ESG GLOBAL SURVEY **2023** CHAPTER 2

SUSTAINABLE INVESTING TRENDS

TAKING ACTION:
INSTITUTIONAL INVESTORS PROGRESS ON THE PATH TO SUSTAINABILITY

BNP PARIBAS

The bank
for a changing
world

FOREWORD

SUSTAINABLE investing is adapting to the requirements of investors at a brisk pace. This is hardly surprising, given that it encompasses the three pillars of environmental, social and governance (ESG) issues, all of which are subject to new thinking and innovations. For example, the environmental side of sustainable investing now takes account of emerging issues such as biodiversity loss, as well as climate change, while the debate around diversity, equality and inclusion issues has fed into the social agenda. In addition, investors increasingly want to engage with investee companies as active owners in areas they are prioritising, as part of their governance agenda.

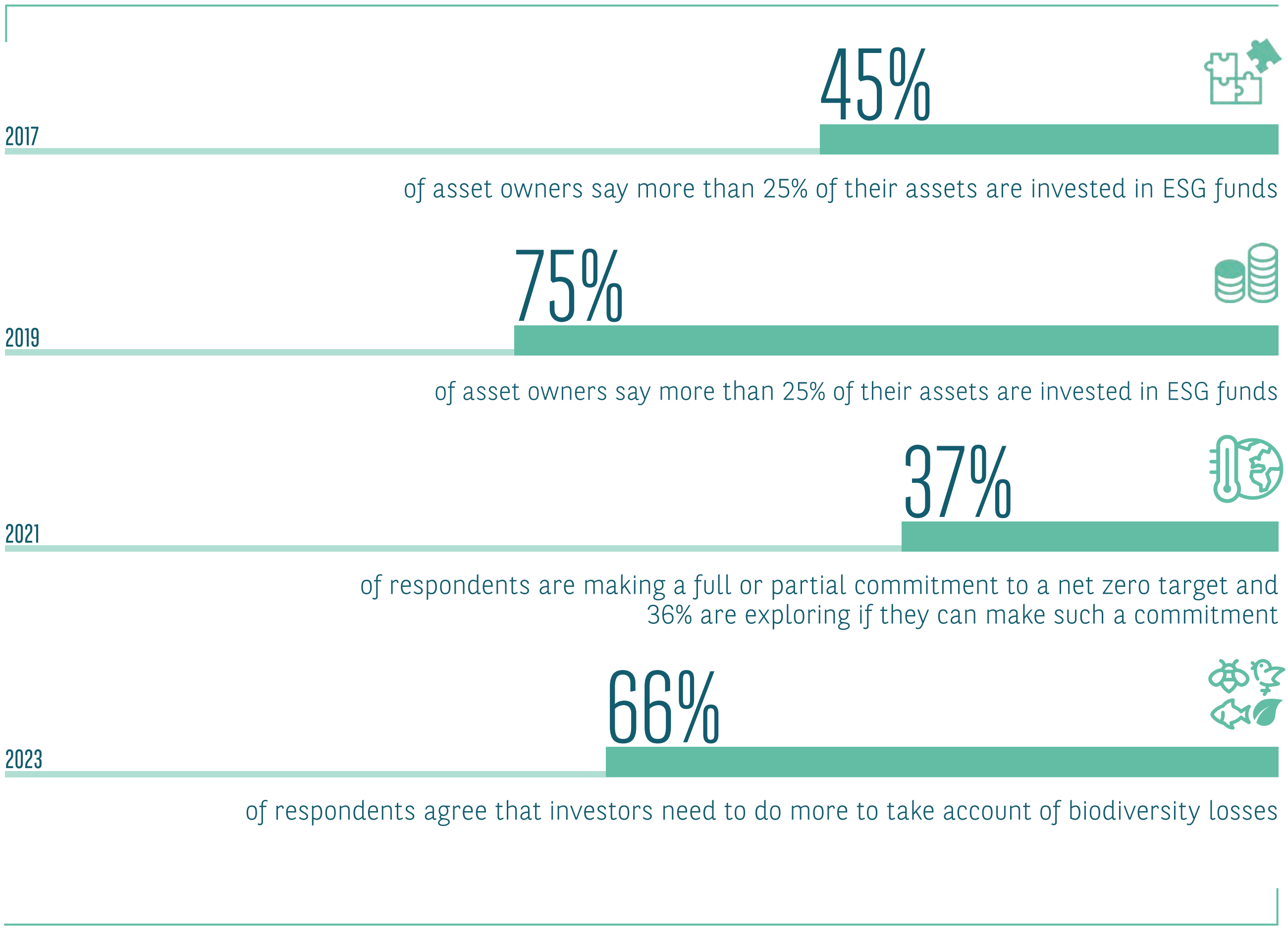
Sustainable investing also uses a wide range of investment approaches, from negative screening and exclusion to ESG integration and the increasingly popular approaches of impact and thematic investing. These approaches are now being applied to most asset classes, including private markets and alternative assets. At the same time, macro-economic issues, such as rising interest rates and the return of inflation, or geopolitical risks, must be considered. And within ESG investing, the emphasis on different aspects varies between regions. For example, North American investors are currently less likely to have made a commitment to net zero than investors in Europe or the APAC region, but they are more likely to have integrated diversity, equity and inclusion (DEI) goals into investment policies. As a consequence of all these issues, sustainable investing is now complex and multi-faceted, while increasingly central to the investment objectives of many investors.

BACKGROUND

BNP PARIBAS'S previous ESG Global Surveys show how ESG investing has advanced among institutional investors over the last six years. In 2017, the first ESG Global Survey found that ESG investing was widely used, with 79% of respondents incorporating ESG in how they invested. But while the use of ESG investing was broad in scope, it was also relatively shallow; just under half (48%) of asset owners invested more than 25% of their assets in specific ESG strategies, with a similar result for asset managers. However, ESG usage was on an upward trend, with both asset managers and asset owners saying that ESG strategies or funds would take a growing share of their investments over time.

And the 2019 ESG Global Survey found that ESG investing was becoming more entrenched, with 75% of asset owners saying that more than 25% of their funds are invested in ESG funds. The use of the United Nations Sustainable Development Goals (UN SDGs) was also on the rise, with almost two-thirds (65%) of investors using them to align their investment approach. In terms of the biggest drivers for ESG investing, just over half (52%) of investors cited improved long-term returns and slightly fewer (47%) gave brand and reputation.

SUSTAINABLE INVESTING IS GOING DEEPER AND FURTHER FOR MANY INVESTORS



By 2021, commitment to a net zero carbon emissions target was growing among institutional investors, with 37% of respondents making a full or partial commitment to achieve a net zero target through their investments, and another 36% exploring if they can make such a commitment. These findings reflected the importance of tackling climate change for investors, following in the wake of the Paris Agreement of 2015, which aims to limit global warming to 1.5 degrees Celsius above pre-industrial levels. Investors were also responding to new regulations, such as the EU's Sustainable Finance Disclosure Regulation (SFDR), and to the demands of their internal and external stakeholders. Other key findings included the fact that the S in ESG continued to be seen as the most difficult pillar of ESG to analyse and integrate, while brand and reputation (59%) overtook improved long-term returns (45%) as the biggest motivation for ESG investing among investors.

In 2023, as issues such as climate change become urgent for many, is there now a consensus on what a sustainable investment means for investors? And how does this translate into investment strategies? For investors committed to a net zero target, how is it being implemented? And what differences and similarities are there between investors in different regions on investing sustainably? This report looks at these and other aspects of how investors are seeking to invest sustainably.

IS THERE NOW A CONSENSUS ON WHAT A SUSTAINABLE INVESTMENT MEANS FOR INVESTORS?

HOW INVESTORS DEFINE SUSTAINABLE INVESTMENTS

THE MAIN FINDINGS

AS part of this year's ESG Global Survey, respondents were asked for the most important element in their definition of a sustainable investment. A key point here is the lack of consensus on the most important element, with only three elements getting more than 10% and none more than 22% on a global basis. This indicates how much each investor's circumstances are a factor in how they view sustainable investing and their priorities.

The most popular element, for 22% of respondents, is that it meets their organisation's own criteria for defining sustainable investments. This is by far the most popular element for North American investors, with 42% of US investors selecting it and 30% of Canadian investors. In contrast, only 18% of APAC region investors and 17% of European investors think that the most important element in defining a sustainable investment is that it meets their organisation's own criteria. These regional differences highlight the difference in regulatory oversight. In North America, investors make their own priority judgements on what is impactful. But in the relatively higher regulatory oversight regions of Europe and Asia, there is less ambiguity for the market to emphasise specific sustainability issues.

IN NORTH AMERICA, INVESTORS MAKE THEIR OWN PRIORITY JUDGEMENTS ON WHAT IS IMPACTFUL. BUT IN THE RELATIVELY HIGHER REGULATORY OVERSIGHT REGIONS OF EUROPE AND ASIA, THERE IS LESS AMBIGUITY FOR THE MARKET TO EMPHASISE SPECIFIC SUSTAINABILITY ISSUES

While organisations will have their own views in Europe and the APAC region, they are more likely to be influenced by policy makers and regulatory bodies, as well as governments, or influential investors. The CIO of a Chinese insurance company said it wanted to start to allocate capital to ESG products, "because in China, the government and the regulator are pushing for companies to accelerate ESG progress". For some European investors, the equivalent driver is the adoption of Paris-aligned climate goals. In turn, this is leading investors to make a net zero commitment and to reduce their carbon footprint. These are two examples of how investors in the APAC region and Europe are often guided by top-down policies and regulation, whereas North American investors tend to take a bottom-up approach.

