Invesco

ESG @Invesco

When it comes to ESG, being green isn’t black and white

Virtual event highlights

17 June 2021

Welcome

Top tip
This document is designed to be viewed on screen as an interactive PDF. The panels below provide quick access to each section, and you can click on the side menus and other navigation buttons throughout the document.

While the appetite for ESG investing has grown considerably in recent years, investors need to be aware that there is no single 'truth' when it comes to ESG and that with opportunities come trade-offs. The following pages provide an overview of each session at ESG@Invesco.

All sessions now available on demand **here**

ESG@Invesco

At a glance

1 day-long virtual event on 17 June 2021 covering key topics and ideas around sustainability

14 sessions discussing the most pressing issues facing current and prospective ESG investors

50+ industry experts and inspirational panellists including in-house experts, academics, and representatives from around the world offering **diverse perspectives on sustainability**

Esther Duflo, 2019 Nobel Prize Winner for Economics, featured as the **keynote speaker**

The event was offered in four languages across EMEA and over **1,200 clients** joined us from **over 46 countries**

To divest or to engage, that is the question

Zoje Vataj, global proxy governance and voting manager at Invesco, brought together **Dr Oğuzhan Karakaş** of the University of Cambridge's Judge Business School, **Matthew Tagliani**, head of EMEA ETF product and sales strategy at Invesco, and Invesco portfolio manager **Erik Esselink** to consider whether divesting is always the best option – or can engagement deliver better outcomes?

Two options
Divestment can be an easy and obvious option when a holding no longer matches up with an investor's beliefs. But it can also have unintended consequences and doesn't always help promote better ESG behaviour. Although often costly, investor engagement can sometimes enhance value by putting pressure on companies to change. However, this pressure can help lead to greater operational efficiencies, lower costs, and help to attract more stable, longer-term investors.

Engagement is where an active asset manager can particularly add value for investors by analysing a stock's potential worth and working with management to encourage greater business sustainability and more ESG-friendly behaviours. For many asset managers, understanding the ESG challenges that a company faces is just as important as understanding its fundamentals. And engaging with companies on these issues can lead to value creation and better returns.

However, engagement can be a long process, with studies showing it typically takes 12-18 months, and that just one in five interactions leads to successful outcomes. Where it is successful, however, it can enhance returns by around 2%.

Successful engagement can also depend on the company's sector, with consumer-facing businesses likely to prove more amenable to actively engage with shareholders rather than risk a public backlash.

While engagement can be a powerful tool for ESG-minded investors, companies mustn't get their objectives confused. Indeed, not every engagement will create value. And sometimes divestment is the only option left, particularly when companies fail to engage, or investors and management are poles apart.

Active or passive engagement?
While there may be greater scope for active managers to engage with companies, their ability to impact management can sometimes be weakened by the size of their stakes in the business. Meanwhile, passive asset managers find their capacity to bring change at companies is limited by their lack of knowledge and expertise. Passive managers must divest if a holding falls out of its benchmark index for non-compliance.

Asset managers with both active and passive investing strategies – like Invesco – can allow active managers to leverage the size and popularity of index-tracking products to force change. So-called 'echo voting' allows active managers to use the voting rights held by the passive business. As such, a joint active/passive approach can lead to greater engagement and more positive ESG outcomes for all investors.

Formalising engagement
Under the EU's Sustainable Finance Disclosure Regulation (SFDR) framework, many asset managers' products are classed as Article 6, requiring some disclosure of sustainability risks but without specific sustainability requirements. Asset managers such as Invesco are considering moving funds to Article 8 and embedding sustainability more formally into their processes. This will require asset managers to detail their engagement processes.

Some believe that, with ever-greater demand for more sustainable products and ESG strategies, Article 8 could soon become the standard across Europe. Nevertheless, it's crucial that asset managers make sure that investors are not left behind as adopting and incorporating sustainability concerns into strategies picks up pace.

It is also essential for asset managers to continue to digest some of the more complex reporting criteria that come with the push for greater sustainability.

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ESG in emerging markets: The reality as viewed in Africa

Gwen Smith, managing director, Africa at Invesco, chaired a panel with **Emily Waita Macharia**, Africa public affairs director at Coca-Cola, **Queen Chinyere Quinn**, founding partner of Kupanda Capital, **Hany Assad**, co-founder of Avanz Capital, and **Claudia Castro**, director of fixed income research at Invesco. The panel discussed how emerging markets need to be engaged with ESG and the conundrum that many African countries face at a time of greater industrialisation.

Local – not global – issues
Although the ESG movement has gathered pace in more developed markets such as Europe and the US, there is a rapidly developing understanding of these issues in emerging markets. While many people consider that ESG and issues like climate change are best discussed at a global level, for many emerging market economies, they present considerable local challenges.

Given the history of catastrophic weather events on the African continent, many countries are well aware of the need to decarbonise. But measures to cut carbon emissions are considerably easier to implement for post-industrialised developed market economies. For African countries at different stages of industrialisation, this transition poses major challenges to their wealth and development.

Many countries have already taken steps to incorporate the United Nations' 2030 Sustainable Development Goals (SDGs), and the corporate world is also changing the way it thinks about ESG. Yet, there are concerns where these commitments overlap with economic growth and adoption of the SDGs has not been as fast as some would like. This could undermine the success of the goals in Africa, which aim to end poverty, protect the planet, and bring peace and prosperity to all by 2030.

Pitching in
It's not just the responsibility of emerging markets to tackle climate change, however. Developed nations, too, must be engaged and shoulder some of the ESG burden that falls on emerging markets. There are significant investment opportunities for investors in developed markets, allowing them to 'pitch in'.

African governments can take advantage of the appetite for sustainable finance among investors in developed nations with issuance tied to climate business plans. Multilateral organisations, such as the International Monetary Fund, may also play a bigger role in the future of sustainable finance on the continent by tying bond issuance to project finance for sustainability projects.

The ESG opportunity in Africa
The scale of the ESG investment opportunity in Africa is difficult to overstate considering there are significant inequalities in everyday essentials such as energy provision and clean water. However, there remain longstanding concerns over risk perception for emerging markets and Africa, impeding the flow of capital.

Capital is not the only resource that developed countries can provide. New technological advances in fields such as agriculture and greater support surrounding education on issues like climate change are part of the engagement process.

Companies such as Coca-Cola are taking action to ensure they also meet their customers' ESG expectations by focusing on waste reduction and moving to more environmentally friendly business practices. Indeed, corporates are playing an increasingly important role in emerging markets by tackling the numerous environmental challenges in the countries in which they operate. Some companies are even partnering with local communities and non-governmental organisations in a bid to bypass central government bureaucracy and get more sustainable solutions for their customers.

What about the 'S' and 'G'?
The idea that emerging markets, and Africa in particular, have low governance standards is gradually being dispelled as markets become more sophisticated in a bid to attract international investment. As such, the risk of doing business in these markets has fallen in recent years. African companies have also been embracing change at board level with greater gender equality to better represent their customers.

The journey towards better ESG behaviours has begun on the African continent, and awareness is likely to increase in the coming years.

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Diversity, equity, inclusion, and social impact – how can companies and investors make a difference?

Mariela Vargova, senior ESG analyst at Invesco, talks with **Nuala Walsh**, CEO at MindEquity Consulting, **Rikia Birindelli-Fayne**, senior director for corporate engagement in EMEA at Catalyst, and **Professor Raghavendra Rau** of University of Cambridge's Judge Business School about social equity and its growing role within business and how capital is allocated.

