Sustainable investing is here to stay

Sustainable investing was once viewed as a trade-off between value and 'values'. Yet today, it's something investors can no longer afford to ignore. What has changed? More granular data, more sophisticated analysis and shifting societal understanding of sustainability, as well as growing awareness that certain factors – often characterised as environmental, social and governance (ESG) – can be tied to a company's long-term growth potential.

Regardless of investor views, ESG is increasingly on the agenda – especially for UK trustees who, from October 2019, will be required to show more formally how they have taken ESG into consideration. The Department for Work and Pensions statement of investment principles requires clear indications on how ESG and investment stewardship factors are considered within investment arrangements. These are 'Financially material (ESG) considerations' over the appropriate time horizon for investment; 'Non-financially material' ESG considerations, if trustee boards have any; A statement on engagement activities.

This new requirement has varying levels of engagement from different schemes. This may be partly due to differing circumstances, but also the range of attitudes in the sector towards what can be a controversial subject. One point worth stressing, however, is that there is an increasing tendency to take more informed views on this area, and this focus will steadily increase as more and more reliable data becomes accessible to investors. Access to good quality information on prospective investments at worst does not change your investment thesis and, at best, it transforms an investor's view. Taking this into account is a key part of the process for pension scheme arrangements.

BlackRock defines ESG integration as the practice of explicitly incorporating environmental, social and governance information into investment decisions to help enhance risk-adjusted returns.

As a result, we have launched a firm wide, global effort to integrate sustainability considerations into the investment process. This mirrors the diversity of clients we serve, as well as the range of investment strategies and asset classes we offer. Across BlackRock, we provide all our investment teams with data and insights to keep them well-informed of sustainability considerations.

This leads to our interest in offering sustainable solutions that allow our clients to attain their financial objectives. The range of sustainable investing options is broad, reaching all the way from green bonds to renewable energy infrastructure. Furthermore, BlackRock is the largest provider of sustainable ETFs, including the largest low-carbon ETF in the market. ETFs are a great choice to navigate this new sustainable environment, for three main reasons.

First, they offer a minimal tracking error, being a relevant substitute for those products that track traditional indices. Second, they have a low cost and are an easy way for schemes to show their ESG involvement without having to invest all their time into this trend, which is here to stay. Finally, ETFs allow investors the opportunity to invest in a wide range of products, with varied exposure to the amount of sustainability they are willing to get involved in.

However, even though the proliferation of ESG options is good, it is important to understand what you are looking at. The BlackRock iShares ESG ETF range can be divided into five areas, which start from avoiding exposures that conflict with your social objectives, all the way to target outcomes that advance your social and financial objectives:

ESG Screened Range: this eliminates exposures to companies or activities that pose certain risks, or which violate an investor's values. It is designed for investors looking to screen out controversial business areas while maintaining a profile similar to traditional benchmarks.

ESG Enhanced Range: the objective is to maximise ESG scores (calculated and provided by MSCI), subject to a target tracking error. It is designed for those investors building sustainable portfolios.

SRI Range: a socially responsible investment (SRI) approach is used to gain exposure to the top ESG performers in each sector. It is designed for those investors with the highest commitment to, and conviction towards, the top ESG performers.

Thematic Investing: this type of investing focuses on an ESG trend, allowing investors access to structural economic themes such as low carbon, clean energy or inclusion and diversity.

Impact Investing: this approach focuses on generating a measurable sustainable outcome alongside a financial return. It is designed for long-term investors looking to drive measurable change.

ESG data has evolved. New technologies and methodologies have allowed us to make great strides in improving sustainability data, as can be seen from the wide range of options that ESG ETFs have to offer. Our research, which relies on back-tested data, shows how ESG focused indices have matched or exceeded returns of their standard counterparts, with comparable volatility.

We find ESG has much in common with existing quality metrics such as strong balance sheets, suggesting ESG friendly portfolios could be more resilient in downturns. This suggests that ESG is not just a box ticking exercise, to be performed by schemes to satisfy the criteria of new regulations. It can enhance returns and ETFs offer a cost efficient and operationally efficient way to get exposure to this theme.

In the UK, we have seen that, ahead of new regulations, local authorities have been shifting their index allocations into low-carbon alternatives. The shift in other regions, such as the Nordic or Benelux countries, has been remarkable over the last few years, forcing investors to include ESG into their investment processes. Regulation and social awareness have been key to the growth of this type of investment. We saw this with one of the largest private pension insurance companies in the Nordic region.

BlackRock worked in close collaboration with the client to create a core sustainable solution for its US equity allocation, which was a part of a broader integration of ESG characteristics within the investment strategy. This case is a testament to the transformation we are seeing in the Nordic region, with institutional investors shifting their portfolios from standard to sustainable benchmarks, and it highlights the importance of collaborating with clients to build solutions that meet their criteria.

Assets in dedicated sustainable investing strategies around the world have grown at a rapid clip, driven by societal and demographic changes, regulation and increased investment conviction. Incorporating relevant sustainability insights can provide a more holistic view of the risks and opportunities associated with a given investment. There is no one-size-fits-all approach, but the opportunity to improve investment processes by integrating material sustainability considerations is real and growing.

To that end, a perfect storm is brewing, that will mean ESG climbs towards the top of the agenda for European pension funds and consultants. Between a changing regulatory environment, improving data and a proliferation of investable products and solutions, the scene is now set for European pension funds to become significant investors in investment strategies that help meet their liabilities, as well as delivering a positive societal outcome. The road won't be smooth, nor will it be immediate, but a continuing increase in ESG investing across the sector is becoming irrefutable.

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