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SEI Manager Research: Year-End Insights on Sustainable Investing

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Snapshot

- Amid the chaos of 2020, investors continued to embrace sustainable investing strategies.
- SEI Manager Research enhanced our sustainable investing analysis to deliver valuable solutions to our clients.
- In 2021 and beyond, we expect both investment managers and investors alike to expand their awareness of (and interest in) sustainable investing.

2020 was a turbulent year across the globe. The coronavirus pandemic, social unrest and political uncertainty that dominated headlines made it easy for many investors to overlook the year's environmental disasters, including devastating wildfires in the US and Australia and a record-breaking number of Atlantic tropical storms.

Amid this chaos—and perhaps even because of it—investors continued to embrace sustainable investing strategies. The year's developments propelled investor concerns beyond their traditional environmental focus and elevated strategies aimed at racial equality, worker health and safety, and other social issues.

This shift in investor behavior may have accounted for the increase in signatories of the United Nations Principles for Responsible Investing (UN PRI), one of the leading proponents of sustainable investing. The number of signatories jumped by 28% from the end of 2019, its highest growth rate since 2010. Similarly, the assets under management of signatories advanced by 20% to $103.4 trillion.[1] Other responsible investing organisations, including the Global Impact Investing Network and The Forum for Sustainable and Responsible Investment (US SIF), also saw an upward trend in growth in 2020.

Investors are not only more involved in sustainable investing strategies; they have also changed their approach to the space. As more investors have begun to adhere to the philosophy that "every investment has an impact," they have moved from exclusionary approaches to ESG integration and positive tilt strategies. In fact, a 2020 survey of 650 institutional investors by Schroder Investment Management found that two-thirds of respondents favoured ESG integration as their approach to sustainable investing.[2] At the same time, 36% of investors favoured a negative screening approach, down from 53% in 2019.

SEI also continued to deepen our work in sustainable investing. While we have offered socially responsible investing options to our clients for more than two decades, SEI Manager Research formalised our proprietary framework in 2018 to assess managers' ability to integrate sustainable investing into their processes, resulting in a three-tiered manager rating system (Strong, Moderate and Weak).[3]

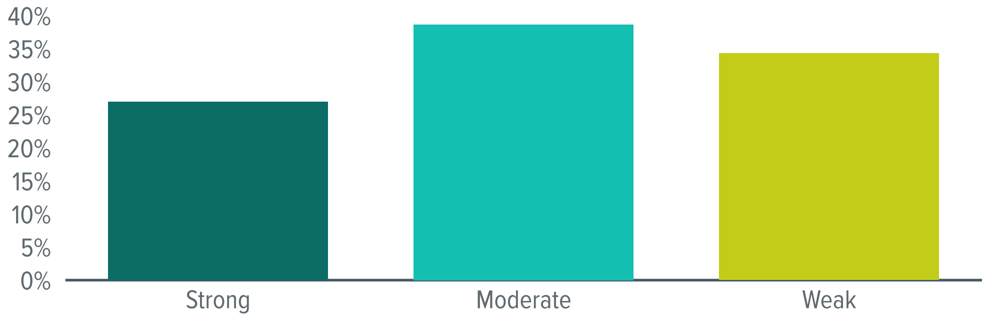
[1] https://www.unpri.org/pri/about-the-pri/322.article
[2] Sustainability - Institutional investor Study - Institutional Investors - Schroders
[3] Please see "SEI Manager Research: Responsible Vetting" (January 2020) for more details.

In 2020, we added dedicated resources and enhanced our sustainable investing analysis to deliver valuable solutions to our clients. Now that 2021 is underway, we are reflecting on our work to gauge the progress that the managers have made in the ever-changing sustainable investing landscape, as well as to identify areas of potential improvement both for ourselves and for our managers.

