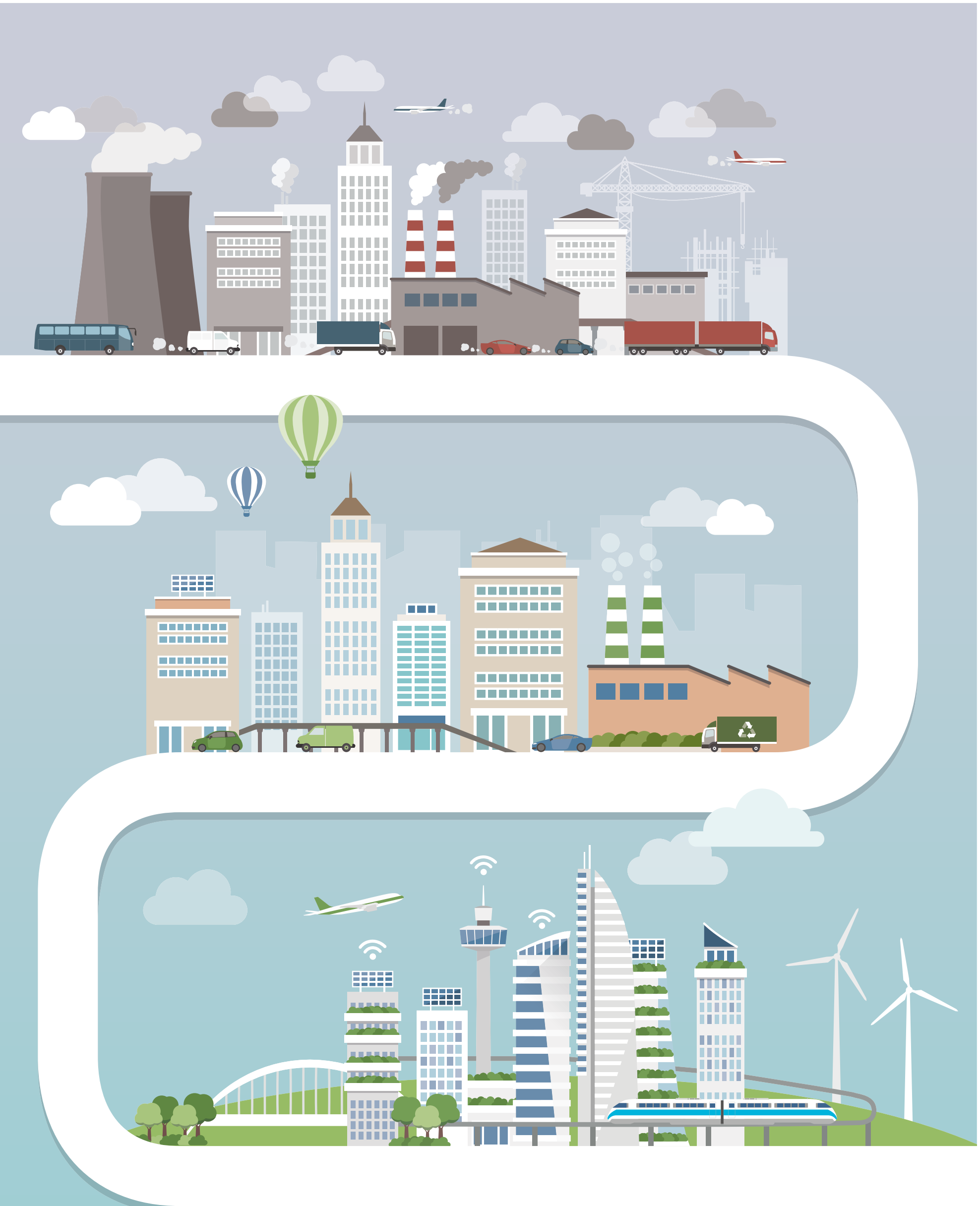


A green evolution

Sandra Haurant explores the changing nature of sustainable investing

Summary

• Aon's recent survey shows a significant shift towards ESG/ sustainable approaches.
• Within sustainable investment, there is a movement towards engagement rather than exclusion.
• Investor engagement is having a real impact on companies, changing cultures and working practices through shareholder pressure.
• Questions remain around what is sustainable or responsible – and always will.
• The Russian invasion of Ukraine and other pressures have seen fossil fuels perform well while also raising questions around the role of defence – and ultimately, around what is ethical, responsible or sustainable.
• Overall, investors are satisfied with returns on ESG investments, suggesting a win-win situation for all.