Asset owners (27%) are also more likely than asset managers (18%) or hedge funds and private equity firms (18%) to agree that the most important element of a sustainable investment is that it meets their own criteria for defining a sustainable investment. In this case, asset managers, hedge funds and private equity firms are likely to be influenced by what their clients want in terms of how they define a sustainable investment.

ASSET OWNERS ARE MORE LIKELY TO AGREE THAT THE MOST IMPORTANT ELEMENT OF A SUSTAINABLE INVESTMENT IS THAT IT MEETS THEIR OWN CRITERIA FOR DEFINING A SUSTAINABLE INVESTMENT

INVESTORS ON THE MOST IMPORTANT ELEMENTS IN A SUSTAINABLE INVESTMENT

What do you consider to be the most important element in the definition of "what is a sustainable investment?"

Global %		North America %	Europe %	APAC %
22	It meets your organisation's own criteria for defining sustainable investments	38	17	18
20	It makes a measurable, positive impact on ESG criteria	13	20	25
16	It is aligned with an ESG objective/pathway e.g., Paris agreement/Net Zero	17	18	13
9	It meets external criteria such as the UN SDGs	3	10	13
8	It meets external criteria such as a taxonomy of sustainable investments	2	11	7

Overall, the second most popular element in defining a sustainable investment is that it makes a measurable, positive impact on ESG criteria, with a fifth (20%) selecting this. However, this falls to 13% in North America, compared to 20% in Europe and 25% in the APAC region. The overall finding here helps explain why impact investing is becoming an important ESG approach (see glossary on page 22 for definitions of impact investing and other methods of ESG investing). For example, when asked to define sustainable investing, an Australian super fund investment manager said: "A sustainable investment would be a company or assets that can deliver returns first and foremost, but without compromising on our sustainability goals, around decarbonisation or labour standards, for example".

Elsewhere, impact investing can be even more fundamental. A senior manager at a Dutch asset manager specialising in impact investing said: "The Brundtland Report[1], and how it defined sustainable development, is still the basis of everything we do. We want no negative impacts from our investments for future generations, or for vulnerable societies now".

While these first two elements in defining a sustainable investment could be quite subjective, the third most popular element is more objective. This is in alignment with an ESG objective or pathway, such as the Paris Agreement or a net zero target, with 16% overall selecting this, although this falls to 13% in the APAC region. This element was less popular among asset owners (13%), than with asset managers (17%) and hedge funds and private equity firms (22%). For the latter, its objectivity is likely to be an advantage in transparently demonstrating the sustainability of a fund or strategy to potential investors and other fund selectors.

> A sustainable investment would be a company or assets that can deliver returns first and foremost, but without compromising on our sustainability goals, around decarbonisation or labour standards.
>
> An Australian super fund investment manager

1. The Brundtland Report was published by the World Commission on Environment and Development (WCED) in 1987 and introduced the concept of sustainable development as a response to the problems of reconciling environmental issues with economic growth and social equity. It is named after former Norwegian prime minister Gro Harlem Brundtland, who chaired the WCED, which was also called the Brundtland Commission.

KEY ESG OBJECTIVES AMONG INVESTORS

FOR investors, their key ESG objectives will be a major determinant of how they apply ESG investing to their investment portfolio. On a global basis, the results show that the most popular key ESG objective is to use active ownership to help promote selected ESG goals at investee companies (46%), ahead of allocating a certain amount or percentage to impact investments (42%), integrating DEI goals into investment policies (41%), making a commitment to net zero by a certain date (41%), and divesting a certain percentage from, or excluding, carbon-intensive assets (36%).

These results are all for key objectives now; in the next two years, a defined reduction of an investor's carbon footprint using scope 1, 2 and 3 methodologies[2] (50%) is the most widely chosen key objective, ahead of making a commitment to net zero (48%), investing in low-carbon assets and the use of active ownership (45%). Looking at these results, it is apparent that there is a trend for investor key ESG objectives to become more focussed on the transition to a low-carbon economy and decarbonisation over the next two years and that this applies across all three regions.

ON A GLOBAL BASIS, THE RESULTS SHOW THAT THE MOST POPULAR KEY ESG OBJECTIVE IS TO USE ACTIVE OWNERSHIP TO HELP PROMOTE SELECTED ESG GOALS

2. Scope 1, 2 and 3 emissions are different categories of greenhouse gas emissions. Scope 1 emissions are directly due to an organisation's activities and operations, while scope 2 emissions are indirect emissions created by the production of energy that an organisation buys. Scope 3 emissions are harder for an organisation to control, as they are indirect emissions from across a company's value chain, from customers using a company's products, to suppliers making products used by a company.

Investor comments in a series of qualitative interviews back up the mix of key ESG objectives and the importance of objectives related to decarbonisation. For instance, an ESG investment specialist at a US pension fund in the healthcare sector said: "We have built out a carbon roadmap, as we have a net zero goal. And then we have five pillars of ESG strategy centred around health equity, climate change, DEI, the circular economy, and data patient safety". And a Dutch asset manager commented: "We have Paris-aligned climate goals, which were set in 2020. Since then, we have been progressing quite well on decreasing our carbon footprint."

On a regional basis, there are some large increases in key ESG objectives related to decarbonisation among North American investors and this applies to both Canadian and US investors. For example, the percentage of investors making a commitment to net zero in Canada is rising from 37% now to 57% in the next two years, while the equivalent figures for the USA are 23% now and 43% in the next two years.

In a similar vein, the objective of a defined reduction of the carbon footprint using scope 1, 2 and 3 methodology rises among Canadian investors from 43% now to 53% in two years, with a rise from 28% to 47% among US investors. And on divesting or excluding carbon-intensive assets as a key objective, US investors are set to overtake their Canadian peers; the number of US investors divesting from, or excluding, carbon-intensive assets as a key ESG objective will rise from 20% now to 48% in the next two years, ahead of the equivalent results for Canadian investors (from 27% now to 37% in the next two years). These findings challenge the perception that US investors are less interested than their peers elsewhere in sustainable investing. For US investors, a possible new driver here could be the investment opportunities in green energy and clean tech. A North American asset owner highlighted this approach, saying: "Our sustainability objectives revolve around what we are doing to reduce greenhouse gases, such as investing in electrical vehicles, renewable energy and so on and so forth".

"

We have built out a carbon roadmap, as we have a net zero goal. And then we have five pillars of ESG strategy centred around health equity, climate change, DEI, the circular economy, and data patient safety.

An ESG investment specialist at a US pension fund in the healthcare sector

KEY ESG OBJECTIVES AMONG INVESTORS BY REGION

What are your organisation's key ESG objectives both now and in the next two years?

Objective	Global % Now	Global % In the next two years	North America % Now	North America % In the next two years	Europe % Now	Europe % In the next two years	APAC % Now	APAC % In the next two years
Use active ownership to help promote selected ESG goals at investee companies	46	45	46	51	51	39	36	49
Allocate a certain % or amount of assets into impact investments	42	44	36	43	42	44	46	45
Integrate DEI (diversity, equity, and inclusion) goals into investment policies to promote more socially-aware companies	41	44	54	41	39	43	36	47
Make a commitment to net zero by a certain date, e.g., 2050	41	48	28	48	45	49	43	47
Divest a certain % or exclude carbon-intensive assets	36	40	22	44	41	41	38	34
Measure alignment of portfolios with Paris Agreement benchmarks to ensure they comply with a certain % of goals	35	44	30	43	39	46	33	40
A defined reduction of carbon footprint using scope 1, 2 and 3 methodology	35	50	33	49	40	50	28	51
A specific % of asset allocation in low-carbon assets	35	45	27	48	40	39	32	52