Defining the issue
Awareness of social equity has grown over the past 18 months as the death of George Floyd last year captured global attention and saw support for the Black Lives Matter movement spread around the world. In addition, the Covid-19 pandemic highlighted existing social inequalities within societies as social distancing and lockdowns put people under greater financial strain. As a result, investors are starting to think more about what they can do to promote social equity in the workplace and in business.

While awareness of social equity is growing, there are many who still do not fully understand the concept. Defining the issue continues to be difficult for companies to address, particularly when companies are unsure of the correct language to use and discuss it publicly.

Not just a 'people problem'
Often it is referred to as a 'people problem' for a company's human resources department to tackle, but social equity and diversity are issues that need to be tackled from the top-down.

Indeed, some companies do not yet understand how greater social equity and diversity in the workplace can be translated into a competitive advantage. Previous academic studies have treated the issue as a moral or ethical issue rather than how it can add value.

The intersectionality of gender, race and ethnicity is leading to a better understanding of the social equity issue which is encouraging companies to take a closer look at the data and address how they recruit, promote, and retain staff. Greater social equity and diversity can increase the pool of people who can contribute to value creation and encourage different business-critical viewpoints in times of crisis.

Commitment to social equity and diversity can be challenged during times of business stress, and there sometimes may be trade-offs, where companies focus too much on one ESG issue at the expense of others. However, companies often have legal duties and responsibilities to ensure that their workplaces are committed to equality. Even concepts such as unconscious and implicit bias are better understood in the modern era, which companies would be unable to deny if challenged on practices related to diversity and social equity. Furthermore, there is considerable reputation damage and personal career risk for executives who fail to grasp social equity's importance.

Less 'virtue signalling', more action
More businesses are moving beyond simple 'virtue signalling' and are taking greater action on social equity and diversity. At the board level, there is greater awareness of the issues and their importance to shareholders. As a result, so-called 'CEO activism' has emerged as a driving force for change in recent years as employees and customers demand the companies they work for and buy from do more to promote social equity. However, there is a need to encourage staff to speak up about social equity in the workplace and watch out for "preference falsification", where people say one thing but believe another because they fear speaking out could damage their career prospects.

Ultimately, investors have a powerful role in how companies operate and are powerful lobbyists for change. They can also act as watchdogs by holding boards accountable, monitoring their progress on diversity and social equity and helping them to meet their goals. Shareholders and boards are starting to see that companies with strong diversity and inclusion processes and those that are greater proponents of social equity are among the more profitable.

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Just how green is a portfolio? The challenges of and need for standardisation in ESG reporting

Kenneth Blay, head of research for global thought leadership at Invesco, discussed the need for greater standardisation in ESG reporting with **Clive Emery**, multi-asset portfolio manager at Invesco, **Stephen Horan**, University of North Carolina at Wilmington, and **Professor Elroy Dimson**, chairman of the Centre for Endowment Asset Management at University of Cambridge's Judge Business School.

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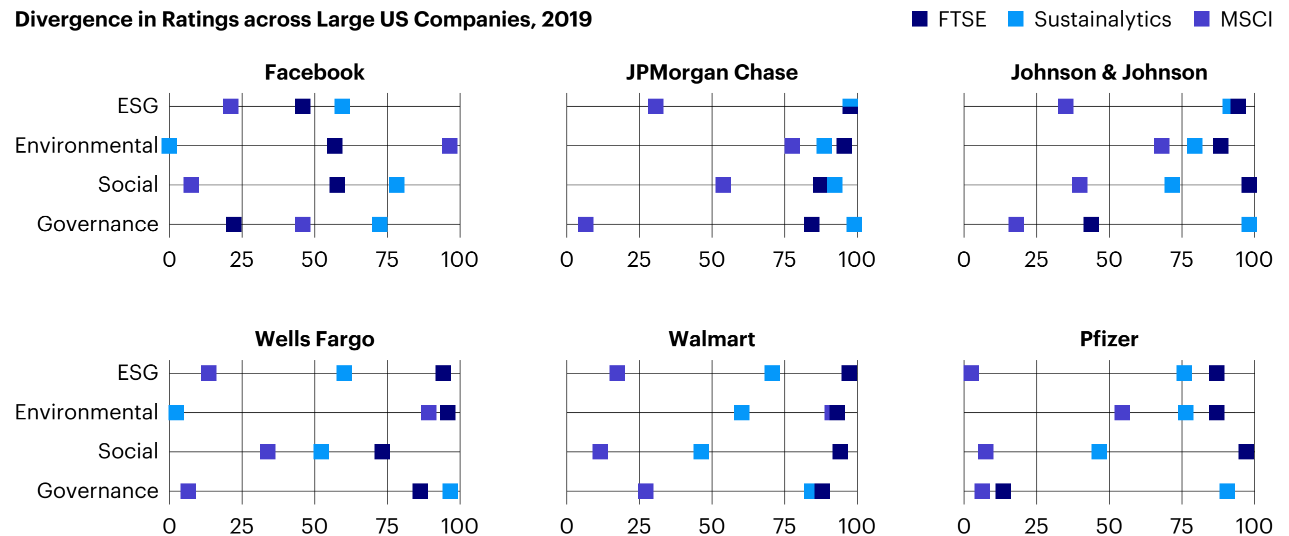
Made to measure
"If you treasure it, measure it," as the well-used adage goes, and that's particularly important for ESG investment. Indeed, ESG data analysis is becoming an increasingly important part of asset managers' investment process. But when it comes to ESG data, it has become increasingly difficult to measure how green a portfolio is without a more standardised approach across the investment industry.

Amid the rising popularity of ESG strategies in recent years, companies are increasingly putting out large amounts of information and data on all sorts of aspects of their business demanded by shareholders. With this flood of data, a new market of around 1,000 data providers has emerged. In the absence of standardised reporting structures, all the data providers have developed their own methods for assessing a company's ESG credentials.

Different outlooks
Often data providers will take different views on a company's outlook and performance under different ESG criteria, resulting in different ratings and making like-for-like comparisons challenging. Such divergence can result from data discrepancies, benchmark choice, data imputation, information overload, or weighting schemes. But the vast amount of ESG data available is also a problem, and it's difficult to see how providers will coalesce around a common set of data points.

With a range of different ESG metrics, many of which are not aligned with each other, it is increasingly difficult for investors to make their own assessments.



Source: Data from MSCI, FTSE Russell and Sustainalytics.

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Confused retail investors

While there have been growing calls for greater standardisation in corporate reporting and ratings, there is an equally pressing need for a more standardised approach to reporting in the retail fund space so that investors can make more informed decisions.

It can be confusing for investors comparing funds using different data points and benchmarks. Marketing materials may carry claims about ESG credentials, many asset managers don't give much information about their investment processes. Furthermore, there is a wide variety of approaches in how asset managers invest in the retail fund space. This can make it harder to compare strategies within a peer group, as there are few common measures available – like performance or drawdown.

Although regulation of the retail fund space is changing, the information for the end investor is still of variable quality. What retail investors often want to find out can be boiled down to the fund's return profile, risk profile, and responsibility profile. Standardised reporting in the retail fund space would also make it easier for investors in different types of ESG products – such as Shariah strategies – or even more bespoke portfolios to make comparisons. Asset managers must also be careful not to confuse investors with data or information that is not relevant to the fund's objective or to the investor's ESG beliefs.

