Introduction to Responsible Investment

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Responsible investment activities and strategies are gaining increasing momentum. Globally, there are now $22.89 trillion of assets being professionally managed under the umbrella of responsible investment, an increase of 25% since 2014[1]. But what investment practices constitute as being responsible and where do they originate from? This article identifies the taxonomy of responsible investment strategies and explores some of the reasons for their increasingly widespread adoption.

The Origins and Evolution of Responsible Investment

The 21st Century understanding of 'responsible investment' originates from the Socially Responsible Investing (SRI) and 'ethical investing' practices that gained traction in the 1970s and '80s. Faith-based organisations began applying exclusionary screens to their investment portfolios. Companies that were excluded – sometimes referred to as "sin stocks"[2] – were those that had a certain percentage of their revenue derived from areas such as weapons, tobacco, alcohol and gambling.

Because of the religious and/or moral judgements involved, many in the investment industry assumed that the use of exclusionary screens in SRI resulted in a financial trade-off. This was one of the main factors that prevented the entry of SRI into mainstream investment practices. Responsible investment strategies have since evolved and developed into a more dynamic toolset, often referred to as Environmental, Social and Governance (ESG)[3] or sustainable investing. This can be used by the mainstream investment community as a measure of a company's value, alongside fundamental analysis of the company's finances.

The ESG philosophy – based on taking a long-term perspective through consideration of ESG factors and a heightened awareness of societal impact – remains similar to SRI. However, ESG is characterised by a more proactive approach that enables investors to combine societal impact with financial returns and still maintain the benefits of portfolio diversity. The various approaches to ESG investment are identified in the Bridges Ventures Spectrum of Capital as follows:

- Responsible - Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products (e.g. integrating ESG risks into investment analysis or an ethically screened investment fund)
- Sustainable – Focus on ESG opportunities, through investment selection, portfolio manage ment and shareholder advocacy (e.g. best in class selection of companies with better/im proving ESG performance relative to peers)
- Thematic - Focus on one or a cluster of issue areas where social or environmental need creates a commercial growth opportunity for market-rate or market-beating returns (e.g. a focus on clean energy)
- Impact-first - Focus on one or a cluster of issue areas where social or environmental need requires some financial trade-off (e.g. a fund providing quasi-equity or unsecured debt to social enterprises)

What is Driving this Shift?

These new and more sophisticated methods of responsible investment are being driven by a number of factors, including both increased demand for and supply of ESG information.

One important factor is increasing demand for ESG investment from younger investors, who may be more likely to want to align their investment portfolios with their own values and beliefs when it comes to sustainability. According to one study, 86% of Millennials (those born since approximately 1980) are interested in sustainable investing[4].

A second factor is increased regulation and standardisation on ESG disclosure. Corporates are subject to an ever growing number of regulations and requirements on sustainability-related disclosures from governments and stock exchanges worldwide. At the last count, governments from 38 of the largest 50 economies in the world have, or are developing, disclosure requirements for corporations on ESG[5]. Guidance provided by these stock exchanges, as well as frameworks such as the Global Reporting Initiative, have gone some way towards standardisation of the ESG data available to investors. This has in turn enabled investment managers to move away from what were traditionally perceived as qualitative judgements to more quantitative assessments of ESG performance.

Increased availability of specific investment products and data has also had a significant impact. Specialist ESG investment research providers give recommendations to active investment managers for use in their decisions, and construct indices that are offered to passive investors. Globally, over 900 clients in the investment industry with over $15 trillion assets under management subscribe to the ESG Research provided by the ratings provider MSCI alone, and over $85 billion in assets are bench-marked in MSCI's ESG indexes[6].

Last but not least, an ever-increasing body of evidence links the incorporation of ESG considerations in the investment process to improved fund performance, lower investment risk and better risk-adjusted returns. ESG stocks identified by MSCI, for instance, have consistently outperformed the emerging markets benchmark since 2007-2008[7].

This research has been instrumental in the mainstreaming of the responsible investment agenda. A number of studies have demonstrated a relationship between high ESG ratings and financial perfor-mance are outlined here. These are backed up by surveys of investors themselves, such as the 2016 Investing for a sustainable future study[8], which found 75% of investors citing improved revenue performance and operational efficiency from sustainability as strong reasons to invest.

Support Networks, Guidance and Regulation

A number of global and local initiatives exist to help Malaysian investors implement ESG principles into their investments. The United Nations Principles of Responsible Investment (PRI) was established in 2006 with the stated aim of providing standards and resources in the burgeoning field of responsible investment. It has helped create global momentum towards driving responsible investment practices. Signatories, which now include Khazanah Nasional Berhad, the sovereign wealth fund of the Government of Malaysia, commit to applying the six Principles to better align investors with broader societal objectives:

1 We will incorporate ESG issues into investment analysis and decision-making processes.	**2** We will be active owners and incorporate ESG issues into our ownership policies and practices.
3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.	**4** We will promote acceptance and implementation of the Principles within the investment industry.
5 We will work together to enhance our effectiveness in implementing the Principles.	**6** We will each report on our activities and progress towards implementing the Principles.

In 2015, the Association for Sustainable & Responsible Investment in Asia (ASrIA) merged with UNPRI to form the Asia (ex-Japan) Network. From a corporate disclosure perspective, Bursa Malaysia Securities Berhad[9], Singapore Stock Exchange (SGX) and Hong Kong Stock Exchange (HKEX) have all adopted requirements for sustainability reporting by listed companies.

Further to this, there have also been efforts to improve engagement between investors and corporates in the region on ESG issues. Six of the 14 countries globally that have developed stewardship codes since 2014 are in Asia – these include Malaysia[10], Taiwan, and Hong Kong.

ReferencesS

[1] Global Sustainable Investment Review, Global Sustainable Investment Alliance, 2016

[2] Sin stocks can also be defined by regional and societal expectations that vary widely across the globe

[3] Environmental, Social and Governance (ESG) is synonymous with Environmental, Social and Governance (ESG) is distinct from Bursa Malaysia's economic, environmental and social (EES) risks and opportunities that form part of its listing requirements as it omits the governance element. This is because there are already specific and comprehensive disclosure requirements for corporate governance in the Listing Requirements, as well as the Malaysian Code on Corporate Governance 2012 and the Corporate Governance Guide. The Sustainability Reporting Guide can be found at: http://www.bursamalaysia.com/misc/system/assets/15789/BURSA%20MALAYSIA%20SUSTAINABILITY%20REPORTING%20GUIDE%20(final).pdf

[4] Millennials Drive Growth in Sustainable Investing, Morgan Stanley, Aug 2017

[5] Global Guide to Responsible Investment Regulation, UNPRI and MSCI, Jun 2016

[6] Global Equity Indexes, MSCI

[7] Kynge, J (2017) The ethical investment boom, The Financial Times

[8] Investing for a Sustainable Future, MIT Sloan Management Review and Boston Consulting Group, May 2016

[9] The relevant requirement is set out in paragraph 29 in Part A of Appendix 9C and Practice Note 9. The link to the consolidated Main Market Listing Requirements is as follows: http://www.bursamalaysia.com/misc/system/assets/15741/listing_requirement_main_market_consolidated_26Jan18.pdf

[10] Malaysian Code for Institutional Investors issued by the SC: https://www.sc.com.my/wp-content/uploads/eng/html/cg/mcii_140627.pdf

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Tags : Responsible, ESG, Investors, Investment, Socially Responsible Investing (SRI), Ethical investing, Sustainable