Now — In the next two years

% Multiple answers allowed

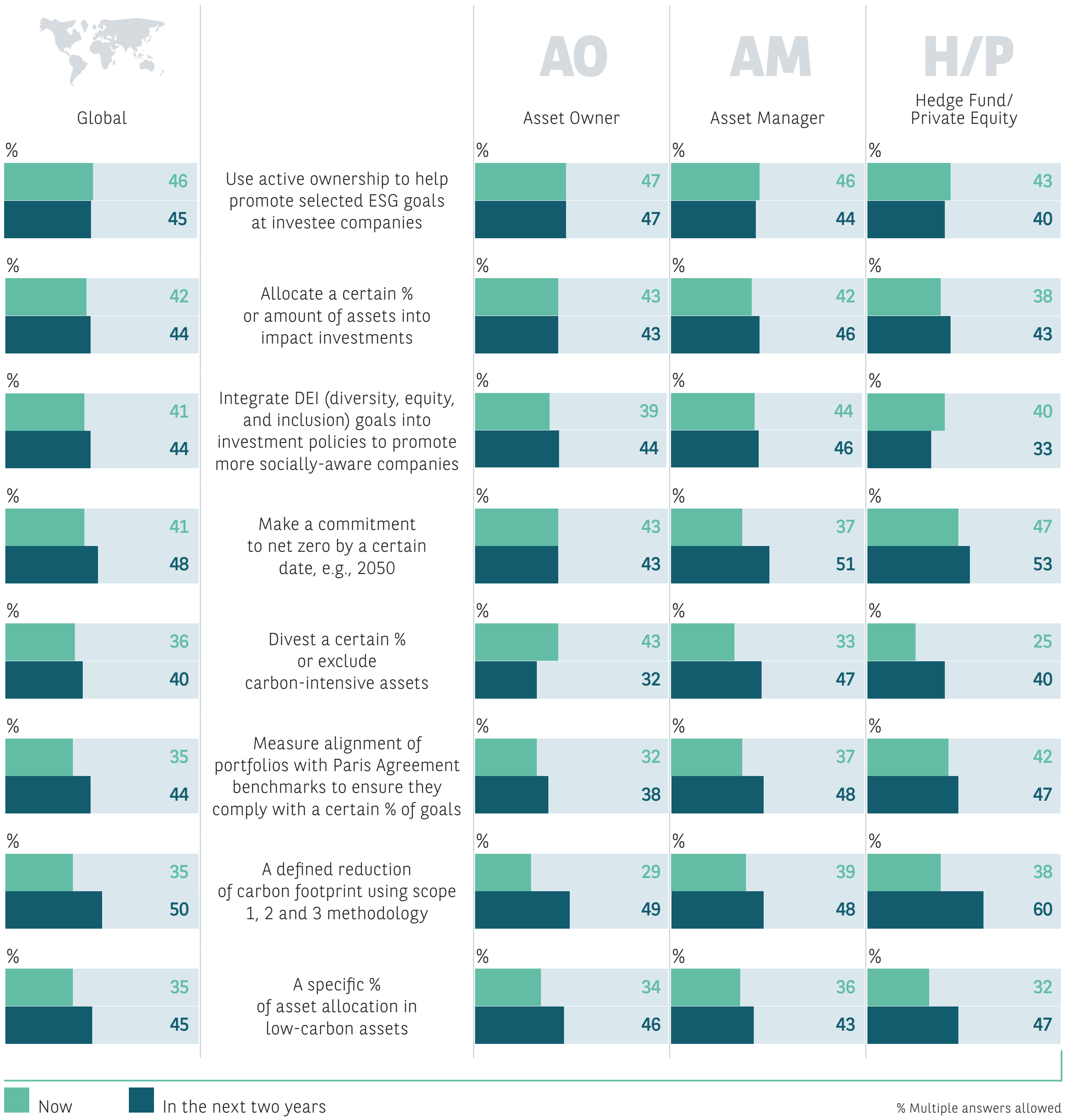
Looking at other findings for key ESG objectives now and in the next two years, there are some intriguing trends. For instance, in Europe, active ownership is set to slip from being the leading key ESG objective now (51%) to the fifth (39%) in the next two years. At the same time, making a commitment to net zero and integrating DEI goals into investment policy will become more important to European investors. Here, it is possible that when asked about key ESG objectives in the next two years, investors naturally focus more on areas where they plan to increase their activity. So European investors may intend to maintain their use of active ownership and when looking ahead, are focussed on areas where they want to do more, such as the integration of DEI goals into investment policies. The future increase in DEI in Europe and Asia Pacific could be the significant finding here, while North American investors, where 54% already have it as a key ESG objective at present, move into a 'use and maintain' approach, as they step up activity elsewhere.

At the same time, it is also possible that key ESG objectives could fall in importance, if investors feel that they have reached their limit. For example, divesting from carbon-intensive assets is set to fall as a key ESG objective among APAC region investors, from 38% now to 34% in the next two years. This likely reflects that divesting assets becomes more difficult over time. Once the low-hanging fruit is removed, investors need to consider diversification, sector exposure and overall portfolio construction, making it more difficult to jettison investments as the pool of carbon-intensive assets becomes smaller. In support of this approach by APAC investors, the findings also show that more APAC investors will set key ESG objectives on reducing their carbon footprint and making a specific allocation to low-carbon assets in the next two years, with increases from 28% to 51% for the former and 32% to 52% on the latter.

These findings show that, overall, investors in the APAC region are tackling climate change. They also indicate that making a commitment to net zero will increase as a key objective for APAC investors. At the same time, investors in North America, who plan to increase divestment or exclusion of carbon-intensive assets, may feel that they can do more here, while for European investors, where there is no change in the use of divestment or exclusions, they are seen as a valid option for investors as part of an engagement approach.

KEY ESG OBJECTIVES AMONG INVESTORS BY ORGANISATION TYPE

What are your organisation's key ESG objectives both now and in the next two years?



% Multiple answers allowed

There are some common trends for all three investor types, particularly the greater use of a defined reduction of carbon footprint using scope 1, 2 and 3 measures (from 35% now to 50% in the next two years on an overall basis), and a specific allocation to low-carbon assets (from 35% now to 45% in the next two years on an overall basis). In both cases, all three investor types plan to increase these activities as key ESG objectives. It is likely that these objectives are related, with the aim of a reduced carbon footprint leading to an allocation to low-carbon assets. And these objectives are almost certainly linked to the objective of making a net zero commitment, which is increasing quite sharply at asset managers and to a lesser extent at hedge funds and private equity firms. This shows a strong impetus for action on decarbonisation among investors, with the use of scope 1, 2 and 3 to measure a carbon footprint adding clarity and transparency to this.

By investor type, one key difference is that more asset owners (43%) cite divesting from carbon-intensive assets as a key objective now, compared to asset managers (33%), hedge funds and private equity firms (25%). But this is set to flip in the next two years, falling as a key objective for asset owners (32%), and rising for asset managers (47%), hedge funds and private equity firms (40%). One possible reason here is that asset owners feel that they have tackled this issue, so do not plan to do more in future, while asset managers, hedge funds and private equity firms are further back on divestment and exclusion and are aware that they should do more in the future.

Another possible factor here is that asset owners, such as large pension funds and insurance companies, have been under greater pressure to divest from carbon-intensive assets to reduce exposure and better align to their investor demands. Delphine Queniart, Head of Sustainable Finance Client Engagement, Global Markets, BNP Paribas commented: "Financial institutions are increasingly incorporating sustainability into their investment strategies in a systematic manner, progressively integrating sustainable investing in mainstream asset classes typically from equities to other asset classes. The approaches and focuses of these institutions are closely linked to their stakeholders and the framework they set. We see that while climate (decarbonisation and pathways) is a key priority at present, topics such as DEI, social issues, environmental and biodiversity loss and governance are set to increase in importance as key topics for active ownership".

"
Financial institutions are increasingly incorporating sustainability into their investment strategies in a systematic manner, progressively integrating sustainable investing in mainstream asset classes typically from equities to other asset classes.

Delphine Queniart, Head of Sustainable Finance Client Engagement, Global Markets, BNP Paribas

HOW INVESTORS APPLY SUSTAINABILITY IN THEIR PORTFOLIOS

AMONG institutional investors, ESG investing is normally first used in mainstream asset classes, typically equities, and then extended over time to other asset classes, such as fixed income, private markets, real estate, and other asset classes.