The recently published *Global Perspectives on Responsible Investing* survey from Aon lays out what the industry has known for some time; today, the industry leans decidedly towards sustainable and responsible investment strategies.

Aon's 2022 survey suggests pension schemes now recognise the influence their investment choices can have, from battling the climate crisis to improving working conditions. The survey questioned 155 investment professionals worldwide and showed that 84 per cent of respondents claim to engage with responsible investment through environmental, social and governance (ESG) integration. Almost half (48 per cent) have a responsible investment or ESG policy in place and are making changes to investments in line with this policy.

Climate change is the most pressing investment concern for 68 per cent of respondents, with socio-economic inequality, cyber risks and biodiversity loss all featuring high on the list of priorities. These core values are transforming into concrete action; one in five UK asset owners have already committed to aligning with the Paris agreement's net-zero target by 2050, and more than half (53 per cent) pledge to do so "soon".

A changing landscape

Some in the industry have seen first-hand the very visible signs of this growing momentum. Before joining Cardano as group head of sustainability, Will Martindale was director of policy and research at the UN-backed Principles for Responsible Investment (PRI), the world's leading proponent of responsible investment. "When I joined PRI, there were 30 staff members, and PRI had around a £2 million a year turnover," says Martindale. "I was there for seven years, and when I left there were 200 staff members and well over £20 million in turnover, which is indicative of the changes that we've seen, and the increased attention that we've seen being paid to responsible investment during that time."

Martindale adds: "We've gone from some sort of quaint, somewhat niche concepts, often with origins in the NGO community, run by individuals who are hugely passionate and inspirational, but with perhaps not huge amounts of experience in the finance sector, to this being a core part of how most investors will understand value in their portfolios, and this has changed within a very short space of time."

Defining terms

To understand the background to this increasing interest in ESG, its useful to consider the terms used in responsible investment. JTC head of ESG services, Victoria Gillespie, says: "Sustainable investment is essentially investment that will continue for the foreseeable future. It's a really broad term, and ESG is a component or a subset of that. ESG is one of the factors, but not the only factor, to allow and enable companies to be sustainable and remain in business for the foreseeable future."

And just what does the integration of ESG into an investment strategy entail? Aon associate partner, responsible investment, Jennifer O'Neill, says: "ESG integration is agnostic as to the values that you're perhaps espousing. So it's not the same thing as ethical investment, which is where you're applying more of a moral lens to the investments that you are making." Instead, she says: "ESG integration is really about understanding the risk profile of that investment, and the opportunity profile, from an environmental, social and governance perspective."

Evolution in action

"Underlying investors now want to know what they're exposed to. And what we've seen is a movement away from 'I don't want to be exposed to ...' towards a more meaningful, 'this is how I want my investment to work for me as an individual, because this is what means the most to me'," says Gillespie. "So it's not the case anymore that the underlying investor pays their pension premium, the pension company invests it and the fund manager goes and does what they'd like with it to get the maximum financial return."

Just as interest in ESG, and strategies of sustainable, responsible investment more widely, have grown, so the approaches used within the space have evolved. Gillespie says: "Over the past decade, we've definitely moved away from exclusionary investments and towards more meaningful investment."

Instead of identifying areas that are problematic and avoiding all related companies that don't align with investors' values, the approach is frequently very different. Today, responsible investment increasingly involves engaging with companies to effect positive changes to products, practice and policy. Investing, but insisting on – and often assisting with – important and fundamental changes to the ways in which a company runs. Gillespie explains: "That could be a reduction in emissions, that could be a movement away from, for example, the use of plastics; we've seen some very meaningful changes in direction and in sentiment."

