rating their tools as industry leading (46%). In addition, asset owners in Europe are less likely to say they are very satisfied with reporting from managers, compared to APAC and the US.

European respondents are also the least likely to believe in the adequacy of their ESG policies (39%, compared with 45% for APAC and 52% for North America) and of their resources in general (37%, compared with 51% in APAC and 56% in North America).

France however had one particularly interesting result – just 13% of respondents say that ESG is not a priority for senior management. This perhaps is not unsurprising. France has long been a leader on ESG issues and reporting on transition risks (financial risks associated with the transition to a low carbon economy) is one of the key requirements incorporated in Article 173 of the Energy Transition Law. The Law requires institutional investors to disclose in their annual reports how ESG and climate change considerations are incorporated into their investment policies. Investors must report on a comply or explain basis. First reporting is due in 2017.

NORTH AMERICA: CONFIDENT ABOUT THEIR CAPABILITIES

> “The US is clearly waking up. The interest is amazingly strong. Two years ago it was as if you needed to do more convincing that ESG in itself was an investment trend. Now everybody understands it and are seeking solutions.”

Andreas Feiner, Arabesque Asset Management

According to our survey, North American institutions are behind their peers in APAC and Europe in incorporating ESG into their investment decision-making processes (70%). Of these respondents, 81% go on to say that they are conducting board-level discussions on ESG as an issue of importance and 73% say they employ individuals dedicated to ESG (compared with 68% in APAC and 56% in Europe).

North American investors are relatively more confident than in Europe and APAC about their ESG-related capabilities across a range of measures, including the adequacy of their ESG policies and resources, their ability to measure ESG impacts, and their capacity to adapt to changes in legislation and their ability to measure the impact of ESG on performance.

04

PEOPLE, TECHNOLOGY AND ANALYTICS

OVERCOMING THE BARRIERS

> "New data is coming on the market every day that offers greater quality and depth. Computing power offers ever greater ways of processing this ESG big data, and we are seeing a shift away from discretionary investing to quant strategies."

Andreas Feiner, Arabesque Asset Management

> "Last year's carbon footprint, last year's biodiversity impact, won't be enough. I think we will see more people wanting to use scenario analysis – a little less talk and more figures."

Jakob Thomä, 2° Investing Initiative

Embedding ESG into the investment decision-making process can only be deemed a success if its impact can be measured and monitored and it helps to drive change.

Measurement of ESG success will be increasingly driven by big data, and advanced predictive analytics. For example, a simple metric such as 'ESG momentum' that quantifies the improvement in an investee company's ESG score, is itself based hundreds of data points, all of which are updated at different times throughout the observation period. Sifting through the data, aggregating it and ensuring a coherent and consistent quantitative perspective are critical to supporting ESG integration.

THE NEW LANGUAGE OF INVESTMENT

Another priority is access to investment talent who can combine ESG and traditional financial skills.

"The trend is for the traditional investment analysts to take greater responsibility for ESG, but they don't necessarily have the background that can take in the ESG information, assimilate it and put it within the investment context.

They need that," warns AMP Capital's Ian Woods. "We're almost bilingual here, where we can speak both an investment and ESG language, and be the interpreter between the two."

Faced with a lack of ready-made prospects with the relevant breadth of abilities, recruitment policies and training will come to the fore. Another critical factor will be retaining the expertise for longer in order to align with the long-term investment ambitions of the asset owner and the asset manager.

> "We are in the process of trying to hire an ESG analyst. We are finding that we either have to look at financial analysts and get them young enough so we can train them in the ways of ESG, or find someone from a sustainability consultancy and train them in the financial side of things."

