FUTURE OF SUSTAINABILITY IN INVESTMENT MANAGEMENT: FROM IDEAS TO REALITY

EXECUTIVE SUMMARY

The future of sustainable investing is in the balance. It involves balancing financial and extra-financial considerations, balancing short-term and long-term goals, and balancing interests among stakeholders and over time, while seeking fair outcomes for all.

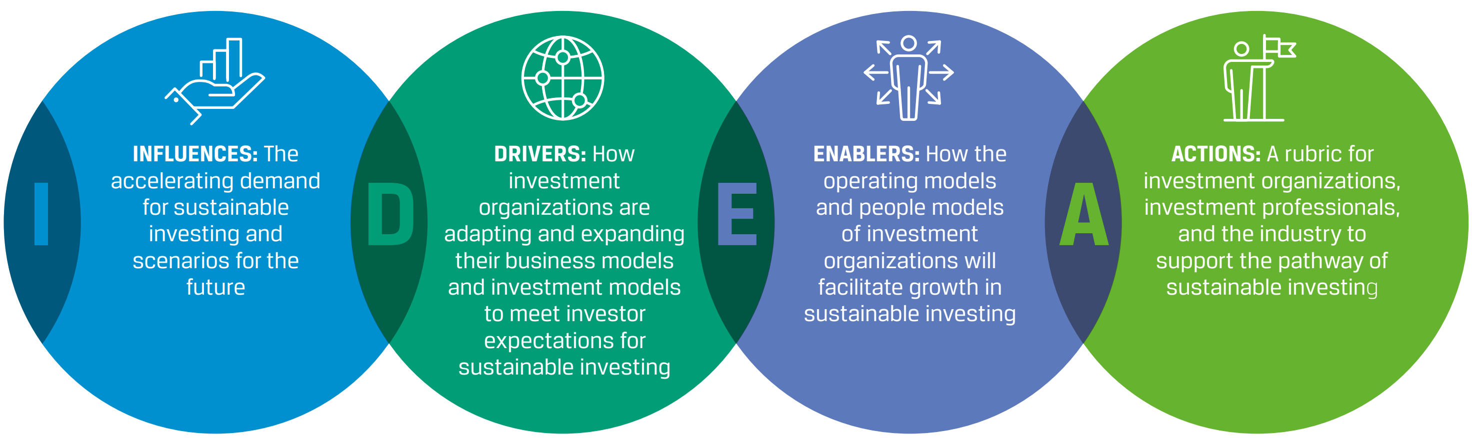
None of this is easy. But sustainable investing is critical to the sustainability of investing. The incorporation of sustainability in investment management is an important element in the industry's mission to serve society by improving long-term outcomes.

Although the future of sustainable investing includes many unknowns, we advance three important tenets where sustainable investing goes further than its forerunners:

- It is additive to investment theory and does not mean a rejection of foundational concepts.
- It develops deeper insights about how value will be created going forward using environmental, social, and governance (ESG) considerations.
- It considers many stakeholders.

In many ways, we are moving from sustainable investing as a good idea to a reality that has implications for all investment portfolios. There is a growing recognition that some ESG factors are economically material, especially in the long term, and it is, therefore, important to integrate material ESG factors in investment decisions.

As we consider a 5- to 10-year time horizon, our report's structure follows the acronym **"IDEA"**:



We suggest that the next stage of development will depend very heavily on industry leadership and innovation in investment thinking and practice, as well as data management. Investors and the investment industry have a considerable role to play in shaping the future.