Avoiding greenwashing

Nevertheless, things seem to be moving in the right direction on standardisation. Surveys of institutional investors suggest they are becoming increasingly bullish about the emergence of a common set of disclosure standards in the next five years. Indeed, common standards will be needed for companies in more carbon-intensive sectors to avoid being accused of 'greenwashing'.

The experts also note that commonplace metrics now widely used in financial reporting, such as EBITDA, were once considered alternative performance measures. ESG metrics are likely to follow the same path.

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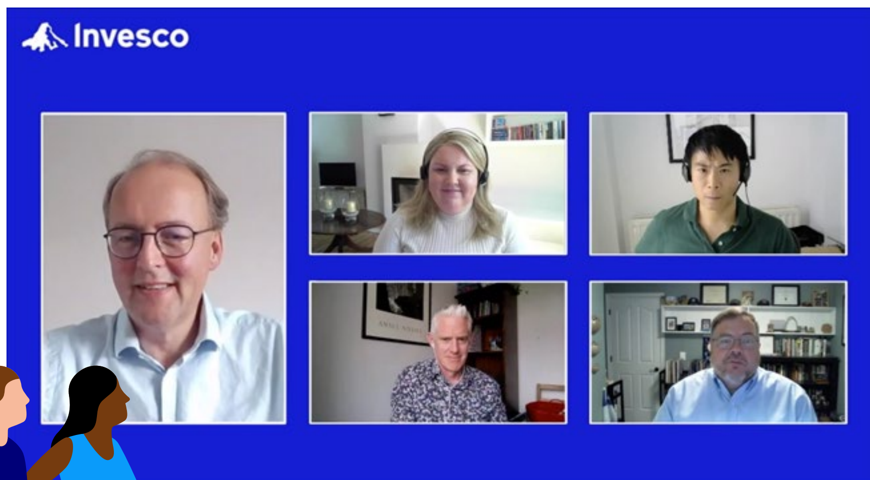
ESG: doing good or sounding good?

Chaired by **Jillert Blom**, head of distribution for Benelux, France and Nordics at Invesco, this panel featured **Elizabeth Gillam**, head of EU government relations and public policy at Invesco, **Alex Edmans**, professor of finance at London Business School, **Mike Barry**, former director of sustainable business at Marks & Spencer, and **Glen Yelton**, head of ESG client strategy North America at Invesco and discussed the trade-offs that sometimes must be made in sustainable investing.



Sustainability as a business model
Sustainability has emerged as a considerable disruptive force in markets over the past decade as the largest companies by market capitalisation demonstrates: oil giant Exxon, the largest company in the world eight years ago, has been replaced by Elon Musk's electric vehicle company Tesla, which was only founded in 2003. Tesla is now worth more than all other listed carmakers put together.

While sustainability as a business model seems to be flourishing, investors are discovering that there are many trade-offs to be made when it comes to ESG investing. Electric cars, for example, still require rare elements for batteries, often found in developing countries with questionable human rights records and deforestation practices. Indeed, ESG investing can be much more nuanced than some investors expect. Every decision – even those made with the best of intentions – can have a downside. There are numerous examples over the years of companies that have made changes for good reasons but with negative consequences.

Regulation can also have a detrimental impact if it takes an approach that is too prescriptive. Recent moves to help identify more environmentally sustainable businesses under the EU's Taxonomy Climate Delegated Act could be too binary and overlook many companies in more carbon-intensive sectors that are nonetheless making efforts to reduce their environmental impact.

What's the 'additionality'?
While sustainability metrics and regulations are helping investors to better understand the companies they invest in, they need to put them in context and ask more qualitative questions that can help them identify value opportunities.

As the so-called 'boots on the ground', active investors can positively impact engagement by working with companies to improve their ESG practices. Divestment can also be a powerful tool but can starve companies and sectors of capital and disincentivise companies to change. A more effective process may be to reward the best-in-class performers from an ESG standpoint to encourage others.

Investors need to ask themselves whether their investments have a direct positive ESG impact or 'additionality'. Even the pursuit of 'net zero' carbon emissions in the coming years to protect the planet can have intended and unintended consequences for companies and the communities in which they are located.

The politicisation of ESG
The increased politicisation of environmental issues, such as decarbonisation and carbon emissions, can negatively affect regions dependent on fossil fuels. This is particularly important as governments try to catch up with years of inaction. Politicisation of issues, such as executive pay, can also have unintended consequences, disincentivising those at the top to perform well.

Investors need to be aware that by doing good in one area, they might potentially be overlooking other ESG issues elsewhere. This is particularly important as some ESG goals and targets might be more measurable – such as reducing carbon emissions – than others – like improving social equity.

Companies have to be aware of their responsibilities too. They need to know why they should become sustainable, particularly given the direction of travel in markets and the allocation of capital. They need to have the right competencies to become sustainable and make changes to how they operate. And, finally, they need to be able to integrate their sustainability strategy into their business.

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The challenges, nuances, and opportunities of implementing ESG in private markets

Kevin Petrovcik, senior client portfolio manager at Invesco, discusses how private markets managers and companies are implementing ESG criteria and what challenges they face. He was joined by **Charlotte Edwards**, ESG credit strategy analyst at Barclays, **Kristofer Dreiman**, head of responsible investments at Länsförsäkringar, and **Stefan Behring**, head of Nordics distribution at Invesco.

The ESG 'canary in the coalmine'
As in public markets, private markets managers are also seeing increased scrutiny of their ESG credentials by investors. Indeed, ESG data is just as necessary for investors as a private company's fundamentals, particularly as a potential source of alpha. Investors are also becoming more sophisticated in how they approach ESG investing, abandoning traditional screening methods and favouring more in-depth analysis.

Non-financial data is increasingly viewed as the 'canary in the coal mine', offering investors an early warning on issues that could impact the company. Institutional investors are increasingly putting more pressure on their asset managers to evaluate and scrutinise private companies to make sure they fit with their ESG policies.

However, private issuers face a greater challenge than their peers in public markets. Indeed, the lack of standardised collection and distribution of ESG data is more acute in private markets than in public markets where there are established reporting structures, regulations, and dedicated compliance staff to handle information requests. Furthermore, there is a plethora of third-party providers and rating agencies focused on public markets.

As such, the lack of data can sometimes make it more challenging for investors to engage with private companies on ESG issues.

Lack of resources
The sheer number of requests for large amounts of data and information from potential investors can be overwhelming for private issuers. The lack of standardisation means that not only is it difficult for investors to compare different private issuers and issuance, but different methods for capturing data are also prevalent.

Part of the problem is the lack of resources available to compile the data, particularly given the lack of standardisation and an early-stage regulatory environment. And while there are myriad rating agencies and data providers focusing on public markets, the private market doesn't enjoy the same coverage.

Private companies have been overwhelmed by ESG data requests from investors and many "slightly different" questionnaires, each requiring time to answer. Some asset managers, such as Invesco, are establishing relationships with private issuers to engage with them on ESG issues and build their own databases to fill gaps in the data.

Solutions from the industry
Increasingly, issuers have shown a greater understanding of the significance of ESG data in recent years and are willing to provide it and engage with investors.

Until the data issue is resolved, it will remain difficult for investors to assess a private issuer's ESG credentials and the potential risks a company faces. Moreover, the lack of more standardised ESG data can make it difficult to compare companies with their peers. But rather than waiting for regulators to step in and resolve the standardisation issue, the industry may instead have to step up and produce its own solutions. One such example has come from the European Leveraged Finance Association, which has created a standardised questionnaire for private companies to answer and make the data reporting process more straightforward.