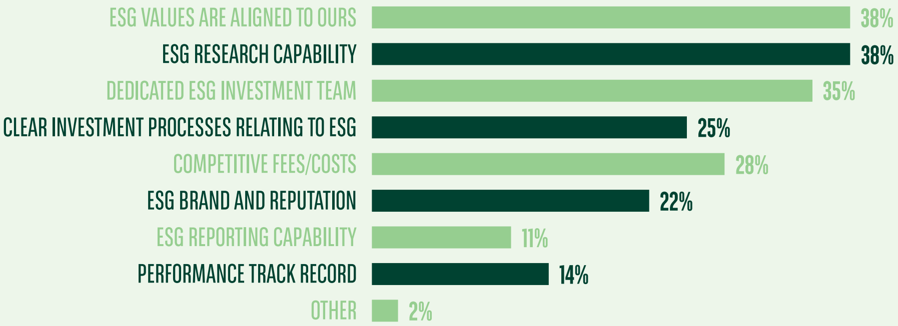
Andreas Feiner, Arabesque Asset Management

With asset owners increasingly seeking to incorporate often highly defined ESG factors into their investments, asset managers will need to plug any capability gaps fast. According to Anne Simpson at CalPERS expectations are rising: "We want to hear from managers on their list of issues, what sources of data they use, and what processes they employ for implementing and monitoring, so we can track how they weigh all this in the process."

THE OPTIMAL ESG STRUCTURE

To asset owners, traditional metrics, such as performance and costs/fees, are less important than dedicated ESG teams, an ESG ethos and high-quality ESG research capabilities.

The most important factors when selecting an investment manager for an ESG-related mandate



APG began to establish its ESG department a decade ago. "In the beginning, it was a separate department, but after a few years we integrated it with the front office," says Gert Dijkstra. "That means our ESG colleagues now work together with the portfolio managers to ensure that ESG becomes integrated into our processes and part of the portfolio managers' targets and that APG speaks with one voice to the companies we invest in."

Similarly, while UniSuper does have a separate, dedicated ESG team, it sees ESG as an investment risk, and it is incorporated as part of its everyday analysis. "We have a bias towards quality," says Sybil Dixon. "And one of the characteristics that makes a quality company is they tend to manage ESG risks well."

At the Korean Teachers' Credit Union (KTCU), an eight-member strategy-planning team deals with ESG strategy. That team belongs to the office of corporate strategy, which is directed by the CEO, who is ultimately responsible for ESG strategy, explains Chief Investment Officer Mr Kang. "Any investment decisions are then held by KTCU's Investment Review Committee, which consists of internal and external experts, including professors, lawyers, accountants and financiers, who must have a high level of ESG strategy understanding."

CONCLUSION AND RECOMMENDATIONS

Across the investment industry and around the world, there is clear recognition that ESG factors are of vital importance – to governments, regulators, and institutional investors – and ultimately to asset managers as they seek to satisfy their fiduciary duties and meet investor demand.

> “PRI is grading what managers are doing in this arena, which is being used as a data point in the hiring and firing of managers. So ESG has turned into a business issue for the management industry. And that in turn has a positive feedback loop effect on asset managers.”

Anne Simpson, CalPERS

Our report shows that there is expected to be a rapid rise in the number of ESG funds coming to market over the next two years. Yet despite the progress being made, barriers to even greater wholesale adoption remain.

Overcoming these barriers will require action in four key areas:

1. SMARTER ANALYSIS

A lack of robust ESG data is the biggest issue for asset owners and asset managers. However, this is expected to be a temporary problem, as more historical data and research are accumulated internally, and external data providers continue to expand their services.

ESG and long term sustainable value creation is not just about the past and the present, but of the future – what investments and strategies will fare best in a dynamic and changing global landscape; who will be the leaders that can adapt and generate positive ESG momentum? In future, the emphasis has to be on developing more rigorous and granular analytics and stress-testing capabilities. This will assist the investment decision-making processes, bolster risk management practices, and demonstrate long-term performance benefits.

2. COMPREHENSIVE REPORTING

If investors are to make more informed, transparent decisions, they need to understand every ESG-related risk and opportunity associated with the companies and sectors in which they invest.

Credit rating agencies' pledge to integrate ESG criteria into their analysis of issuers' creditworthiness is a big step forward.[6] Market data vendors, meanwhile, can provide metrics to help fill in the data gaps. Custodians can act as the connector between the agencies, vendors and the investors, deploying smart technologies in big data and analytics to support the ESG integration journey. In-depth management and client reporting will also be crucial for firms to identify relevant ESG factors, monitor ESG-related risks, assess performance, and report to stakeholders on the impact of their investments.

