Sustainability Toolkit

What are Investors' Expectations Surrounding Sustainability?

Investor expectations are a key driver of corporate sustainability initiatives. It is important to understand how large public equity funds and activist investors influence corporate engagement in this area and shape future trends.

Click below (or scroll on mobile devices) to view some of the key questions and issues you need to consider

How are large public equity funds driving corporate engagement and risk assessment? +

Who are 'activist investors' and how are they impacting sustainable business strategies? +

What are the foundational principles that shape our understanding of sustainable investment? +

What are the trends to watch? +

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How are large public equity funds driving corporate engagement and risk assessment?

Impact of COVID-19 on Investor ESG Expectations

- Investors see the COVID-19 pandemic as a dress rehearsal for a future climate-related disruption.
- Investors are focused on company resilience and crisis management during the pandemic because these factors reflect a company’s approach in the face of uncertainty. Investors are looking for frequent communication, realistic assessments of the current circumstances, evidence of the ability to improvise, diversification, supply chain stress testing, and consideration of long-term impacts. Investors want to know how companies are prioritizing employee well-being and economic value-add.
- Companies should expect investors to double-down on their commitments to climate change in light of the COVID-19 pandemic. COVID-related shareholder proposals will affect the 2021 proxy season.

The “Big Three”—BlackRock, State Street, and Vanguard—are institutional investors that wield tremendous investment power—each controlling trillions of dollars in assets under management.

Together,

the Big Three hold about **80%** of all indexed money and **22%** of the shares of a typical S&P 500 company.

- This concentrated control of voting power gives the Big Three a disproportionate influence over corporate governance policy, strategy, and priorities concerning sustainability issues.
- Large public equity investors, responding to the growing swell of retail investor pressure surrounding corporate sustainability matters and the increasing prevalence of sustainability-related activist campaigns, have signaled a conceptual shift in investment purpose from shareholder primacy to a multi-stakeholder model which focuses on leading companies for the benefit of all stakeholders—customers, employees, suppliers, communities, and shareholders.
- This evolution in investment philosophy coincides with the transfer of trillions of dollars in assets from older generations to younger generations. This wealth transfer will continue over the next few decades and represents a changing of the guard. As millennial investors come of age and emerge as policymakers, business leaders and heads of state, they will continue to demand that companies examine and accurately disclose their sustainability-related business strategies, risks, and opportunities.
- Corporations that fail to implement sustainable business strategies and properly assess sustainability-related risks will ultimately experience skepticism from the markets, and higher costs of capital.

> “Our investment conviction is that sustainability integrated portfolios can provide better risk-adjusted returns to investors. And with the impact of sustainability on investment returns increasing, we believe that all investors need to consider sustainability in their portfolios.”
>
> Larry Fink, Chairman & CEO, BlackRock

Who are 'activist investors' and how are they impacting sustainable business strategies?

Activist investors are shareholders of a company that engage in a range of activities meant to influence the management or strategic direction of a company.

- These activities may include contacting shareholders, approaching management, requesting meetings with the board, launching "vote no" campaigns, issuing shareholder proposals, and in some cases, publicly criticizing management and board performance.
- Splashy, public, activist campaigns have plagued major companies causing the loss of revenue, reputational harm, and suboptimal stock performance.
  - **Examples of activist campaigns:** Nike's sweatshop controversies in the 1990s and Costco's supply chain slavery controversy from 2015.
- Increasingly, investors are using shareholder activism to achieve positive corporate sustainability outcomes. Sustainability-motivated activist investors often address topics like board diversity, employee retention, climate change, environmental impact, supply chain ethics, and data security and privacy.
- In some instances, management has supported those proposals. In 2019, BP determined to support a call from a group of institutional investors for the company to broaden its corporate reporting to describe how its strategy is consistent with the goals of the Paris Climate Agreement.

Trends in ESG shareholder proposals for the 2020 proxy season:

- The 2020 proxy season has seen Companies and proponents much more willing to reach negotiated settlements on environmentally and socially-focused proposals as compared to governance proposals. A review of withdrawn proposals through the beginning of June 2020 shows 44 environmentally-focused proposals where presumably the subject company and the proponent reached an agreement on the subject matter of the proposal.