However, not all investors are concerned with the data. Suppose issuers can show that they have made progress and that executives are engaged with investors. In that case, they may be willing to overlook the lack of data – standardised or otherwise – particularly in a shifting ESG landscape. Indeed, signing up to declarations such as the UN's Principles for Responsible Investment may mean less to some investors than a demonstrable commitment in addressing ESG within the business.

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Can ESG drive a New World Order? Managing shared global climate risks in the face of rising domestic pressures

Arnab Das, global market strategist for EMEA at Invesco, talks to **Marianne Nessen**, senior adviser to the executive board of Sveriges Riksbank, **Pramit Pal Chaudhuri**, former member of the Indian government's National Security Advisory Board, **Jacob Funk Kirkegaard**, senior fellow at the Peterson Institute for International Economics and resident fellow at the German Marshall Fund, and **Linda Yueh**, Oxford fellow and adjunct professor at London Business School and visiting professor at London School of Economics, about how climate risk is reshaping the global economy and geopolitical landscape.

A transatlantic carbon club
Climate risk is one of the most pressing ESG issues and will completely change the way we live. It's also likely to significantly disrupt the longstanding geopolitical balance, given how the energy transition will impact the global economy.

Tackling climate change will require a considerable amount of spending in the coming years. However, it will also significantly negatively impact some parts of the economy and a disproportionate impact on some geographical areas and electorate. Nevertheless, the process of transforming the global economy has already begun with Europe and the UK introducing efforts to cut emissions, while new US president Joe Biden has started to act more decisively since taking office earlier this year.

The emergence of a 'transatlantic carbon club' will likely significantly impact its trading partners. Energy importers, such as Europe, will see their dependence on trading relationships with fossil fuel exporters like Russia and countries in the Middle East and North Africa. Other trading relationships might strengthen due to decarbonisation, as exporters of resources for battery technology, for example, become more important.

China and India changing
For countries like China and India, with strong industrial and manufacturing sectors, tackling climate risk is likely to be more challenging in the pursuit of continued strong economic growth. However, there are signs that climate change and ESG, more broadly, are becoming greater priorities already.

While China has committed to net-zero carbon emissions, its own target for 2060 is behind those pursued in the US and Europe. Yet, many Chinese companies are stepping up to the challenge of ESG, although a lack of reporting frameworks makes it more challenging to assess and monitor.

In India, prime minister Narendra Modi's government is also prioritising lower emissions but will need to lower its dependence on coal and is relying on 'cleaner' carbon-emitting natural gas as a transition fuel. However, the country is pursuing a transition to more renewable energy sources with the aim of generating 450 gigawatts of renewable energy by 2030. Further support has come from the international community with efforts led by US secretary of state John Kerry. India also seems to be making great strides in adopting ESG and is investigating how accounting standards can incorporate these issues.

Central banks playing their part
It's not just governments that are taking more direct action to tackle issues like climate change.

The strong political resolve to tackle ESG issues is also influencing central banks, regulators, and other supervisory bodies in their oversight of capital markets. Many have already started to consider what tools they have at their disposal to implement change.

Central banks, for example, are increasingly treating climate risk as a potential risk to financial stability, bringing it within their remit. Over the past couple of decades, the central bank toolbox has expanded to include rate-setting powers, quantitative easing, and other fiscal stimuli. The European Central Bank has shown how big a role central banks can play in tackling climate change.

Despite the measures and targets that have been announced, governments can also play a further role by intervening in market economies. One such way would be an agreement on carbon pricing, which would significantly reduce emissions.

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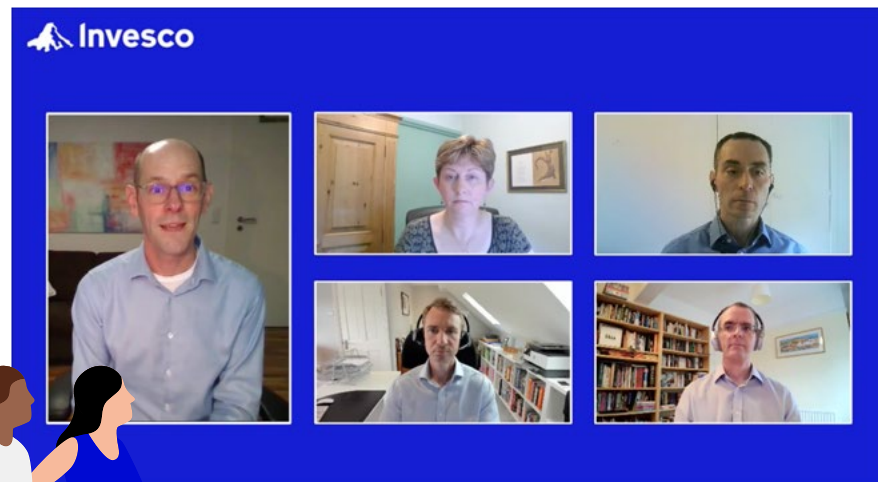
Designing investment solutions for a low carbon economy

Georg Elsaesser, senior portfolio manager at Invesco, speaks with **Jason Eis**, executive director at Vivid Economics, **Dr Christopher Mellor**, EMEA ETF head of equity and commodity product management at Invesco, **Faith Ward**, chief responsible investment officer at Brunel Pension Partnership and chair of the Institutional Investors Group on Climate Change, and **Luke Greenwood**, co-head global fixed Income of Invesco, about what the transition to a low-carbon economy means for investors and how it is likely to impact business.



Winners and losers
Although the drive towards lowering carbon emissions is the right thing to do environmentally, there will also be some people that are disproportionately affected. As such, policymakers will need to think carefully about how decarbonisation impacts groups to make it as socially inclusive as possible to prevent anybody from being left behind by the transition to a low-carbon economy. As well as investment into climate solutions, all stakeholders will need to make sure that they address how workers in high-carbon sectors are impacted.

Whatever form it takes, decarbonisation of the global economy will see winners and losers. And this is where investment opportunities could arise, not just on a stock-by-stock basis at a sector level but also in investors' geographic allocations. As such, a longer-term approach to low-carbon investing may yield a better return, particularly as many institutional investors will be looking to invest over multiple years. A longer-term approach will also reflect the challenge that decarbonisation poses for the global economy, with no quick fixes available.

Investment risks
It's important to consider investment risk alongside climate risk when investing in the decarbonisation theme, particularly as the transition period could be volatile. Investors whose approach to low-carbon investing is too narrow could also find themselves with significant concentration risk if they solely focus on the companies that have low emissions now.

Investors have a critical role to play in decarbonisation. They will have to think about how they engage with carbon-emitting companies, particularly those working to lower their carbon output. Such an approach is likely to see investors abandon portfolio tilting and divesting, which were more traditional ways to reward and punish companies for their environmental impact. Indeed, a more exclusionary approach would starve some areas of the market of finance and disrupt global economies and stall the energy transition.

Better quality data
While there have been advances in the ESG data over the years, more progress is needed to enable investors to make more informed decisions about portfolio allocations. To do this, however, there needs to be better quality data made available to investors. As scrutiny of companies' approach to decarbonisation increases, they will be expected to give investors greater details on their plans and pathway towards a lower-carbon future. Information like Scope 3 emissions – indirect emissions that result from activities in a company's value chain – is important for investors to make sure capital is allocated to those companies that are actively trying to reduce their carbon footprint. As investors reward those companies that demonstrate with data how they are reducing their carbon emissions, others will start to follow.