3. TALENT AND TEAMS

Incorporating ESG factors into investment decision-making requires an additional layer of specialist skills alongside traditional financial analysis and risk management. Firms will therefore need to recruit or develop investment talent with the appropriate mix of skills.

Rather than an afterthought or bolt-on to an existing investment strategy process, ESG factors need to be tightly integrated into investment decision making from the outset. For this to be effective, firms will need to set explicit ESG investment objectives, and then construct an appropriate benchmark and portfolio that mirror those goals. Monitoring the results will give firms valuable feedback they can use to further fine-tune the processes. This will bolster a virtuous feedback loop, to benefit the entirety of the investment value chain.

4. GOVERNANCE

Ultimately, good governance will be critical to successful ESG policies. In turn, strong governance depends on clarity and communication.

A first step for asset owners is to develop clear ESG investment goals and performance expectations, and create robust policies to support these. Senior management buy-in will be essential to drive through the organisation's ESG vision and ensure institution-wide adherence to it over the long term. Then they should clearly communicate their selected objectives and policies to their asset managers.

Similarly, asset managers will need strong leadership to ensure that sufficient resources are committed to recruiting, training and retaining the necessary investment talent, developing sophisticated analytical skills and tools, measuring and monitoring performance, and providing comprehensive reporting to end investors.

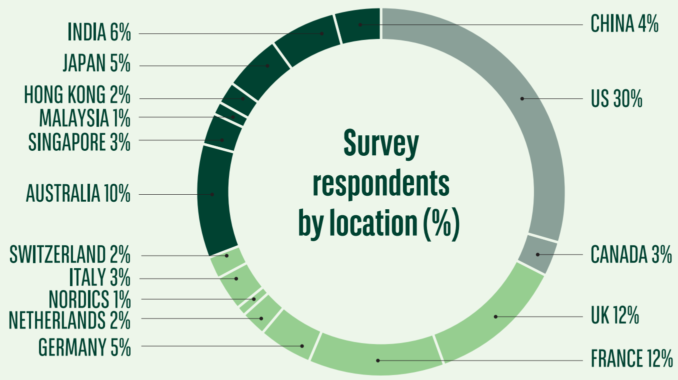
Institutions that commit to an ESG-focused policy framework and devote appropriate resources to these four key areas can expect to enhance risk-adjusted performance and attract assets as the shift towards sustainable and responsible investment gathers pace.

---

[6] PRI statement on ESG in credit ratings, launched on 26 May 2016 by PRI and UNEP Inquiry https://www.unpri.org/download_report/20983 [download].

ABOUT THE RESEARCH

Breakdown of respondents by location



In February and March 2017, Longitude Research, in association with BNP Paribas Securities Services surveyed individuals within 461 institutions. They included asset managers and asset owners (pension plans, insurers, official institutions, sovereign wealth funds and endowments). The survey was conducted by a combination of telephone interviews and online. The results were supplemented by a series of in-depth interviews.

Location split by asset owner and asset manager

COUNTRY	ASSET MANAGERS	ASSET OWNERS	TOTAL
US	69	68	137
Canada	8	7	15
UK	23	33	56
France	35	22	57
Germany	10	15	25
Netherlands	2	7	9
Nordics	3	1	4
Italy	5	7	12
Switzerland	8	2	10
Australia	17	27	44
Singapore	12	1	13
Malaysia	0	2	2
Hong Kong	7	3	10
Japan	11	10	21
India	16	10	26
China	6	13	19
Other	1		1

FOLLOW US

FIND US

securities.bnpparibas.com

Designed by the graphics department, corporate communications, BNP Paribas Securities Services.

170720C_SFO_GEFE_WP_EN

e-accessibility

The digital version of this document is conform to Web content accessibility standards, WCAG 2.0, and is certified ISO 14289-1. Its design enables people with motor disabilities to browse through this PDF using keyboard commands. Accessible for people with visual impairments, it has been tagged in full, so that it can be transcribed vocally by screen readers using any computer support. It also includes integrated vocalisation which offers reading comfort to all. It has also been tested in full and validated by a visually-impaired expert.

e-accessible version by ipedis

BNP PARIBAS

The bank
for a changing
world