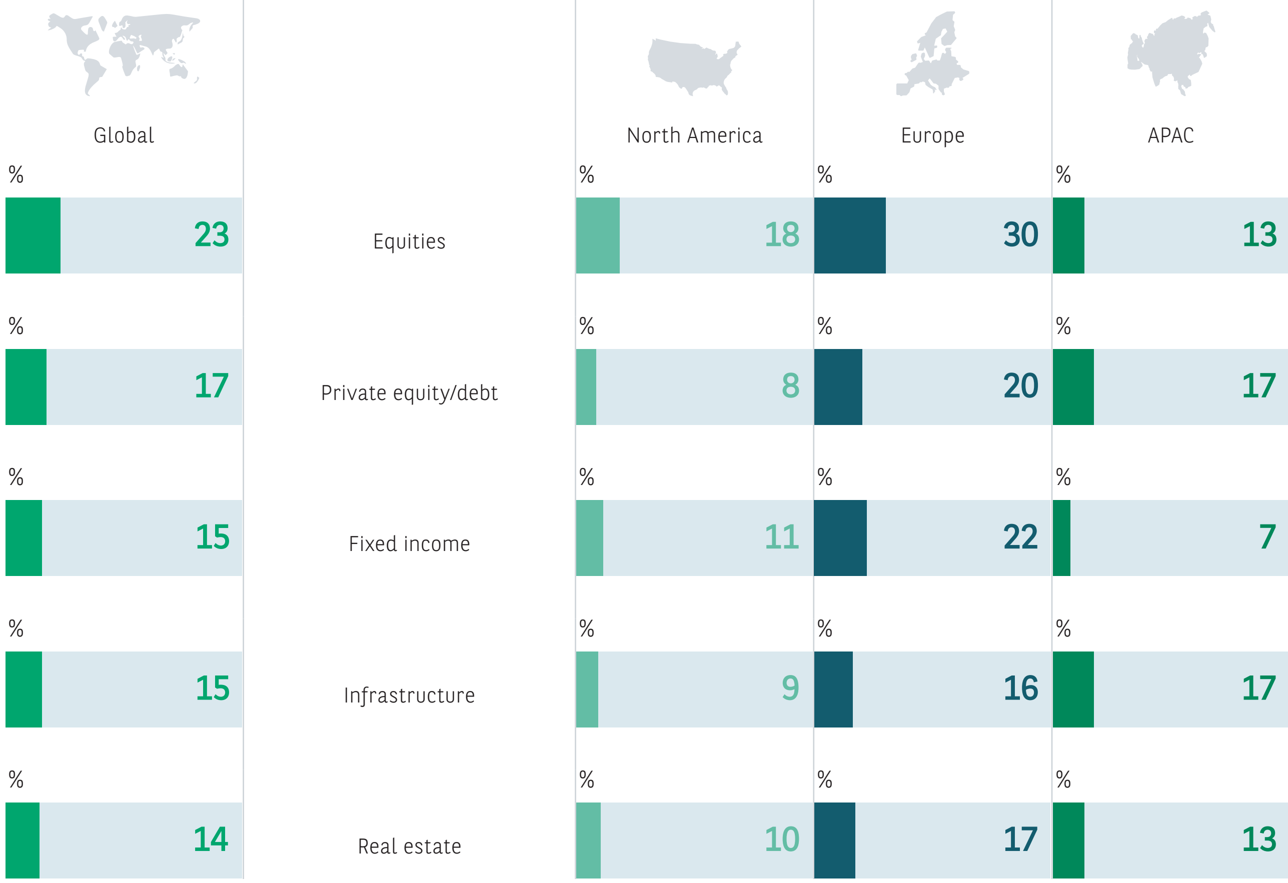
This trend can be seen when investors are asked what percentage of their allocations to different asset classes use ESG investing. Nearly a quarter (23%) of respondents said that 50% or more of their equity investments incorporate ESG. For fixed income, 15% of respondents say 50% or more of their fixed income investments incorporate ESG. ESG is also being incorporated into private debt and equity, with 17% of respondents having 50% or more of their private debt/equity investments incorporating ESG.

23%

NEARLY A QUARTER OF RESPONDENTS SAID THAT 50% OR MORE OF THEIR EQUITY INVESTMENTS INCORPORATE ESG

USE OF ESG BY ASSET CLASS (% OF RESPONDENTS WITH 50% OF MORE OF INVESTMENTS INCORPORATING ESG)

What percentage of your investments in the following asset classes incorporate ESG?



Top 5 – % of assets in ESG (>50%)

In general, European investors are more likely than North American and APAC investors to have 50% or more of their investments in the asset classes above incorporating ESG. The exception to this is Canada, as the countries with the highest percentages of respondents with more than 50% of their equity investment incorporating ESG are Canada (43%), France (40%), Sweden (33%), Denmark (45%), Spain (30%) and the UK (33%). In contrast, only 5% of US respondents have 50% or more of their equity investments incorporating ESG. For US investors, a higher percentage of respondents, 57%, compared to 37% overall, have between 1% and 25% of their equity investments incorporating ESG. A similar pattern can be seen for the use of ESG in fixed income investments, with more European investors with 50% or more of their fixed income investments incorporating ESG, than APAC or North American investors.

For investors, increasing the range of asset classes used for ESG investing poses various challenges. A European pension fund investment manager said: "On the credit side, the issue, especially for leveraged loans, is that less than 10% of the companies are public and data is sporadic. Often you must use the sector or industry average for a company when you don't use real numbers". The same challenge can apply to private market assets, as a European asset manager said: "On private equity, private debt, real estate, infrastructure and farmland, our ESG policies are to be developed in the next few years, because the data is lagging, but the potential impact is much greater".

> On the credit side, the issue, especially for leveraged loans, is that less than 10% of the companies are public and data is sporadic. Often you must use the sector or industry average for a company when you don't use real numbers.
>
> A European pension fund investment manager

METHODS USED FOR SUSTAINABLE INVESTING

INVESTORS use a wide range of approaches to ESG investing and this is evolving over time. At present, ESG integration is the most widely used approach, by 70% of investors globally, followed by negative screening (54%), thematic investing (47%) and impact investing (45%).

European investors are the biggest users of these techniques; 75% of European investors use ESG integration, 54% use negative screening, 53% seek to invest in the best in class in a particular sector and 52% use impact investing. APAC investors are keen on negative screening (62% vs. 54% overall). While North American investors have lower usage rates for these ESG approaches, ESG integration and negative screening are two approaches they favour now. By organisation type, asset owners stand out here for their use of active ownership (51% vs. 46% overall), while asset managers make more use of negative screening and impact investing than most respondents. Hedge funds and private equity firms use ESG integration more than the average score for respondents but make less use of active ownership and impact investing.

ESG INTEGRATION IS THE MOST WIDELY USED APPROACH, BY 70% OF INVESTORS GLOBALLY

SUSTAINABLE OR ESG INVESTING APPROACHES EXPLAINED

ESG integration means taking financially material ESG considerations into account in the investment decision-making process. By doing this, investors believe that they can enhance risk management and may improve future returns.

Negative screening is the use of a screen, or filter, to exclude certain investments, such as companies with negative ESG characteristics, or activities or sectors that an investor wants to avoid.

Best in class investing means investors focus on finding companies which are highly rated on ESG criteria. It can be used when investors allocate to sectors where many companies are poor performers on ESG criteria, but some exposure to the sector is considered important.

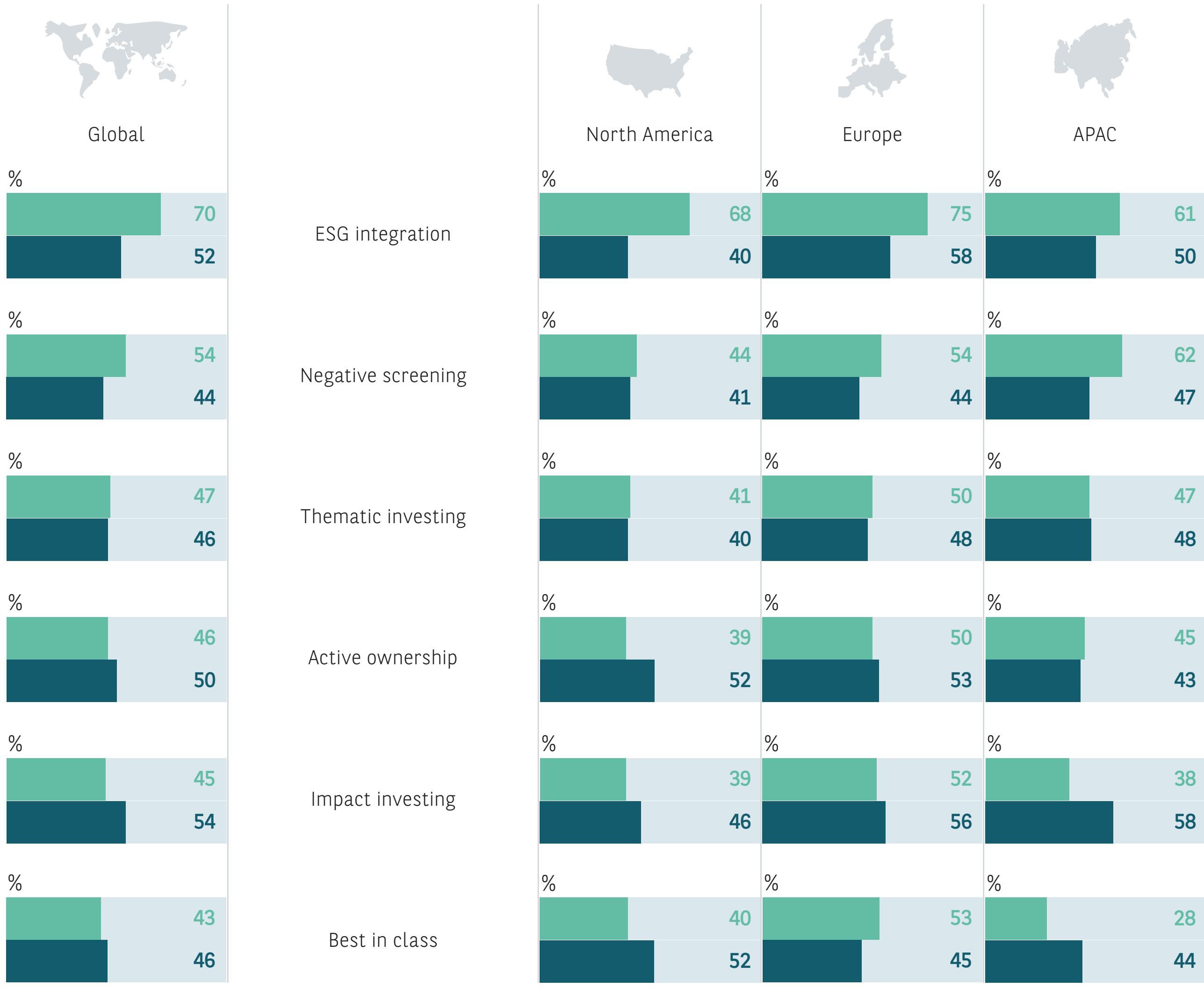
Thematic investing is investing with a focus on activities seen as benefiting from long-term trends, such as a shift to renewable energy and clean tech.