Influences:

The accelerating growth of sustainable investing

- In the first half of 2020 alone, the Principles for Responsible Investment (PRI) signatories increased by 28%, to more than 3,000 entities, and the assets under management grew 20%, to more than US$100 trillion.
- 85% of CFA Institute members* now take E, S, and/or G factors into consideration in their investing, up from 73% in 2017.
- Client demand as a motivation for investment organizations to consider ESG factors increased significantly in the last three years. Demand as a motivator was highest in the Americas region (65%), an increase of 20 percentage points since 2017.
- According to Google Trends, the topic "environmental, social, and corporate governance" has never been as popular as it is today.
- The COVID-19 pandemic has focused investors on the vulnerability and resilience of the financial system and intensified the discussions around sustainability.
- Sustainable investing carries implications for the CFA Institute future state scenarios of Fintech Disruption, Parallel Worlds, Lower for Longer, and especially Purposeful Capitalism, which takes on a new tenor and urgency. The new scenario applications — climate energy and social status, as below — extend our scenario framework.

New Scenario Applications

Climate Energy: Carbon pricing regimes emerge, supported by national regulatory frameworks to deliver transparency, liquidity, and ease of access. Investment organizations account for carbon prices, and the quality of climate risk management becomes a differentiator. Climate views are increasingly incorporated into wealth management, retail, and defined contribution contexts, following the lead of institutional investors. Investment professionals deepen their understanding of climate risk resilience and mitigation.

Social Status: Innovations occur in transparency and reporting as social factors become better defined and measured. There is a greater ability to compare organizations on previously hidden areas of operation. Social media is increasingly influential in highlighting good and bad examples of company behaviors. Alternative data sources add further information to enable assessments to be made on the softer aspects of corporate conduct.

Drivers:

Business model: The core attributes on value and competitive differentiation of investment organizations

Commitment: The business model for investment organizations pursuing sustainable investing must make commitments on the full range of resources, processes, and incentives that are necessary to drive an innovation of this magnitude.

Investor interest: Although only 19% of institutional investors and 10% of retail investors currently invest in products that incorporate ESG factors, 76% of institutional investors and 69% of retail investors have interest in ESG investing.

Objectives: Among those with a values objective (or a dual objective combining financial outcomes with values), 73% of institutional investors and 67% of retail investors would be willing to give up some return in exchange for meeting their values objective.

Investment model: The component parts of the organization's investment philosophy, beliefs, and capabilities

Implementation: The most used features are best-in-class/positive screening (used by 56% of survey respondents) and ESG integration (53%), followed by ESG-related exclusions (48%). Voting, engagement, and stewardship are used by 40%, and thematic is used by 35%.

Expected growth areas: Industry professionals expect to see more ESG index tracking and quant funds, ESG thematic products, ESG multi-asset products, climate transition strategies, long-term engagement, and better benchmarks.

*In the mainland of China, CFA Institute accepts CFA® charterholders only.

Enablers:

Operating model: How the organization manages its products and services, with special consideration of data, technology, systems, and tools

ESG ratings: Company ratings are widely used, with 63% of investment professional respondents using them as a part of their data analysis. In addition, 73% expect the influence of ESG ratings on firms' cost of capital to be greater in the next five years.

Climate risk: 40% of investment professionals surveyed incorporate climate risk into their analysis, and the most common types of risk considered are physical and transition risks.

Greenwashing: 78% of practitioners surveyed believe there is a need for improved standards around ESG products to mitigate "greenwashing." The ESG disclosure standard under development by CFA Institute aims to increase the transparency and comparability of investment products with ESG-related features.

Alternative data: A majority (71%) of industry roundtable participants agreed that alternative data have the potential to improve the robustness of sustainability analysis, and 43% expect sustainability to benefit from the application of artificial intelligence.

People model: The staffing model and the attract-and-retain methods used

Research commitment: 90% of investment professionals expect their firm's commitment to ESG research will increase, up from 72% just two years ago.

Current structure and roles: About one-third of investment organizations have dedicated ESG specialists, and a third have portfolio managers conduct ESG analysis.

Demand for ESG expertise: A review of 10,000+ LinkedIn investment professional job posts found that approximately 6% mentioned sustainability-related skills. Demand for sustainability talent is rated as "very high."

Supply of ESG expertise: An analysis of 1 million investment professionals on LinkedIn found that <1% had disclosed sustainability-related skills in their profile, despite 26% growth in sustainability expertise in the last year. Women represent 42% of ESG analysts, which is much higher than the 26% of women overall in the sample.

