A new era of investing

Andrew Nicoll, Global Business Lead for Responsible Investment

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- Asset managers will be required to integrate sustainability factors into their investment decision making, and show evidence of this through clear and consistent disclosures and client reporting.

- Against the global macro environment and industry change, we expect clients' expectations to evolve over time to demand greater ESG integration and to focus more on ESG best-in-class and outcome-focused strategies. This will take time, but it is the inevitable result of the regulatory objectives, net-zero targets and other commitments being set by corporates and evolving retail customer demands.

2020 saw unprecedented change around the globe – economically, socially and politically. The most significant impacts resulted from the global coronavirus pandemic which has potentially changed many aspects of life for ever. The investment landscape has been changing too, driven by increasing pressure from governments and regulators to address climate change and a new focus on sustainability, recognising the direct impact that companies can have on systems and economies to sustain significant and prolonged positive transition. The pandemic has only accelerated the focus on climate change and continues to shine a light on responsible investment (RI) more broadly.

The far-reaching regulatory reforms in the EU and beyond have seen fundamental shifts by companies setting 2050 net-zero emissions targets, which in turn have driven an increased focus on all ESG (environmental, social and governance) areas, pushing everyone to raise standards and increase transparency and accountability. This in turn has changed the investment landscape through significant changes in client expectations and demand, and will result in fundamental shifts for investors and asset managers across the globe.

To understand what this means for the investment industry and to the clients we serve it helps to unpick some of the central themes.

Integration

ESG considerations are not new – such themes have been key inputs (albeit to different extents) to fundamental investment approaches for many years. However, the EU regulation's intention is for ESG to be considered by all investors. So the fundamental shift now taking place is how investors can demonstrate that sustainability risk, as represented by ESG considerations, has been integrated into their investment decision making. Investment firms across the globe are now grappling with this challenge. To deliver genuine integration of ESG into research and investment processes requires a significant commitment and investment in data and systems infrastructure. However, clients' expectations are evolving rapidly, and increasingly asset managers are required to demonstrate that they have genuinely embedded ESG not just in their investment research, but across all aspects of their company and culture.

Transparency

In the past decade the investment industry has increasingly been pushed by EU regulators and policymakers to increase transparency to customers, through initiatives within MiFID, the Treating Customers Fairly principle and the recent Asset Management Market Study. Meanwhile, the incoming European Sustainable Finance Disclosure Regulations (SFDR) represent a different aspect of the transparency agenda. Asset managers will be required to integrate sustainability factors into their investment decision making, and show evidence of this through clear and consistent disclosures and client reporting. Historically, funds were being marketed with a confusing lexicon of RI, sustainability and ESG terminology. One of the key objectives of regulators has been to ensure a clear and consistent set of minimum standards which funds are required to meet in order to be marketed as genuine ESG or sustainable outcomes funds.

Choice

Historically, clients invested in pooled funds have been able to choose between "standard" strategies or dedicated ESG or sustainable funds, while those with segregated mandates have had the flexibility to create customised ESG and exclusion preferences. However, the new investment landscape will see ESG considerations being integrated across the full spectrum of investment strategies offered by asset managers. The level of consideration at security and portfolio level will vary depending on what the strategy is aiming to achieve and whether it aims to be a focused ESG or sustainable outcome fund, meeting the requirements of SFDR articles 8 and 9. Against the global macro environment and change set out earlier, we expect clients' expectations to evolve over time to demand more ESG integration and to focus more on ESG best-in-class and outcome-focused strategies. This will take time, but it is the inevitable result of the regulatory objectives, net-zero targets and other commitments being set by all corporates and evolving retail customer demands. Therefore we believe it is essential that asset managers can support clients at all points in this journey. In turn, this will increase choice for clients, bring about greater suitability and achieve better outcomes.

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Conclusion – looking to the future

In 2021, we are entering a new era of investment – one where ESG elements are considered integral to all risk and opportunity factors. An era where RI consideration and integration is the baseline. We see this driving improved choice and product innovation. As an industry we will take greater ownership for promoting the benefits of good governance, social responsibility and environmental awareness for long-term sustainability and better outcomes for our clients. As fiduciaries and responsible allocators and stewards of our clients' capital, we have a responsibility to not only them, but our employees, future generations and the economies we support. Never has there been a more pivotal moment for the industry to respond.

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