Impact investing is the process of investing with the objective of making a positive, measurable impact on ESG criteria while also generating a financial return.

Active ownership refers to engaging with an investee company by shareholders, through a dialogue, voting and other steps, with the aim of positively influencing the company's approach to environmental, social and governance matters. Ultimately, if shareholders believe active ownership is not working, they may decide to divest, or sell their shares in a company.

ESG APPROACHES USED NOW AND WITHIN THE NEXT 2 YEARS BY REGION

Which of the following ESG approaches/strategies do you employ within your organisation and which do you expect will also play a part within the next two years?

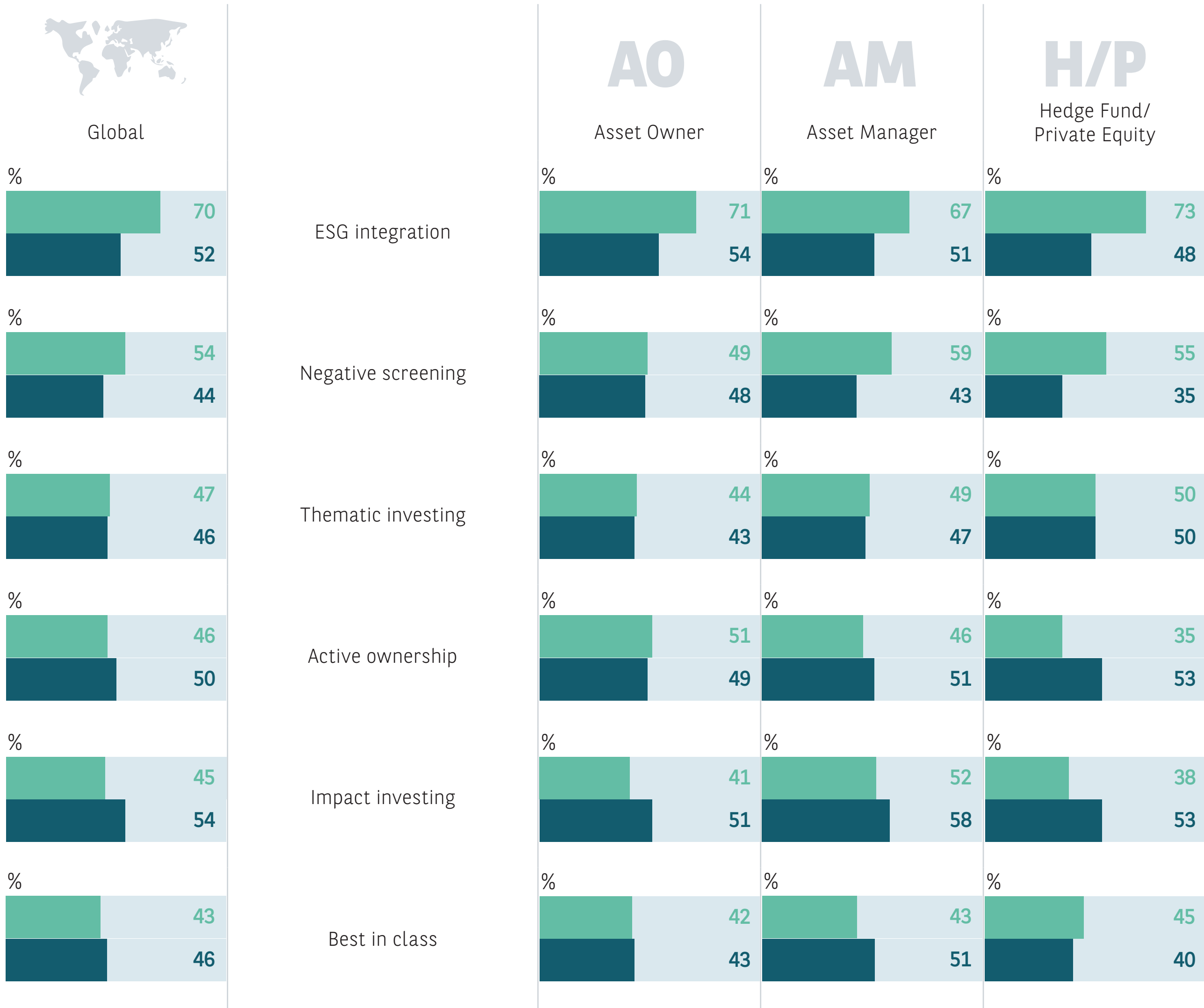


Now In the next two years

% Multiple answers allowed

ESG APPROACHES USED NOW AND WITHIN THE NEXT 2 YEARS BY INVESTOR TYPE

Which of the following ESG approaches/strategies do you employ within your organisation and which do you expect will also play a part within the next two years?



Now In the next two years

% Multiple answers allowed

Asking respondents about the methods they expect to play a part in the next two years shows some interesting changes from the approaches in use now. The focus on ESG integration (70% to 52%) and negative screening (54% to 44%) is expected to fall, while the use of impact investing increases from 45% to 54%. Active ownership also rises from 46% to 50%, while there is a small increase in the use of best in class, where investors select the best stocks on an ESG scorecard in a particular sector, from 43% to 46%. The point to note here is that impact investing and active ownership are approaches to ESG investing which aim to bring about positive changes through how assets are invested and how investors fulfil their ownership responsibilities. It can also be argued that best in class investing is similar, as it involves selecting the best investments from an ESG perspective in a sector. Greater use of these approaches then ties into investors' plans to reduce their carbon footprint and work towards net zero targets.

It is also noticeable that this trend applies to all three regions. For impact investing, its use is set to rise from 39% of North American investors and 38% of APAC investors now, to 46% and 58% of investors respectively. For Europe, the rise is from 52% of investors now to 56% within the next two years for impact investing and from 50% to 53% for active ownership. The increase in the use of impact investing is also seen at asset owners (41% to 51%), asset managers (52% to 58%), hedge funds and private equity firms (38% to 53%). The latter group, hedge funds and private equity firms, also expect to see a large increase in their use of active ownership, from 35% to 53%.

IMPACT INVESTING, USE IS SET TO RISE FROM 39% OF NORTH AMERICAN INVESTORS AND 38% OF APAC INVESTORS NOW, TO 46% AND 58% OF INVESTORS RESPECTIVELY

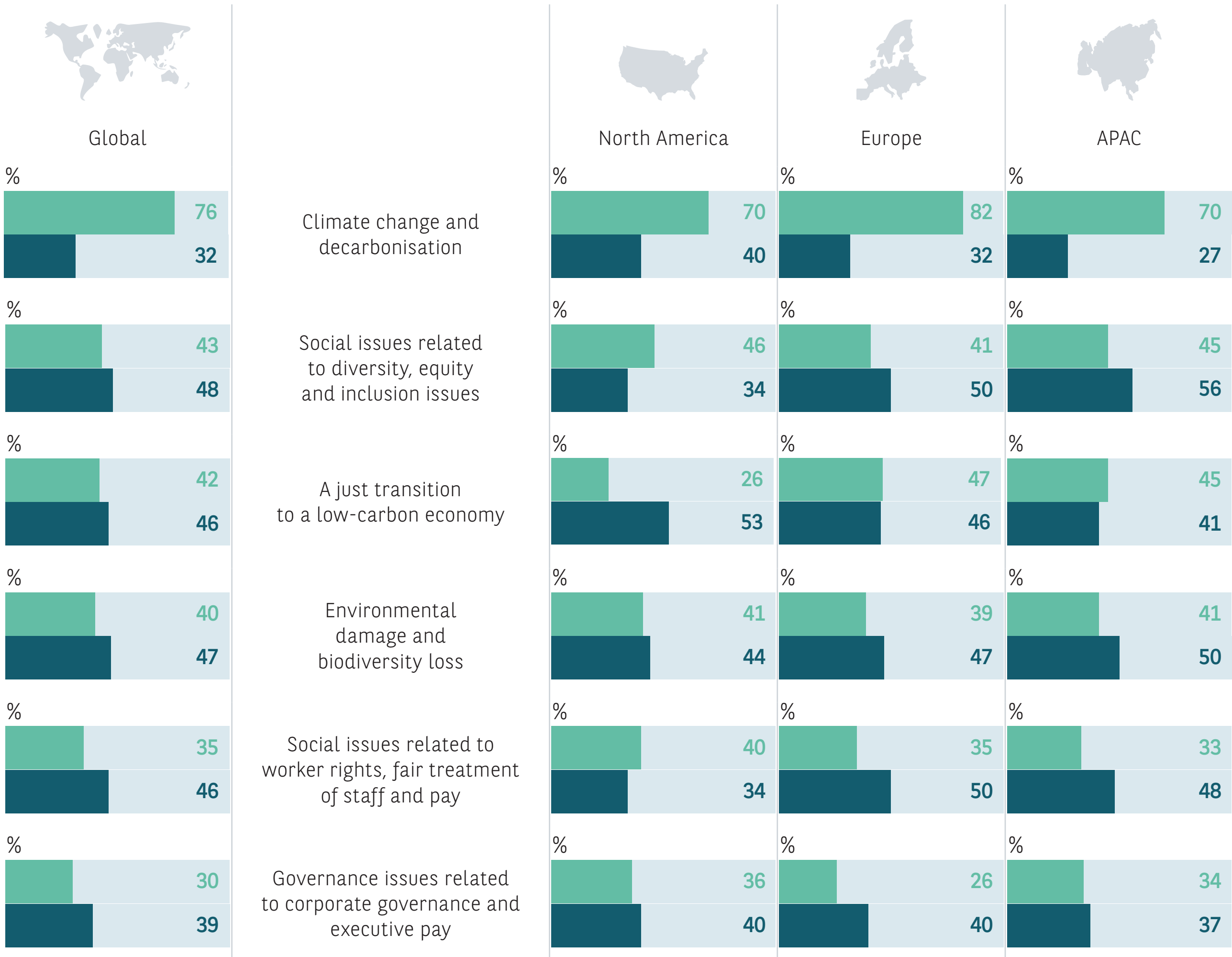
ESG INVESTING PRIORITIES FOR ACTIVE OWNERSHIP

