Sustainable investing in the mainstream

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An investment process needs as a minimum, a clear definition in order to establish credibility in the financial mainstream. Unlike investment terms such as "growth" and "value", sustainability has had a number of predecessors, which have touted an impressive range of acronyms. Ironically, in the roots of sustainable investing, the initial "ethical" approach was probably the clearest; remove those investments with which you do not wish to be associated. Perhaps brutal and simplistic, but clearly defined. Then the marketers took over, creating an avalanche of acronyms: SRI, CSR, ESG, SI and RI. Among investors, confusion reigned. The more cynical became doubtful of these fungible definitions and accused asset managers of obfuscation and possibly "green-washing" – pretending to meet environmental standards.

Was this continual re-branding necessary? To define sustainability we can revert to a definition used in the UN's Brundtland Report over 25 years ago: "The concept of meeting present needs without compromising the ability of future generations to meet their needs".

It's noteworthy that the Brundtland Commission drew on the principles presented in the 1972 Stockholm Declaration, so there is little new about the meaning of sustainability.

By definition, if a style of investing is to be mainstream, a large proportion of investors need to be prepared to adopt it. In the early days this was certainly not the case and understandably so. It was primarily religious groups that wished to align their investments with their faiths and thus imposed exclusions, for example on alcohol and weapons. Different religions imposed a diverse set of prohibitions so a range of funds became available.

From time to time, public opinion also supported bans on particular types of investments – weapons during the Vietnam War, divestment from South Africa during Apartheid, and the current movement of divestment from fossil fuels - but this has sometimes proved more transient. However, in a limited number of fields, investment exclusions appear more lasting, such as the 2008 Cluster Munitions Convention, now signed by 112 organisations. Nevertheless, it is evident that a large number of signatories is not necessarily a guarantee of mass investment acceptability.

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Perhaps the most cited measure that sustainable investing is already a mainstream investment activity is the 1,200 signatories of the UN Principles for Responsible Investing (UNPRI), which includes asset owners with over USD 30 trillion - about 20% of the world's invested capital. Interestingly, a branch of economics has also joined the fight. Believing that economic indicators such as GDP do not necessarily reflect the quality of life or social progress, other indicators have emerged, such as the Gross National Happiness, the Genuine Progress Indicator, and more recently the Social Progress Index, presented at the recent Skoll World Forum. These measures are not without their criticism, essentially focused on the subjectivity of some of their measures. It is this point that is highly relevant to the world of sustainable investing.

With so many signatories and associated assets, why is sustainable investing not unquestionably mainstream? Some argue that this form of investing has struggled to earn the necessary intellectual credentials demanded by the financial markets. Simply excluding stocks and sectors, negative screening might meet the requirements of niche groups but was unlikely to be admired for its investment sophistication. Hence the change to positive screening and a best-in-class approach – a risk and return approach that evaluated extra financial factors with measurable financial risks. But underlying all this intellectual jostling was the concern that sustainable investors worried more about morals and ethics than financial returns. That is a difficult pitch to the pension fund trustees or funds' board who are required to treat the financial interests of their members as paramount.

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If this is the final obstacle to sustainable investment's mainstream credibility, there are grounds for euphoria. This sentiment is based on the rising tide of data that is available to asset owners, asset managers and companies. It is data, especially its archiving, that will allow for both extensive testing and integration of sustainable factors into financial return analysis.

Mega-data providers have merged after a period of consolidation, notably MSCI's purchase of RiskMetrics (which in turn had purchased ESG data providers KLD, Innovest and IRRC), the growth of Sustainalytics and GMI ratings, and Bloomberg's acquisition of New Energy Finance. These purchases have been assimilated into comprehensive databases. The breadth of coverage provided by these data firms, such as RepRisk's offering on 36,000+ companies, allows for comprehensive interrogation of companies over time. Furthermore, the data provides the opportunity for both long-term analysis but also shorter term reaction to unfolding incidents, whether they involve corporate fraud, employment conditions or environmental disasters.

But there is more data on the way. Corporations have continued to improve their own data collection and reporting, following standardized frameworks such as the Global Reporting Initiative and the International Integrated Reporting Council.

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There are a number of data clearinghouses collecting data on sustainable issues and developing standards for sustainability accounting.

Leaders include the Carbon Disclosure Project, collecting data on greenhouse emissions, water scarcity and forestry footprints; and the Sustainability Accounting Standards Board which is developing industry-specific standards.

Other in-depth research is emerging from organizations like CERES and the INCR as well as many investment banking research departments. Finally, the investment consultants are also developing data sets of their own on how well investment managers integrate sustainability into their investment processes.

Is sustainable investing set to join the mainstream? We believe its time has arrived. The definition of sustainability has been available for decades. There are substantial financial assets represented by signatories to sustainable protocols. The time of skirting around the edges, waiting for evidence that sustainable factors really do impact financial returns is coming to an end.

This new era is certainly made possible because of the wealth of available data and the unrelenting pressure for more of the same. Lack of acceptance and integration has never been about the availability of financial analysis methods or portfolio construction tools. Both have been around for a number of years. Lack of acceptance has really been about a lack of access to the quantitative inputs that elucidate the sustainability performance of companies. With the increase in data availability, quality asset managers will be able to determine how best to incorporate sustainability into client portfolios.