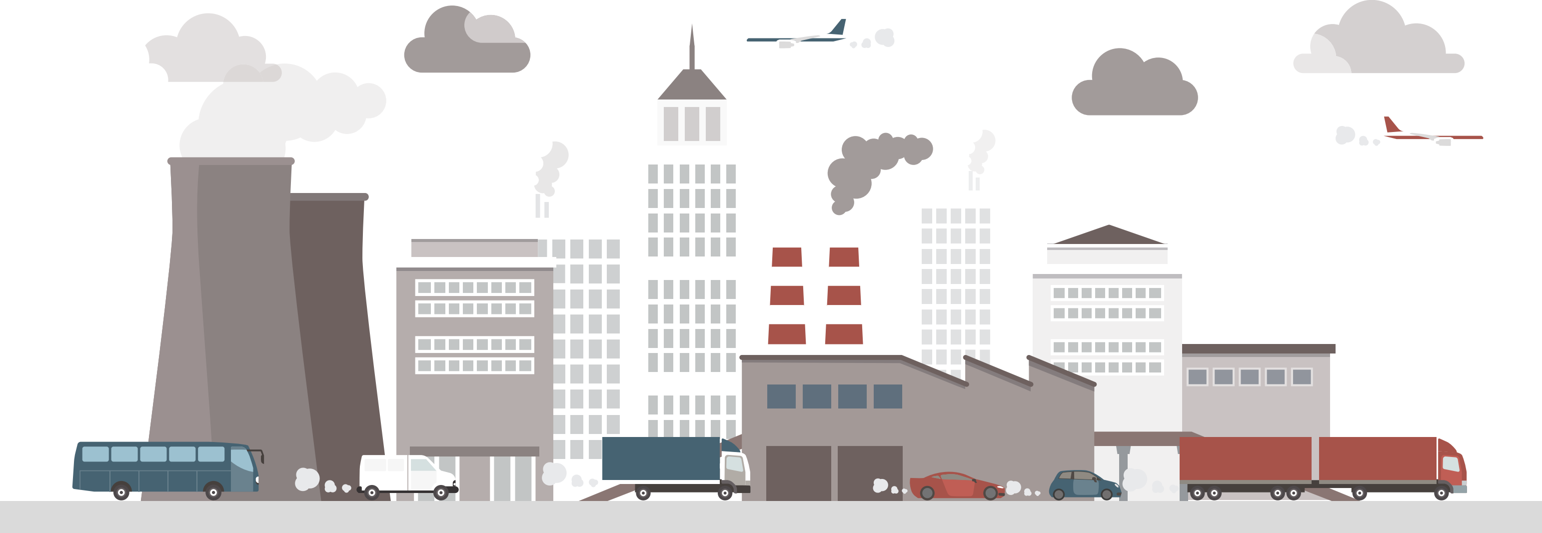
Change from within

There are, of course, plenty of 'real world' cases of investor engagement having an impact; one recent example is that of Britain's second-largest supermarket chain Sainsbury's. The company did not comply with the requirements of the real Living Wage – an hourly rate evaluated by the Living Wage Foundation, which uses a basket of goods in order to calculate how much a person needs to earn to be able to meet day-to-day expenses. "Obviously, in the high inflation environment that we find ourselves in that's particularly important," says Martindale.

"Sainsbury's has been responsive to engagement undertaken by investors calling for increased wages, particularly for its own directly employed staff; but it hasn't at this stage, committed to roll that out for its contracted staff," he says. Sainsbury's AGM takes place on 7 July, and, says Martindale, investors will be: "Using shareholder resolution, engagement and investment as tools to try and drive behaviour change within Sainsbury's."

Divest or engage?