The lack of quality data can also make it harder to build more efficient ETFs that positively impact the environment. While there have been considerable inflows to ESG strategies in recent years, some of the products on the market may not be as sophisticated and nuanced as investors wish. Strategies that directly tap into the sectors facilitating decarbonisation – such as solar power – will always attract flows. Still, increasingly investors are looking for products that reward the companies taking greater steps to reduce their emissions. And those ETF products and providers that realise this may garner more inflows than their peers.

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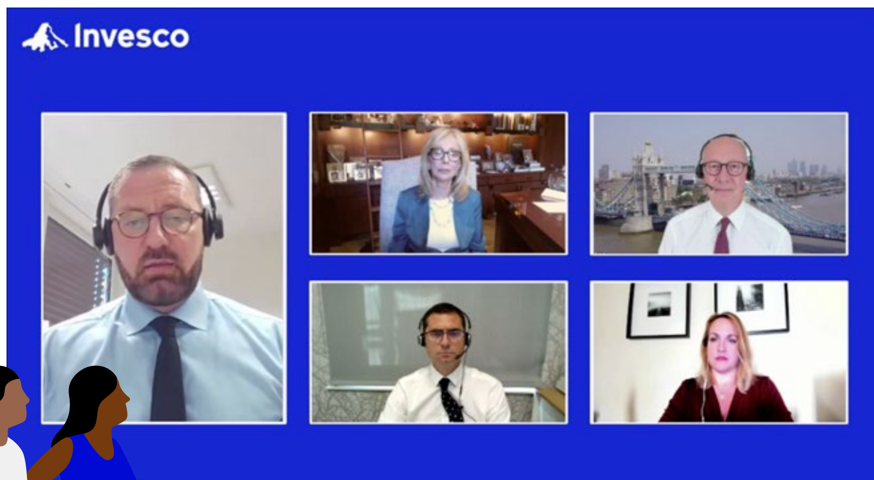
Living Las Vegas: Towards sustainable cities

Dr Henning Stein, global head of thought leadership at Invesco, speaks with **Mike Bessell**, managing director and European investment strategist at Invesco Real Estate, **Jan Jones Blackhurst**, executive director at UNLV Black Fire Leadership Initiative on Caesars Entertainment Board of Directors and chief executive in residence at UNLV International Gaming Institute, **Simon Birkett**, founder of Clean Air in London, and **Stephanie Smith**, director of portfolio operations at Invesco Real Estate about how ESG is reshaping our cities and will influence them for years to come.



What a so-called 'energy glutton' can teach us
Cities like Las Vegas in the US have shown how it is possible to integrate ESG into almost every part of city planning. Despite what many consider an 'energy glutton', Las Vegas has plenty to teach other modern cities about integrating ESG whether it is about tackling homelessness, recycling of 'grey' water, or LED light shows.

Las Vegas has moved from developer-driven planning and decision-making in the late 1980s to a greater engagement process. Today developers are treated as partners, and any new developments are designed and planned with the people who live and work in the city.

It is continuing to innovate to make its cities more sustainable and attractive, for example, working with Elon Musk's The Boring Company as part of plans for alternative transport that is intended to remove cars from some of the city's busiest areas and, therefore, reduce emissions.

The air we breathe
Air pollution is one of the world's most serious environmental risks and kills an estimated seven million people per year. It may also have been a factor in how the Covid-19 coronavirus was transmitted and how severely some people were affected. For cities and urban areas, air pollution is a grave issue given how densely populated they are. Nevertheless, there are several ways that cities are trying to tackle the issue by targeting net-zero carbon emissions for buildings.

Reducing carbon emissions will also be important for mitigating the urban contribution to climate change, particularly as cities consume 60-80% of global energy and are responsible for up to 70% of greenhouse gas emissions. The planting of more trees and recycling of water and tackling urban heat island effect will all contribute to reducing their climate risk.

Refurbishing, not redeveloping
Asset managers, like Invesco Real Estate, are increasingly introducing programmes to help the commercial real estate sector integrate ESG and particularly environmentally friendly planning into their buildings. It's not just about their carbon emissions on a day-to-day basis; up to 75% of the total carbon emissions are embedded in a building's construction and demolition, particularly in the manufacturing of construction materials. As such, real estate investors increasingly must work with what they already have by refurbishing rather than redeveloping. They must improve the efficiency of their assets constantly, while balancing any upfront environmental costs of improvements.

Investors are also working with building managers to tackle social issues also. This will be crucial as people return to their offices following the disruption caused by the coronavirus pandemic. It's increasingly important that real estate assets serve the communities and the people that use them most. In making these improvements and tackling ESG issues, stakeholder engagement is key.

Smarter cities
The emergence of 'smart cities' is also likely to impact urban design and how cities become more efficient in the future. The collection and interpretation of data will likely have a significant impact on how we live and work. Yet, the technology to make this happen is still at an early stage. And it will also require some degree of lifestyle change if they are to be truly effective.

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Walking the walk: ESG@Invesco. The challenges of ESG in asset management – and how we are navigating it with our clients

Matthew Heath, chief marketing officer for EMEA at Invesco, speaks with our panel of experts including: **Doug Sharp**, senior managing director and head of EMEA; **Stephanie Butcher**, chief investment officer; **Rene Marston**, head of product strategy and development; **Glen Yelton**, head of ESG client strategy for North America; and **Anna Duchnowska**, managing director in asset management for Europe at Invesco Real Estate.

What Invesco clients are saying about ESG
ESG continues to come up again and again in conversations with clients – and has increased dramatically over the past two years. Despite Invesco's clients' growing familiarity and understanding of ESG investing, they often have very specific ideas about what it means to them. While some clients are focused on exclusion, others take a more nuanced approach to ESG focused on engagement. It is a two-way conversation, and their needs often evolve as the facts change. It's not simply a box-checking exercise for clients any longer; they engage and take an active approach to ESG investing. And with its long experience as an ESG investor, Invesco has strong foundations from which to build and meet client needs.

What Invesco clients expect from ESG
Nevertheless, clients want to see positive ESG outcomes when they invest. It's not enough to just implement ESG practices – they want to see asset managers actively engage with companies and other asset owners on the issues. As such, ESG-focused strategic investment objectives are becoming increasingly important.

How Invesco is responding to an evolving environment
With a robust underlying investment process, Invesco has adapted specific products and its stock picking process for ESG-minded investors upon request. Regulation, meanwhile, has created the framework for Invesco to operate in. The introduction of the SFDR in March saw new reporting structures for asset managers and could have a significant impact on fund flows in the future. While many funds are considered Article 6 under the new framework, which carries minimal ESG requirements, Invesco is responding to client demand for more Article 8 products, where ESG is incorporated into a fund's structure.

To do all this, however, you need data. And that's why Invesco has been investing heavily in its proprietary ESGIntel system to provide the information required to make informed investment decisions and complement its financial analysis.

How ESG is being embraced in real estate
The importance of having a strong ESG-focused real estate offering has been underlined by the sector's energy consumption and role in reducing carbon emissions. Engagement with the sector on issues such as decarbonisation can enhance returns, as more efficient buildings reduce their operating costs at the same time as they cut emissions. Occupants are more likely to accept higher costs if the building is more resilient and has higher ESG credentials, attracting prospective investors and boosting liquidity and pricing.

