

## ESG Investing: A New Era

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**June 7, 2018**  
**Centre for the Study of Financial Innovation**  
**Regulating Sustainable Finance Forum**  
**London**

*As prepared for delivery.*

Good evening and thank you for joining us. Before I turn to the topic at hand, let me provide a brief background on ICI Global. ICI Global carries out the international work of the Investment Company Institute—a leading global association serving an international membership of regulated funds and their managers, with combined assets under management of 29.2 trillion US dollars.

We pursue a robust policy agenda encompassing a wide range of cross-border issues affecting global regulated funds and their investors. Sustainable investment is a vital area of interest for our members and their investors and helping asset managers work with policymakers to best meet investors' needs is one of ICI Global's top policy priorities.

This is the new era of ESG investing. Increasingly, investors around the world are seeking to invest in a way that reflect their values. The demand for such strategies has resulted in an emphasis on incorporating environmental, social, and governance factors into investment decisions. This is often referred to as ESG investing. This dynamic area has greatly evolved from the early days of "socially responsible investing," and is rapidly growing around the world. For example, MSCI estimates that, in 2017, asset managers who signed the Principles for Responsible Investment, or PRI Framework, managed 56 trillion US dollars in assets — a 17 percent increase from the year before.

As investors shape and drive this global market, fund managers are continuing to look at how they can best meet investor demand. For example, asset managers are using approaches such as negative screening, impact investing, and thematic investing to meet the expanding range of investors' ESG needs. Separately, asset managers also are becoming increasingly sophisticated about how to incorporate ESG factors into the investing process more broadly to ensure long-term shareholder value.

In short, it is an exciting time for asset managers and investors worldwide. It is also a crucial time as policymakers across the globe are considering whether and how their intervention could further shape ESG investing.

Of course, funds and their investors have always thrived under sound regulation, and we have already met with policymakers about certain issues surrounding sustainable finance. In our discussions, we have emphasized that regulators must be careful not to suppress current innovation or restrict investor choice. Instead, policymakers must find the right balance of potential regulation that strengthens—not stifles—this dynamic market.

This is even more important in today's global industry, where the laws of one jurisdiction could affect practices, products, and markets in other parts of the world. To get a better sense of how sustainable finance is progressing, I thought it might be helpful to briefly walk through the ESG investment landscapes in Asia, the United States, and Europe.

I will start with Asia. ESG investing is on the rise in Asia as in other parts of the world. Asian policymakers have generally been supportive of sustainable finance and have focused on voluntary measures. We particularly see this increasing interest in the

pensions space. For example, Japan's Government Pension Investment Fund, or GPIF, the world's largest pension fund, has made significant allocations to ESG strategies. It is now the world's leading proponent of responsible investment and is aiming to invest 10 percent of its equity portfolio in companies with strong ESG practices.

Other countries, such as Korea, Taiwan, and Malaysia, are also incorporating sustainable finance into various aspects of their government pension funds. As investors' interest in sustainable finance increases, it is important to note that not all investors are seeking the same flavor of ESG. Of course, this is not just true in Asia, but around the world.

A recent report produced in a partnership between the World Bank and Japan's GPIF notes a range of priorities and preferences among investors. For some, incorporating ESG factors is important, but financial return remains paramount, while others are willing and able to sacrifice some financial return in pursuit of other goals. The report also acknowledges that a definitive list of ESG issues does not exist and it is unlikely there would be any agreement upon them. The differences in investors' preferences are important to keep in mind as we look at the ESG investment landscape in other regions, such as the United States, which I am going to turn to next.

The United States is second behind Europe in terms of assets invested in ESG strategies. According to Morningstar, as of November 2017, there was about \$257 billion in US mutual funds and ETFs with ESG-specific investment strategies. Similar to Asia, ESG investing has largely been market driven. In terms of policymakers and regulators, both the US Securities and Exchange Commission, or SEC, and the Department of Labor, or DOL, have recently offered their views on issues surrounding ESG investment.

Let's start with the SEC. The SEC is focused on making sure that ESG-themed funds have appropriate disclosure so that investors understand what strategy the fund is using. When a fund complex launches a new fund, the SEC reviews the registration statement. Currently, the SEC is reviewing each new fund application that has either "ESG" or "sustainable" in its name to ensure that its name accurately reflects the fund's approach to investing.

Our engagement with the SEC, has emphasized that asset managers are taking a variety of approaches to ESG investing. They are not simply limited to screening portfolio companies for a few different ESG factors. But instead have multiple strategies, including incorporating ESG factors into their investment process.

We have also emphasized that even within a particular style of ESG investing, funds may use different sources of research and a variety of strategies to achieve their objectives. Understanding the different ways that asset managers and funds approach ESG investing hopefully will help the SEC staff properly evaluate fund disclosures. Fully disclosing the investment process in easy to understand language accomplishes two particular goals: first, it enables the SEC to protect investors from "greenwashing," and second, it enables investors to choose a fund that is best for them.

Now let's move on to the DOL. In April, the Labor Department released guidance, outlining how fiduciaries can incorporate ESG factors into retirement plans. The guidance did not break new ground but did try to clarify the prior ESG investment guidance. The recent guidance re-emphasized the need for fiduciaries to focus on investors' economic interests. Specifically, it reminded fiduciaries that they cannot put their ESG-related values ahead of the plan beneficiaries' economic interests, and that fiduciaries are entrusted to ensure the best retirement outcome for beneficiaries. This means that a fiduciary can integrate material ESG factors into its investment process or engage with portfolio companies on material ESG issues. But it must always prioritize the plan's economic interests, and when evaluating investments, the fiduciary must make financial factors the main consideration.

I suspect that US regulatory trends in ESG investing will continue to evolve, but they provide an interesting backdrop as we move to the European Union and examine the Commission's proposed legislation.

I am not going to delve too much into the legislation, but ICI Global is pleased that the Commission's proposal seems to help asset managers put investor needs first by giving them more information about how fund managers are approaching sustainability. EU policymakers are trying to give investors more information by developing taxonomy and a common language around sustainable finance. These objectives are laudable, but the enormity of the task should not be underestimated. There are many different ways to measure whether an economic activity or a company's business approach is sustainable, and we encourage the Commission to obtain broad feedback from the industry about any standards and metrics.

There are numerous aspects to the Commission's legislation, which we are still analysing and digesting. One issue, however, that we hope the Commission will focus on and take meaningful action to improve, is corporate disclosure. Currently, there isn't a consistent disclosure framework for companies to disclose ESG-related information, so it can be difficult for asset managers to compare across different companies. There are also issues with data availability and reliability. As you might expect, obtaining high quality research on ESG-related factors is expensive. Many large vendors have recently entered this space, but their ESG ratings are subjective and often vary significantly from vendor to vendor.

As the Commission's proposal moves forward in the legislative process, we look forward to working with policymakers. However, policymakers here and around the world should be aware of the constantly changing nature of sustainable finance. As investor demand continues to drive this market, it is critical that regulators put in place rules that strengthen—not stifle—innovation and choice. Implementing regulations that protect and safeguard investors while fostering innovation and choice is the best way to serve investors here and around the world.

Thank you.

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