Training: Training in ESG has increased, but still fewer than half of respondents say their firm provides ESG training. Only 11% of respondents consider themselves proficient in the area, but an equal number are currently being trained, and more than 70% have interest in training — half of these within the next year.

Actions needed:

We suggest that the industry must make a transition toward increased adoption of sustainable investing and increased effectiveness and impact of sustainable investing. A **rubric for progress** provides a framework to produce a combination of a grade for performance and a guide to improve performance. The guide we suggest for improving performance includes the following elements for the industry, organizations, and investment professionals.

1. **ESG education**

   Industry: ESG knowledge and skills are developed to a critical threshold across the industry so that ESG thinking is embedded in all investment settings.

   Organizations: Provide training to build ESG expertise, and hire new resources as needed.

   Investment professionals: Core knowledge on ESG considerations is acquired by all industry professionals. T-shaped skills help professionals make better connections and draw on multiple disciplines.

2. **System-level thinking**

   Industry: Theory and practice integrate system-level thinking on top of traditional investment thinking, in an additive and complementary way.

   Organizations: Organizations do much more to integrate ESG and sustainability into their investment models.

   Investment professionals: Investment professionals understand the main features of systems theory and use this thinking when considering sustainability topics.

3. **Collaboration synergy**

   Industry: Strengthened collaborations within and across organizations drive engagement and combinatorial power.

   Organizations: Stewardship commands considerably more focus, and there is much more resourcing committed to ownership duties and opportunities.

   Investment professionals: Strengthened collaborations within organizations and across groups and functions provide a more joined-up, holistic, and teamwork-oriented approach to sustainability.

4. **ESG data**

   Industry: ESG data practices are developed to support more substantial decision-useful application, and data go from being part of the sustainability problem to part of the solution.

   Organizations: Investment organizations reduce the cultural impediments and structural limitations that have prevented the efficient handling of the large and growing datasets involved.

Investment professionals: They understand the issues of materiality and validity of ESG data and are adept at evaluating all forms of data: hard data, soft data, and alternative data.

5. **Sustainability innovation**

Industry: Organizational commitment to sustainability innovation incorporates better incentives, agility, and iteration and comes from all parties.

Organizations: Demonstrated commitment to sustainability innovation through organizational agility in people and processes and iterative improvements.

Investment professionals: Demonstrate a willingness to explore new approaches to sustainability investment approaches, measurement, and impact.

6. **Purposeful culture**

Industry: Positive ethics and values are martialed into organizations that have purposeful culture and a mission-driven ethos.

Organizations: Organizational transformations produce purpose-driven organizations with a strong fiduciary culture, recognizing the need for more balance.

Investment professionals: Individuals with strong values make up a more committed and happier workforce, and individual accountability contributes to purposeful cultures.

Role of CFA Institute

As the largest global association of investment professionals, CFA Institute has committed to the development of sustainable investing in the following ways:

- **Supporting company reporting efforts** by providing the investor view on advisory committees and working with accounting standard setters to look for harmonization opportunities.
- **Educating investment professionals** via a specialist certificate, professional development, practitioner-focused research, and the CFA Program curriculum. In the next edition of the curriculum, ESG content will increase by 130%, with 23 readings in seven topic areas. This is equivalent to ESG coverage in 16% of readings, and ESG coverage will likely reach 20% or more as ESG standards develop and practice advances.
- **Creating standards** to improve product transparency and comparability in investor reporting, with the CFA Institute ESG Disclosure Standards for Investment Products expected in late 2021.

Conclusion

Within sustainable investing lie the fundamental elements of the sustainability of investing. Investors and the investment industry have a considerable role to play in determining the pathway and shaping a future worth investing in.

Methodology:

The report is informed by the views of more than 7,000 industry participants, including 3,500+ retail investors, 920+ asset owners, and 3,050+ investment practitioners. Research was conducted via surveys and virtual roundtables across 31 markets globally.

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