As such, Invesco Real Estate has fully integrated ESG into almost all the phases of its investment management process and has developed various tools to help it as a responsible investor. Undertaking thorough assessments before acquisition, Invesco Real Estate also carries out ongoing analysis to make sure investments continue to meet its ESG requirements as well as regulatory demands.

What's next for Invesco?
Invesco is continuing to listen and engage with clients to better understand and support their needs. We are also working with other industry groups to help enact change and engage on the issues that truly matter to our clients. Engagement will remain a key part of the investment process for Invesco, pushing and encouraging businesses to demonstrate more ESG behaviours to add value for clients. In real estate, Invesco has commitments to reach net-zero by 2050 and annual reductions of 3% for energy, water, and waste consumption in its buildings until 2040.

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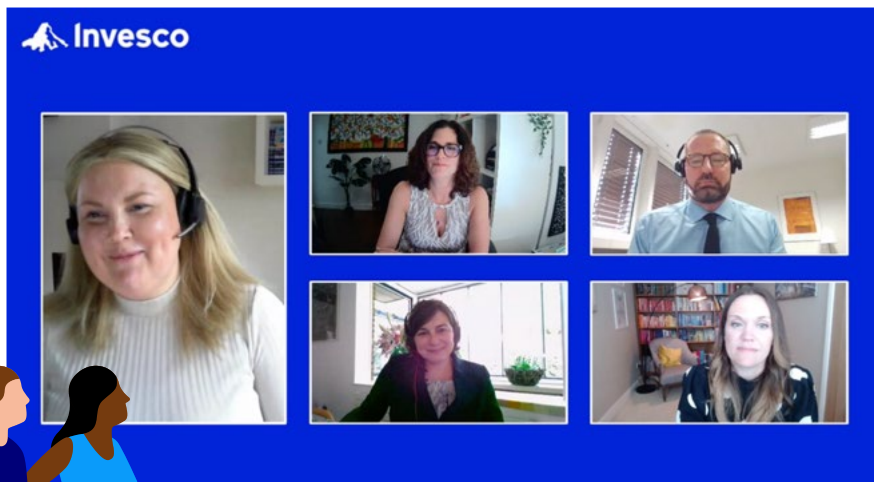
Tackling the biodiversity crisis: ESG and the nexus of nature

Elizabeth Gillam, head of EU government relations and public policy at Invesco, talks about the unprecedented biodiversity crisis the world is facing with **Henning Stein**, Invesco's head of global thought leadership, **Maria Lettini**, executive director at FAIRR, and **Nadia Humphreys** from Bloomberg's sustainable finance solutions.



Overshadowed by climate change
The declining diversity of species on the planet has typically been overshadowed by concerns about climate change. But more than half of global GDP is dependent on properly functioning biodiversity and ecosystem. It's crucial, therefore, that investors look at biodiversity and environmental destruction more closely because it feeds into almost every sector in one way or another.

One area that has highlighted the interconnectedness of biodiversity and climate change is agriculture – and animal farming in particular. The agriculture sector receives much funding and incentives, such as the EU's Common Agricultural Policy, yet it is also a significant contributor to greenhouse gas emissions. Animal farming relies on significant amounts of grown food, water, and land. As such, it poses a considerable risk to environmental goals – even though it is not considered a high emissions sector.

The emergence of plant-based protein alternatives has been a significant development in the food technology space in recent years. While it was prohibitively expensive when the concept of lab-grown or 'cultured' meat first emerged, costs have now come down and is much more affordable. This could be a game-changer and free up millions of acres of pastureland, resolve animal welfare issues and provide global access to a low-cost, high protein diet in the developing world.

Additionally, advances in 'ag tech' – agricultural technology – is also attracting more investment and greater interest from investors in pursuit of plant-based food alternatives. As plant-based diets become more appealing and viable, it could fuel a change in behaviour, further reducing the biodiversity impact and helping to reduce carbon emissions.

Better regulation needed
The need for a more robust and clearer regulatory regime is imperative and would help ensure that biodiversity doesn't get overlooked. A more central set of standards would be welcomed by investors, including common terms of reference and language around biodiversity. Currently definitions vary sufficiently to allow false claims to be made, particularly with the lack of clearly defined goals.

Too much regulation, on the other hand, could complicate what is a very nuanced issue which often stretches across international borders. Nevertheless, there is supportive legislation coming through on biodiversity, such as the EU's Sustainable Finance Taxonomy, which more clearly defines where a company is making a substantial contribution to biodiversity or the protection of natural species.

While a more stringent regulatory regime would provide the 'stick' to scare companies into safeguarding biodiversity, governments need a 'carrot' to encourage companies to innovate and take more risks. Such a constructive environment could encourage economic growth and be a more positive and proactive approach to what is a profoundly serious issue.

Changing the way we invest
With greater awareness of biodiversity as an issue, investors can play a more active role in how it is tackled. However, like all ESG issues, there is a lack of quality data surrounding biodiversity making it difficult for investors to make informed investment decisions. New initiatives such as the EU taxonomy will help and allow investors to hold companies accountable and offer greater transparency.

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What investors want: Our research on client perceptions of ESG investing and what we can do to improve their engagement

Owen Thomas, head of UK advisory sales and strategic partnerships at Invesco, multi-asset portfolio manager **Clive Emery**, and **Dr David Stillwell** of the University of Cambridge's Judge Business School consider the findings of Invesco's survey of how more than 200 advised investors interact with ESG.

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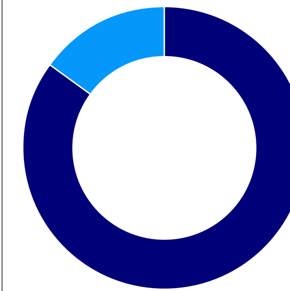
Sustainability is now mainstream
Surveying more than 200 advised investors in the UK, research carried out in partnership with Research in Finance, found that there has been a major structural shift in sustainability as an investment theme and can no longer be considered a fad.

Indeed, the survey found that sustainability is fundamental to investors in their everyday life, not just investing. And particularly to the younger generation.

The importance of sustainability has translated to investors' portfolios, with 85% interested in sustainable investing. Additionally, some 52% of investors who don't have a sustainable investment currently would like to make one in the next 12 months, indicating the potential for the sector. However, three quarters of the 160 advisers who took part in the survey said they recommended sustainable products to clients, representing less than 10% of assets.

The majority of advised investors are interested in sustainable investing (SI)

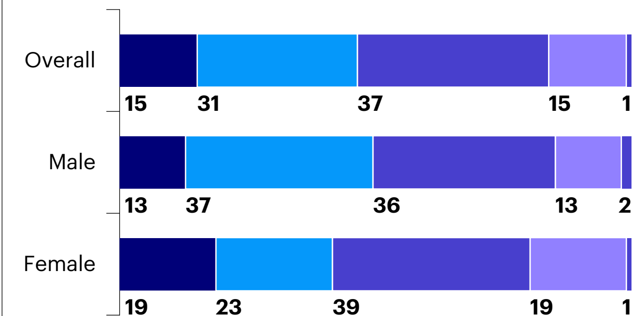


85%
are interested, with only

15%
stating that they have no interest at all

Attitudes towards SI (%)

- Adviser has or is helping SI
- Interested in SI and discussing with advisor
- Recently interested in SI
- Not interested in SI
- Other



Source: Research in Finance, Invesco Study.
Q: Which of the below best summarises your attitude towards sustainable investing? 1. My financial adviser / wealth manager is helping / has helped me to invest more sustainably. 2. I am interested in Sustainable Investing and have been talking to my financial adviser / wealth manager about it. 3. I have become interested in Sustainable Investing lately, but have yet to take action. 4. I am not interested in Sustainable Investing and have not been researching this area. 5. Other. Base: All respondents (201), Male (120), Female (80).