GIVEN that interest in active ownership is rising, it is interesting to note the topics that investors see as priorities now and in the next two years. By a considerable margin, climate change and decarbonisation are the key priorities now, with 76% selecting this ahead of social issues related to diversity, equity, and inclusion (43%), a just transition to a low-carbon economy[3] (42%), environmental damage and biodiversity loss (40%) and social issues related to worker rights, fair treatment of staff and pay (35%). The high priority given to climate change and decarbonisation applies across the three regions and across asset owners, asset managers, hedge funds and private equity firms. This finding ties into other outcomes, such as the increases in net zero commitments and in divesting or excluding carbon-intensive assets, as key ESG objectives.

3. A just transition to a low-carbon economy refers to the need to support workers and communities affected by the transition away from fossil fuel use and to a more sustainable, low-carbon economy. It recognises that this will be a complex process, with millions of jobs in carbon-intensive industries around the world disappearing and being replaced by jobs in low-carbon activities, which will need different skills. For this transition to happen in a socially and economically just manner, it will require planning, dialogue and support for entire communities on a large-scale.

TOPICS SEEN AS KEY PRIORITIES FOR VOTING, ENGAGEMENT, AND POSSIBLE INVESTMENT CHANGES NOW AND IN THE NEXT TWO YEARS

Which of the following topics are seen as priorities for voting, engagement and possible investment changes (e.g., exclusion or divestment) now and in the next two years?



Now
In the next two years

% Multiple answers allowed

Active engagement with companies over carbon emissions is seen as crucial to the transition to a low-carbon economy. This is illustrated by a European asset owner, who spoke about how investors can work with energy companies to help them move away from using fossil fuels towards renewable energy sources, such as offshore windfarms. "It's about changing a company from A to Z, rather than just investing in it once the change has been made", he said. As such, active ownership can mean, as a US asset owner explained, engaging with companies that are struggling to become more sustainable. "When we engage with laggards, it's not that they think climate change is an immaterial factor. They want to work on it, but they don't have the buy-in, or the resources to make that change."

"When we engage with laggards, it's not that they think climate change is an immaterial factor. They want to work on it, but they don't have the buy-in, or the resources to make that change.

A US asset owner

Over the next two years, investors plan to increase their voting, engagement, and possible investment changes, such as divestment and exclusion, to a broad spread of ESG issues and there are some distinct regional variations. On an overall basis, climate change and decarbonisation are priority topics for only 32% of investors in the next two years, a big change from 76% now. Given the overall investor interest in decarbonisation, as shown by investors' key ESG objectives, this finding can be interpreted as showing how investors want to increase the attention given to a range of topics, rather than abandoning the issues of climate change and decarbonisation. As part of this, investors may also have set up processes to deal with companies on decarbonisation, which should lead to more targeted engagement on climate issues. For example, a European asset manager said: "In general, the majority of our investee companies have a set of science-based targets that are aligned with what we expect from them. Where that's not the case, there is an engagement trajectory." Another European asset manager explained that, through the increased ESG data provided by the SFDR, it is now in the process of using the implied temperature rise (ITR), which calculates how many degrees temperature rise a company is aiming at through its climate action plan. "We are trying to get a grip on that and are planning to use that in our engagement, probably with companies that are most at risk", she commented.

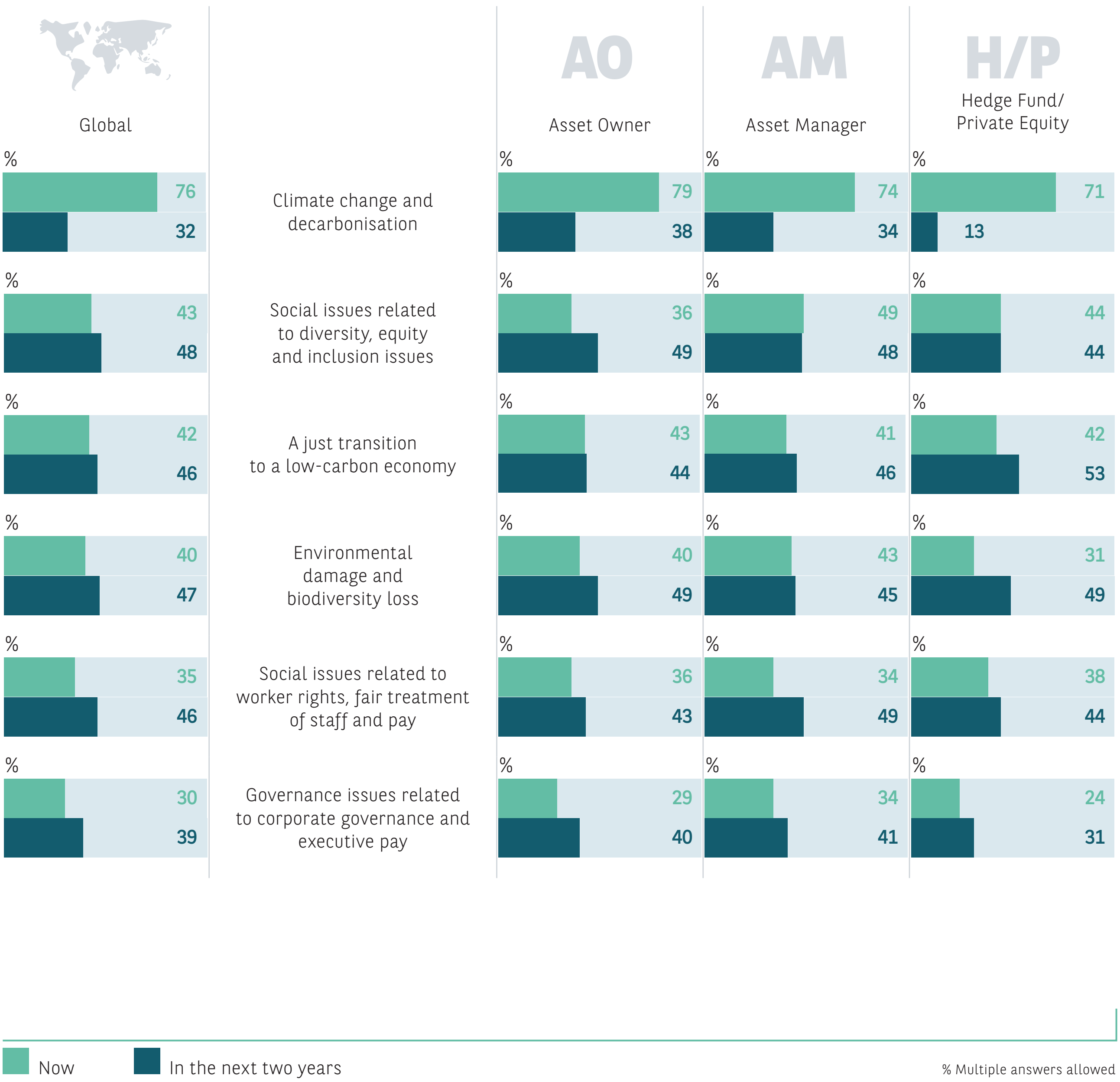
In Europe and the APAC region, environmental damage and biodiversity loss will be a key topic for more investors in the next two years than now, while for North American investors, a just transition to a low-carbon economy will become a more important topic. We can also see those social issues, both around DEI issues and worker rights, are increasing as priorities in Europe and the APAC region, but not in North America, where they are decreasing as priority topics. Again, this could be because North American investors are downplaying future action on DEI issues, as this has been a focus for some time, whereas APAC and European investors see it as an area where they plan to do more. However, the US was the only region where a majority of investors see the just transition becoming a key priority for their strategies over the next 2 years. One possible reason for this is that because of the importance of the oil and gas sector in the US economy, investors are aware that if it is to be replaced by greener energy, then a just transition is needed to support communities and workers currently dependent on the oil and gas sector.