But while some areas are shifting, the argument for an exclusionary approach continues to be particularly vehement in the fossil fuel industry. In a paper entitled *The Divestment Dilemma*, published by Aon, authors O'Neill and Aon head of climate change insight, Mark Jeavons, said: "There are arguments that denying capital to fossil fuel companies may force a reassessment of their priorities



surrounding ESG factors (such as the development of additional fossil fuel reserves), and so their strategic decision making. In some instances, these organisations will then seek to reduce or eliminate their exposure to fossil fuel producers as a way of improving their resilience to climate change risks."

On the other hand, the opposing argument claims that engaging with companies is essential in order to push for behaviour changes. As the authors of the paper put it: "Retaining investment holdings provides the ability to exert influence on companies through engagement to improve behaviours. This is an approach followed by many investors, with an option to divest should this engagement not yield meaningful results."

A question of values

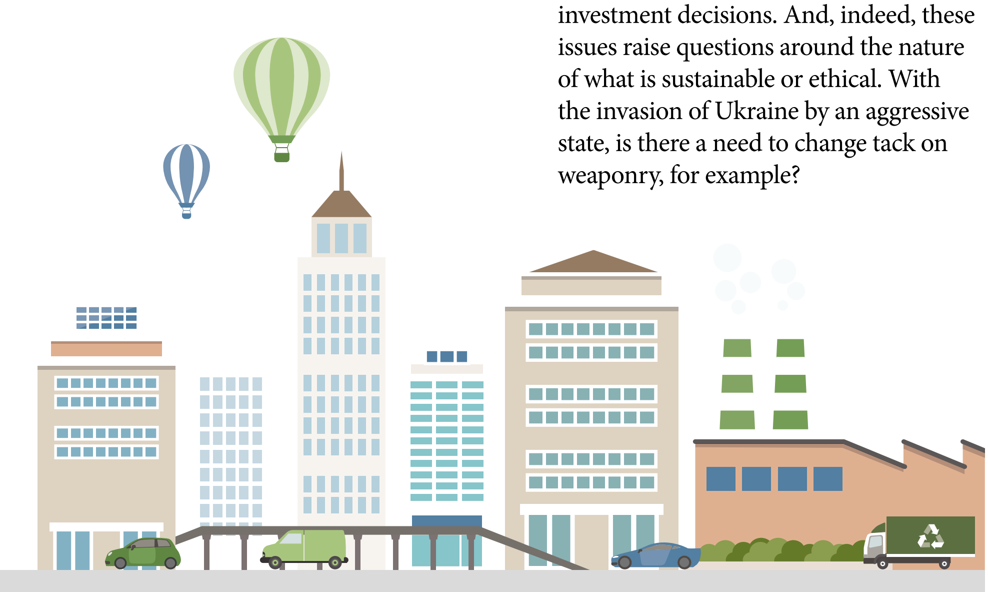
At a time when fossil fuels have performed well, it's a necessary debate to have. "The high inflation environment, and then the Russian invasion of Ukraine, has led to the strong performance of fossil fuels over the last six months. That has added some pressure on sustainability strategies," says Martindale.

The divest or engage in fossil fuels debate demonstrates the ways in which the wider world necessarily influences investment decisions. And, indeed, these issues raise questions around the nature of what is sustainable or ethical. With the invasion of Ukraine by an aggressive state, is there a need to change tack on weaponry, for example?

Martindale says: "Conventional weaponry, when used for national defence, has never been an excluded activity *[for us]*." However, any company involved in cluster munitions or landmines, where there is "clear international community condemnation of that type of weaponry", would be excluded. "We will continue to assess companies on the types of activity that they undertake and whether those activities come with different ESG risks," he says.

This is a field that must question itself constantly, but it's also one that is achieving results. According to Aon's survey, 69 per cent of respondents with exposure to responsible investments said they were either satisfied or very satisfied with their returns to date, while 28 per cent were 'neutral'.

Investments that produce returns while making positive changes in the world. A win-win situation for all? Increasingly, pension schemes seem to think so. As O'Neill says: "We see a number of pension schemes having a desire to positively influence the society in the community that they're operating in, and recognising that as institutional owners of capital, they have a real opportunity to do so."



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