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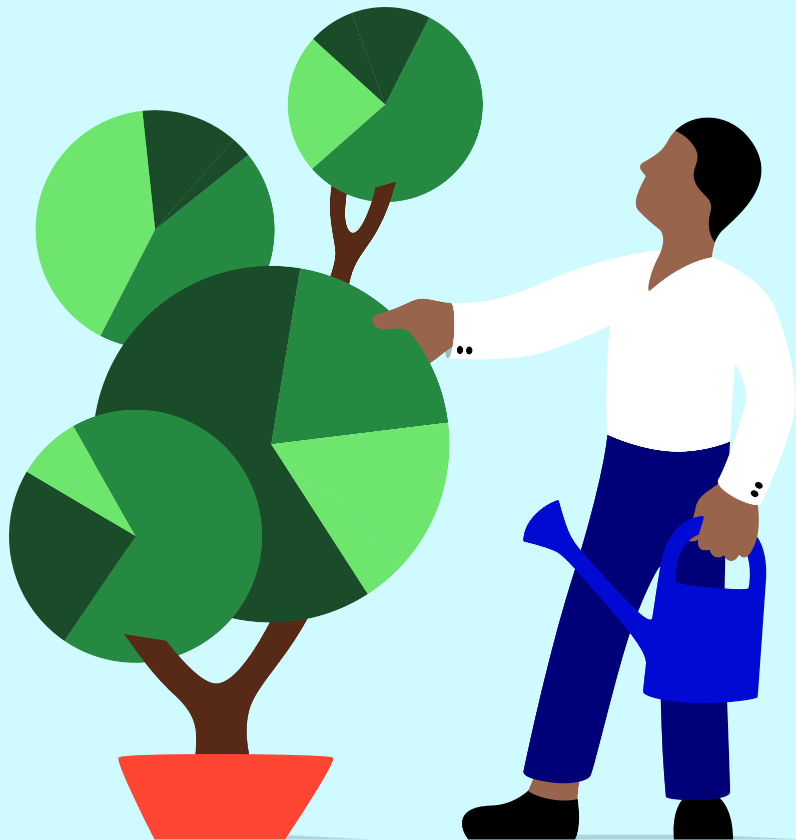
“Advisers on the blogs who say, ‘I haven’t got any ethical clients,’ it is nonsense. You have just not asked the question properly.”

Adviser, Early adopter



Nascent knowledge levels
The low levels of assets held in sustainable products can be linked to a lack of knowledge surrounding sustainable investing, which remains low despite high levels of interest. Respondents noted that the terminology can be overwhelming, with too many phrases that are difficult to understand. Asset managers need to make the language easier to understand and standardised to reach investors confused by the mixing of terminologies and language. This extends even to commonly used terms, like ESG, which many investors fail to understand.

However, investors are keen to have greater engagement and discussions about sustainable investing. And while 62% of advisers have a framework to discuss their clients’ sustainability preferences, there is a significant proportion that cannot discuss their preferences. And of those advisers that do ask more than half are a yes/no question on whether the client prefers to invest sustainably or not. Nevertheless, many end-investors have to broach the subject themselves, the survey found, suggesting that despite having the frameworks in place, many advisers are not initiating the discussion. Some 81% of investors said they were willing to have a conversation with their advisers about sustainable investing.

How to tell funds apart
One of the biggest challenges, though, is the inability of investors to distinguish different types of sustainable fund, which can make it harder for investors to research funds. This lack of comparability may also be found in other concerns about the perceptions of performance drag of sustainable strategies, higher perceived volatility, or poorer performance.

The range of sustainable investment strategies with different risk-return profiles can confuse investors. Better education is needed to explain how they work and enable investors to have better, more informed discussions about different products.

Making more informed choices
Increasingly, sustainability is being treated as a factor – alongside value or growth, for example – by investors in their portfolios as a contributor to long-term returns. While there might be some valid concerns about volatility given concentration risk, this might diminish over time as sustainability as a factor is better understood.

The willingness to invest sustainably was highlighted by a Judge Business School study, which found that with greater information available, investors were able to make more informed choices. Indeed, investors across the board were generally more willing to make trade-offs when it came to investing sustainably, sacrificing returns for products with a more sustainable investment profile.

“...sustainability is fundamental to investors in their everyday life, not just investing. And particularly to the younger generation.”

Stakeholder capitalism: putting the world first. A fireside chat with Paul Polman, ex-Unilever CEO and Co-founder and Chair of IMAGINE

Glen Yelton, head of ESG client strategy for North America at Invesco, interviewed **Paul Polman**, former Unilever CEO and co-founder and chair of IMAGINE, for a fireside chat to discuss whether we need to rethink our views on returns of social and environmental capital, as well as the role of businesses and leaders in positions of privilege in driving change.

The need to move faster
Many companies are moving in the right direction and now better understand the ESG challenges, such as climate change and inequality, that society faces. However, more needs to be done to encourage markets to move faster and at greater scale to address such burning issues. There are several barriers that CEOs face to moving faster when addressing these issues. By acting together, business leaders can help push the rest of an industry into acting faster and collaborating on some of the most pressing ESG issues.

Lessons from Covid
Past crises, and most recently, the coronavirus pandemic, has shown that opportunities to tackle some of the most pressing ESG issues have been missed. Issues such as inequality and climate change "all kept going in the wrong direction" after the global financial crisis a decade ago, leading to the destruction of natural resources and biodiversity. The Covid-19 pandemic has shown the limitations of growth and how moving towards a sustainable and inclusive model of growth can benefit societies.

Businesses cannot succeed in failing societies and ecosystems, nor can they stand by and watch: executives have a duty to work together to correct longstanding environmental and social issues.

The misconception that companies cannot be purpose-driven and profit-driven is outdated, and there is a realisation that purpose fuels profits and gives you more motivated employees, better relationships in the value chain, more satisfied customers, stronger links with the communities, more innovations, and, ultimately, better business outcomes.

From CSR to RSC
Companies need to move from corporate social responsibility (CSR) – which deals with risk management – to becoming an RSC, or responsible social cooperation. This involves companies looking at regenerative opportunities and taking full ownership of the impact and consequences of their own businesses and those in their value chain. Indeed, the idea that companies can outsource their responsibilities simply won't work anymore. Companies that work for the long-term benefit of society will escape from the "rat race of short-termism".

Another example of an RSC company considers multiple stakeholders and the long-term positive returns for all, rather than "myopically focusing on the optimisation of shareholder return". Finally, RSC companies also play a role in driving bigger system changes.

Change of mindset
More investors are changing the way they think about ESG, transitioning to an investment mindset rather than a box-checking exercise. The best companies understand this and are starting to understand that sustainability has to be part of their core strategy. Those companies that want to attract talent, build brands, or meet changing consumer demands will have to embrace ESG concerns.

While there is more interest and considerable inflows to ESG strategies, more needs to be done to increase the number of products available to investors and improve the tools, research, and data available to investors.

It's not easy being a CEO
Today's executives face greater challenges than many of their predecessors could have imagined, from Covid-19 to digital disruption and decarbonisation. This has seen a considerable CEO turnover, with the average tenure dropping to just four-and-a-half years for publicly traded companies. However, there is a new generation of purpose-driven CEOs emerging that are better equipped to deal with the challenges of modern markets.