- At least five proposals focused on climate-related reporting voted on during the 2020 proxy season have received majority support. This represents a notable increase compared to the 2019 proxy season, where no such proposals received majority support.
  - **B. Hunt Transport Services** - a proposal seeking a report describing if and how the company plans to reduce its contribution to climate change, and align its operations with Paris Agreement goals received **54.5% support**
  - **Ovintiv** - a proposal seeking disclosure of the company's climate-related targets, risks, and opportunities aligned with Paris Agreement goals received **56.4% support**
  - **Phillips 66** - a proposal seeking a report assessing the public health risks of expanding petrochemical operations and investments in areas increasingly prone to climate change-induced storms, flooding, and sea level rise received **53.9% support**
  - **Chevron** - a proposal seeking reporting on climate lobbying aligned with Paris Agreement goals received **53.9% support**
  - **Enphase Energy** - a proposal seeking a report on the company's ESG performance—specifically citing waste, water reduction targets and products-related environmental impacts as topics that potentially pose significant risks to the company—received **51.8% support**

Source: Harvard Law School Forum on Corporate Governance

What are the foundational principles that shape our understanding of sustainable investment?

United Nations Principles for Responsible Investment (PRI)

- The United Nations Principles for Responsible Investment (PRI) is a global organization that encourages and supports the uptake of responsible investment practices in the investment industry.
- The principles were developed by an international group of institutional investors and reflect a commitment to developing a more sustainable global financial system. There are over 2,800 signatories from over 60 countries, representing $80 trillion in assets.
- These six principles are a voluntary and aspirational set of investment principles that offer a menu of possible actions towards incorporating ESG issues into investment decision-making.

Principle 1

We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2

We will be active owners and incorporate ESG tissues into our ownership policies and practices.

Principle 3

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4

We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5

We will work together to enhance our effectiveness in implementing the Principles.

Principle 6

We will each report on our activities and progress towards implementing the Principles.

What are the trends to watch?

Unprecedented investor demand for sustainable investment options

- According to a 2019 survey conducted by Morgan Stanley of 800 U.S. individuals with minimum investable assets of $100,000, among individual investors, four key findings emerged:
  - Investor interest in sustainable investing and adoption continues to rise.
  - Investors want products that match their interests.
  - Investor conviction outweighs financial trade-off concerns.
  - Investors want more product choices.
- Of those surveyed,

85% of the general population expressed interest in sustainable investing and **95%** of millennials expressed interest.

Going a step further, **52%** of the general population take part in at least one sustainable investing activity, while this rate jumped to **67%** for millennials.

Additionally, **84%** of investors wanted the ability to tailor their investments to their values, with **90%** of millennials sharing this conviction.

Overall, **86%** of investors believe that corporate ESG practices can potentially lead to higher profitability and may be better long-term investments, and perhaps most importantly, **88%** of investors believe that it is possible to balance financial gains with a focus on social and environmental impact.

ESG Mutual Funds and Exchange-Traded Fund Experience Record Sector Growth

- Mutual funds and exchange-traded funds (ETFs) focusing on sustainability, also known as impact or ESG funds, attracted $20.6 billion in new total assets in 2019. This amount is almost four times the amount of assets invested in 2018, which totaled $5.5 billion.
- In 2019, the U.S. ETF market alone grew to $4.4 trillion assets under management, which represented a 30% increase over 2018. ESG ETFs represented $52 billion in assets under management globally in 2019.
- The ESG ETF market is expected to grow to $20 trillion in the next few decades.

Consensus surrounding standardized sustainability metrics

- In January 2020, a task force sponsored by the International Business Council of the World Economic Forum released a framework proposing a set of standardized ESG metrics for reporting companies to utilize in their sustainability disclosure efforts.
- The task force was comprised of close to 120 CEOs of multinational companies, and the “Big Four” accounting firms (Deloitte, Ernst & Young, KPMG and PwC). As companies come to a consensus surrounding standardized sustainability metrics, investors can more critically analyze sustainability disclosures.

Sustainability Toolkit

Explore the topics	Defining Sustainability	Public Policy: Climate Change	Public Policy: COVID-19	Public Policy: Environmental Justice	Public Policy: UN Sustainable Development Goals
Engaging and Advising BODs	Investor Expectations	Corporate Disclosure: The Basics	Corporate Disclosure: Standards and Initiatives	Setting Corporate Goals	M&A and JV Transactions
Green Bonds and SLLs	Carbon Markets	Marketing Claims	Crisis Management	Insurance Implications	Sustainability NGOs