For asset owners, environmental damage and biodiversity loss (40% to 49%), social issues around DEI issues (36% to 49%), social issues around worker rights (36% to 43%) and governance issues (from 29% to 40%) are all set to increase in importance as key topics for active ownership. For asset managers, the biggest increases are on social issues around worker rights (34% to 49%) and governance issues (34% to 41%), followed by a just transition to a low-carbon economy (41% to 46%). And for hedge funds and private equity firms, there are increases for environmental damage and biodiversity loss (31% to 49%), a just transition to a low-carbon economy (42% to 53%), social issues related to worker rights (38% to 44%) and governance issues (24% to 31%).

THE US WAS THE ONLY REGION WHERE A MAJORITY OF INVESTORS SEE THE JUST TRANSITION BECOMING A KEY PRIORITY FOR IN THEIR STRATEGIES OVER THE NEXT 2 YEARS

KEY PRIORITIES FOR VOTING, ENGAGEMENT AND POSSIBLE INVESTMENT CHANGES

Which of the following topics are seen as priorities for voting, engagement and possible investment changes (e.g., exclusion or divestment) now and in the next two years?



% Multiple answers allowed

Overall, the survey results show that over the next two years, for the 50% of respondents who plan to use active ownership as part of their ESG investing approach, they intend to prioritise several topics. While climate change and decarbonisation are a key priority at present, other topics will also become important in the minds of investors soon. Asked about how their active ownership approach will evolve, a European asset manager said: "Health will be a topic going forward, which will translate into the food transition and that is also connected with biodiversity. Another theme for us is the circular economy and that will translate into the materials transition".

"Health will be a topic going forward, which will translate into the food transition and that is also connected with biodiversity. Another theme for us is the circular economy and that will translate into the materials transition.

A European asset manager

WHILE CLIMATE CHANGE AND DECARBONISATION ARE A KEY PRIORITY AT PRESENT, OTHER TOPICS WILL ALSO BECOME IMPORTANT IN THE MINDS OF INVESTORS SOON

41%

THIS YEAR'S FINDINGS SHOW THAT JUST OVER FOUR-IN-TEN INVESTORS HAVE A KEY OBJECTIVE OF MAKING A COMMITMENT TO NET ZERO BY A CERTAIN DATE

OTHER STEPS INVESTORS ARE TAKING TOWARDS A LOW-CARBON ECONOMIC MODEL

IN 2021, the ESG Global Survey found that net zero was an important component of ESG investing, as institutional investors started to adopt the goal of net zero carbon emissions by a certain date, usually 2050, to support the Paris agreement on limiting climate change. In 2021, 37% of investors had made a public commitment to a net zero goal, while 36% were actively investigating the feasibility of implementing a net zero policy at their organisation. This year's findings show that just over four-in-ten (41%) investors have a key objective of making a commitment to net zero by a certain date, such as 2050. This rises to nearly half (48%) of all investors in the next two years, with little difference between the three regions.

Looking at the data, there is, as would be expected, a strong relationship between investors with a commitment to net zero which is one of their key ESG objectives and the number of decarbonisation activities they are undertaking. While 41% of investors overall have a commitment to net zero as a key ESG objective now, this rises to 48% for investors using three or more decarbonisation activities. In addition, while 44% of investors say that portfolio decarbonisation is either a high priority or a top priority now or in the next two years, this rises to 61% for investors undertaking three or more decarbonisation activities.

In terms of how they will decarbonise their portfolios, as they have already shown, investors are making use of underweighting carbon-intensive sectors or investing in only the best ESG performers (44%), excluding carbon-intensive sectors (43%), and exercising active ownership (37%). This is followed by steps around measuring their carbon footprint using scope 1 and 2 emissions (35%) and the biggest material impacts of their portfolios on carbon emissions (34%), then other steps, such as working with other asset owners (29%) and undertaking carbon credits and carbon-offsetting (26%).

Among investors who are undertaking three or more decarbonisation activities, the most widely used here are underweighting carbon-intensive sectors or restricting investments to the best ESG performers (53%), excluding carbon-intensive sectors (52%) and calculating the carbon footprint of some, or all, or their assets (49%).

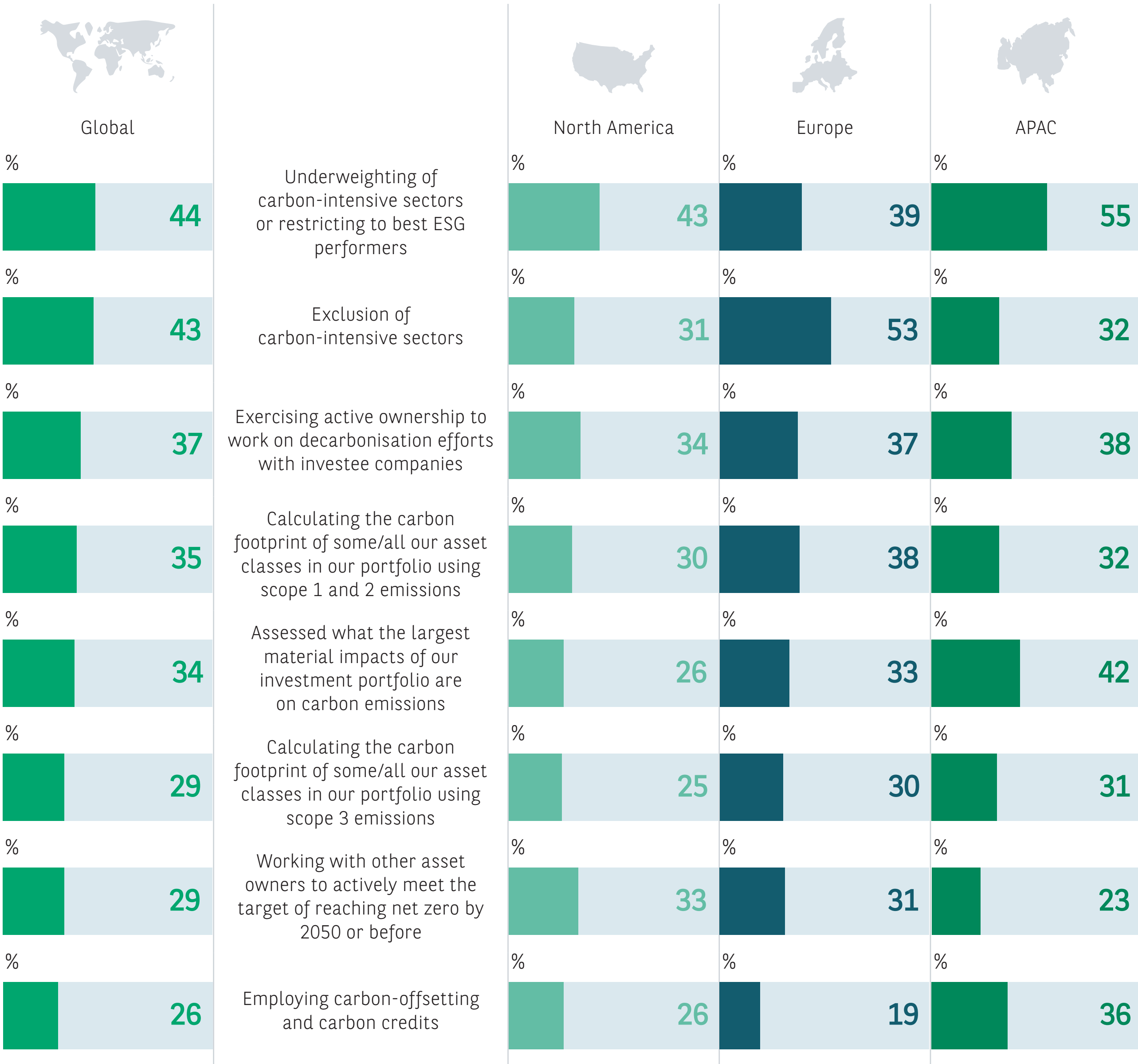
On a regional basis, APAC investors are more likely to employ underweighting of carbon-intensive sectors, while Europeans are more inclined to use exclusion and less likely to use carbon-offsetting and carbon credits. North American investors are slightly less likely to calculate their carbon footprint and to assess their portfolio's impact on carbon emissions.

Among organisation types, one point of difference on decarbonisation stands out, which is that hedge funds and private equity firms are more likely to use active ownership to work on decarbonisation efforts with investee companies (53% vs. 39% for asset owners and 30% for asset managers). This finding makes sense, as private equity firms, with board representation and often sizeable stakes in investee companies, have a good opportunity to make active ownership work.

HEDGE FUNDS AND PRIVATE EQUITY FIRMS ARE MORE LIKELY TO USE ACTIVE OWNERSHIP TO WORK ON DECARBONISATION EFFORTS WITH INVESTEE COMPANIES

DECARBONISATION ACTIVITIES BY REGION

Please provide details about your decarbonisation activities if your organisation is already decarbonising its investments or plans to start doing so in the next two years.