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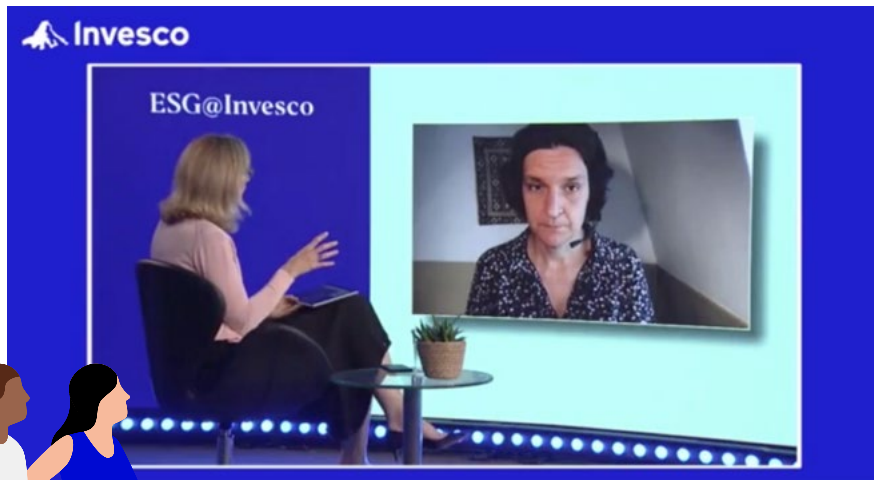
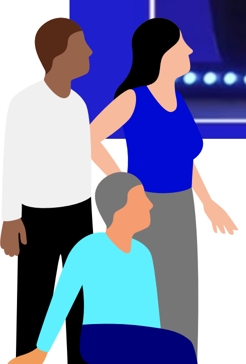
Economics: a force for good? Keynote address by Esther Duflo, 2019 Nobel Prize Winner for Economics

Stephanie Butcher, chief investment officer at Invesco, talks to **Professor Esther Duflo**, 2019 Nobel Prize Winner for Economics, about what society and asset managers can and should do to support innovation in social justice and equity.





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Solving the economic problems without economists
Many of the most important issues facing markets today are at their core economic: Brexit, international trade, immigration, growth, climate change, racism, discrimination, social policy, and the Covid-19 pandemic. While many of these problems might be best tackled by economists, the public have lost their faith in them. Indeed, polls have highlighted declining trust in economists in recent years. This is particularly challenging when it comes to an economic issue as important as decarbonisation and the transition to a low-carbon economy.

For example, while carbon pricing – or a carbon tax – is considered as an effective way of limiting emissions, it has been overlooked by both policymakers and voters because they believe restrictions on carbon emissions are more effective or that it will be levied on taxpayers, despite assurances from economists.

Part of the reason is that economists make bad forecasters. In the words of economist John Kenneth Galbraith, "the only function of economic forecasting is to make astrology look respectable". Another legacy that economists must tackle is the belief by famed economist Milton Friedman that the social responsibility of a business is profit: an idea that has been challenged by the growing appetite for ESG investing – but lingers on regardless.

Nevertheless, there are important ESG lessons that can be learned from economics.

Legitimacy of government
As well as economists, trust in governments – and politicians – have also fallen in recent years and the tendency to treat government as a punching bag has grown. As was seen during the Covid-19 pandemic, however, in countries where trust in government was greater, there were fewer deaths.

Over-reliance of financial incentives
The pandemic has also shown how economists and policymakers relying too heavily on financial incentives is outdated. Many social programmes in the West are predicated on Victorian attitudes of not making things too easy for people to prevent them from abandoning work. However, there has been little evidence to suggest that people who receive benefits do not work as hard.

Don't take preferences for granted
People are often much more willing to change their mind than is widely believed. As the pandemic has shown, people who act one way today may change their behaviour based on what their peers do. While people are often flexible and influenced by others, dignity still matters. In recent years, levels of dignity have fallen, and there have been more deaths of despair, making it a vital issue to be resolved after the pandemic ends.

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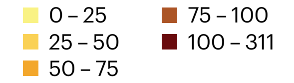
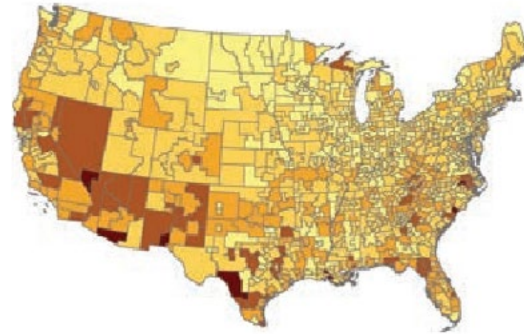
“People are often much more willing to change their mind than is widely believed. As the pandemic has shown, people who act one way today may change their behaviour based on what their peers do.”

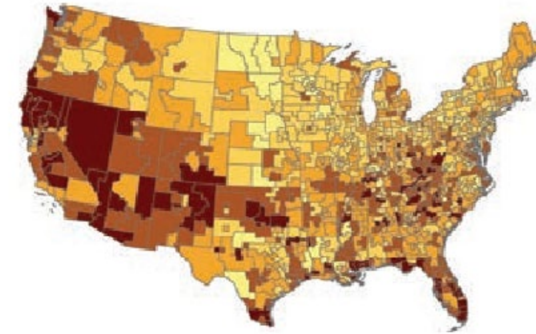
Deaths of Despair: Deaths due to suicide, drugs and alcohol



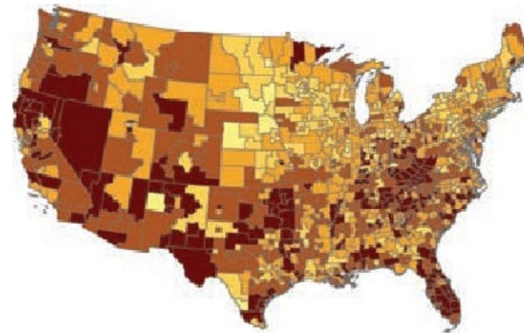
2000



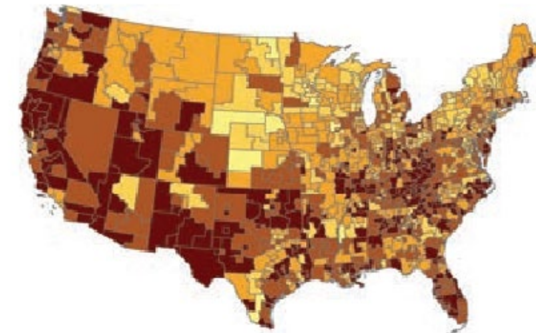
2007



2011



2014



Sources: National Vital Statistics System; authors' calculations. Deaths of despair refer to deaths by drugs, alcohol or suicide. The units are deaths per 100,000.

Applying a data-driven approach to the ‘S’
While asset managers have a lot of data on environmental challenges, they are many years behind policymakers in understanding and evaluating data related to social issues. Many in the financial sector still make investment decisions based on the returns they offer, rather than what the social impact is. And while the message is starting to get through to some investors, there are still many who haven’t yet grasped the concept.

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Further reading

We’re pleased to share this curated list of our favourite books, research, reports and insights on topics related to the sessions from ESG@Invesco. Happy reading!

Invesco

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Data as at 30 June 2021, unless otherwise stated.

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