% Multiple answers allowed

On decarbonisation, investors are very much aware that they are in the early stages of a journey, according to some of their comments. For example, a US asset owner said: "We are still in the process of building out a 2050 net zero plan. We've worked with a lot of big pension plans, who might have engagement strategies for 200 to 300 companies. That's what we hope to do. We want to make renewable energy about 30% of our portfolio in 2040". And a CIO at an insurance company in China explained how its decarbonisation efforts are in line with Chinese government policy. "Our overall decarbonisation strategy, because of the government requirement for this, is to follow companies that can reach the government's decarbonisation goals. And we will avoid or divest from companies that are not capable of following the government's decarbonisation goals". Investors that have embraced impact investing, such as a European asset owner with a focus on impact investing, often have more ambitious decarbonisation goals: "We have set ourselves a goal to go beyond net zero, to have a positive impact. There is a hierarchy to that. The first part is to exclude all investments that have a huge negative impact and cannot be sustainable, like the fossil fuel sector. The next step is to bring down those negative impacts of investments in the portfolio, so we check if investee companies have a climate action plan and if their operation is in line with that."

"We have set ourselves a goal to go beyond net zero, to have a positive impact. There is a hierarchy to that. The first part is to exclude all investments that have a huge negative impact and cannot be sustainable, like the fossil fuel sector. The next step is to bring down those negative impacts of investments in the portfolio, so we check if investee companies have a climate action plan and if their operation is in line with that.

A European asset owner

SETTING CARBON REDUCTION TARGETS

AS part of their decarbonisation work, investors must work with other parties, from other investors to their external asset managers. One way of working with asset managers is to set, or impose, carbon reduction targets. Overall, just over half (52%) of investors are doing this. Most investors, 41%, are setting a soft target or working with an asset manager aligned with their decarbonisation goal. But 11% are setting a hard target in the investment management agreement. A further 32% of investors say that although they are not setting a carbon reduction target at present, it is likely to happen in the next two years. Only a minority, 16%, have no plans to introduce carbon reduction targets for their asset managers.

APAC investors are leading the way here, as 17% have set hard targets, while 47% are using soft targets or an alignment on decarbonisation. European investors are not far behind, with 8% using hard targets and 47% soft targets. And in both regions, more investors plan to start using targets in the next two years; 36% in the APAC region and 30% in Europe. North American investors are some way behind their peers when it comes to carbon reduction targets, with 43% having no plans to introduce them and only a third using them at present.

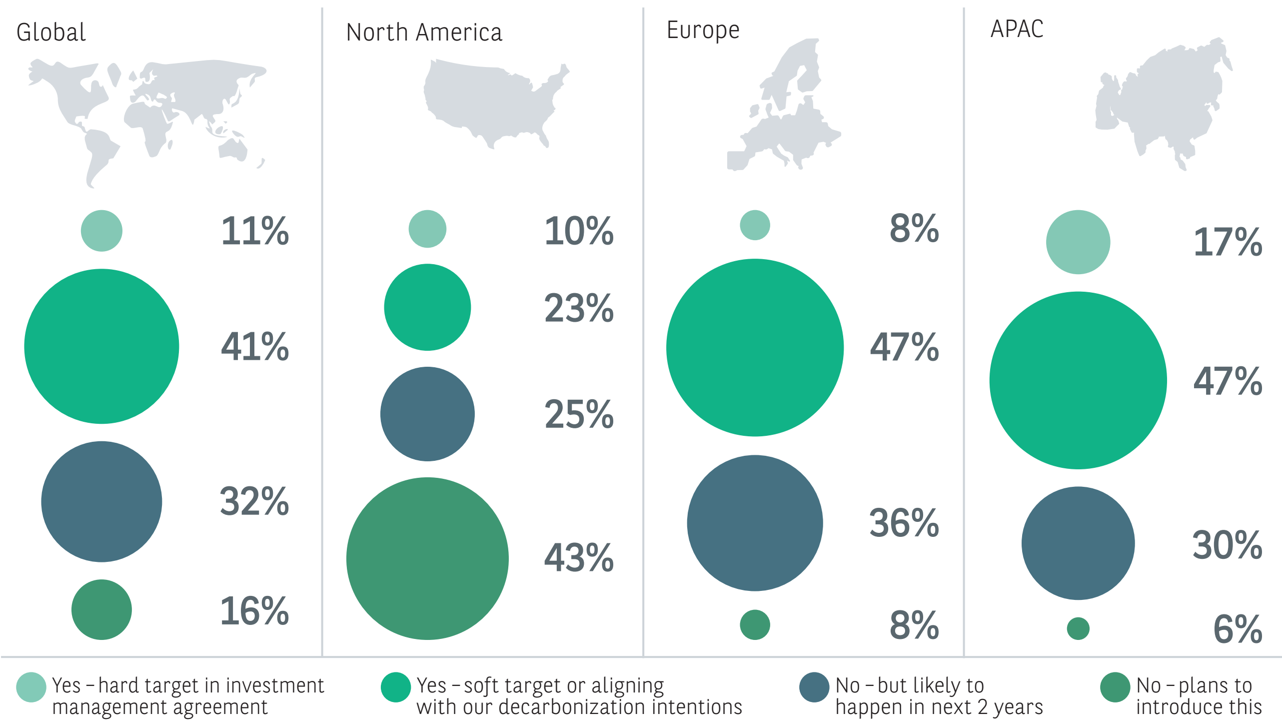
ONLY A MINORITY, 16%, HAVE NO PLANS TO INTRODUCE CARBON REDUCTION TARGETS FOR THEIR ASSET MANAGERS

> We want to be sure that their responsible investing thinking is integrated into all processes. That is checked on a quarterly basis by the fiduciary manager, if there is still the right responsible investing attitude at the asset manager.
>
> A European asset owner

One APAC asset owner explained how they use both soft and hard carbon reduction targets for their asset managers. "Some have a hard target to be 40% lower than the market. Others have a risk-based target, for example, for 25 basis points of tracking error, we want the manager to use that tracking error to maximise the carbon reduction". And a European asset owner, which uses fiduciary management, said it has an ESG dashboard which shows its carbon reduction against a benchmark. This investor also said it wanted to be aligned with its asset managers on sustainability. "We want to be sure that their responsible investing thinking is integrated into all processes. That is checked on a quarterly basis by the fiduciary manager, if there is still the right responsible investing attitude at the asset manager".

INVESTORS ON THEIR USE OF CARBON REDUCTION TARGETS

Are you imposing carbon reduction targets on your external asset managers?



CONCLUSION

ONE of the most striking findings in this research is the diversity of views on the most important elements in defining a sustainable investment. This highlights the potential growing gap between having a globally consistent approach to sustainable investing versus individual investor views. This is clearly reflected in the data from our study where we saw a difference between North America and other regions, with investors in the former focussing on what is important to their organisation as sustainable investors, while investors in Europe and the APAC region are more aligned to external criteria, primarily regulation and policy signals.

Contrasting this, the research also shows how investors around the world are now taking action on climate change. Global agreements, such as the Paris Agreement of 2015, have led many investors to set targets for net zero emissions. The adoption of net zero targets is a good example of how ESG investing evolves over time, and how investors have become more sophisticated in their analysis, requiring data to become more nuanced. While ESG investing is driven often by values, which can shift the focus among organisations and individuals, sustainable investing recognises that a common goal, in this case producing a sustainable economic and social model in an era of global warming, requires united action if it is to work. So, investors in, say, China and the USA can find harmony in defining net zero as a goal, while their views on other aspects of ESG investing might differ considerably.

The importance of sustainable investing, with decarbonisation as the objective, also explains why investors are moving from more passive approaches, such as excluding certain investments, to more active approaches, such as exercising active ownership and the use of impact investing. This is because approaches such as active ownership and impact investing enable investors to make more effective use of their assets under management, by bringing positive changes at investee companies. If investors can scale this approach, then the chances of effective action to support decarbonisation and a transition to a low-carbon economy also increase.

Looking at the range of investor responses in this survey, and from their own comments, we can see a wide dispersion of investor attitudes and actions on sustainable investing. But this, and previous research from the BNP Paribas ESG Global Surveys, show that there is a general trend towards an increased take-up of sustainable investing. Within this, we can see some encouraging developments, such as the fact that many in the APAC and North American regions are moving ahead on sustainable investing. Another positive sign is that sustainable investing is now often applied to asset classes such as private equity and private debt. Delphine Queniart concluded: "The survey shows investors are moving from more passive approaches, such as excluding certain investments, to more active approaches, such as exercising active ownership and the use of impact investing. As institutional investors prepare to scale up their efforts, private markets are becoming progressively more important for investors' ESG strategies. However, investing in private markets for sustainability and impact is not always easy to do. Despite the challenges, the impact can be very effective, and the findings show that hedge funds and private equity firms are becoming supporters of sustainable investing." There is a huge amount still to do, and erratic severe weather events are an unsettling reminder, but this research shows that many investors are making definitive progress on investing more sustainably.

"The survey shows investors are moving from more passive approaches, such as excluding certain investments, to more active approaches, such as exercising active ownership and the use of impact investing. As institutional investors prepare to scale up their efforts, private markets are becoming progressively more important for investors' ESG strategies.

Delphine Queniart

FOLLOW US

FIND US

securities.cib.bnpparibas

BNP PARIBAS

The bank
for a changing
world