SEI Manager Research's ESG Ratings: A Recap

During 2020, we evaluated more than 130 managers via conference calls, video calls and questionnaires. Our rating system assigned a Strong rating to just over 25% of the managers. Approximately 38% of managers received a Moderate rating. The remaining managers were rated as Weak.[4]

Manager ESG Ratings

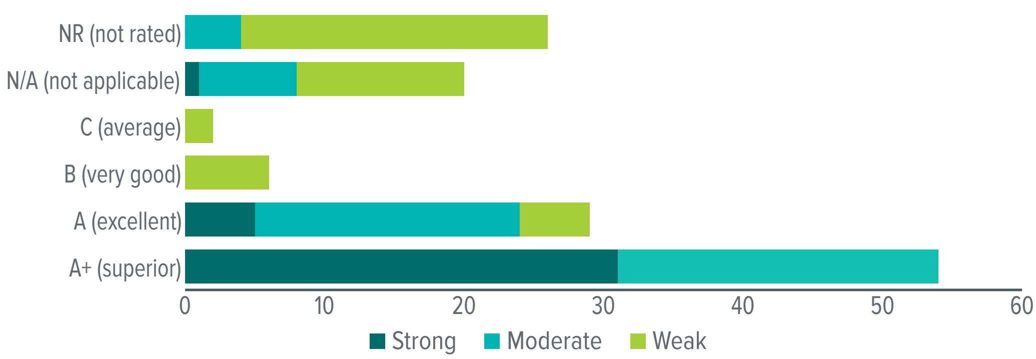


Source: SEI

Our findings on growth within the sustainable investing universe were consistent with global trends as managers continued to build teams, products and strategies to meet investors' needs. While the UN PRI adoption rate among managers we evaluated lagged the industry overall, it jumped to more than 80% after six of those managers became signatories in 2020.

Importantly, a manager's signatory status influences our analysis—but does not guarantee a Strong (or even a Moderate) rating. In fact, of the UN PRI signatories that we analysed, we rated 23% as Weak, while one-third of the signatories received Strong ratings. Meanwhile, 85% of the non-signatory managers were rated as Weak.

ESG Rating by PRI Grade



Source: SEI

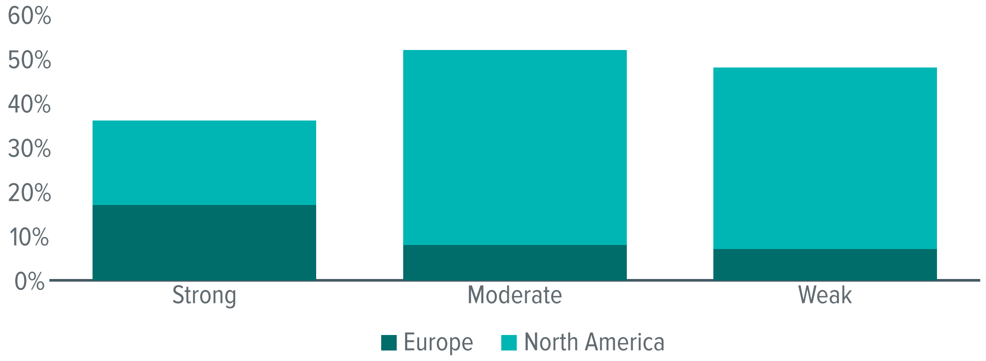
The UN PRI assigns signatories a letter grade for Strategy and Governance practices, ranging from A+ to E (although none of the managers we reviewed were graded D or E). The UN PRI's methodology is based on company self-assessments and indicates managers' responses to core elements of the module and additional elements. We note this rating as part of our evaluation, but firms with an A+ grade don't necessarily make our honor roll. We rated 43% of the UN PRI's top achievers Moderate, while the remainder received a Strong rating. We did not rate any of the UN-PRI A+ firms as Weak.

[4] As of November 11, 2020

Firms' ESG profiles and implementation practices vary, so those with Moderate ratings but strong PRI grades fell short of our upper echelon due to a range of factors. Moderate-rated firms have often just recently begun to build a sustainable investing platform, which tends to lead to limited ESG integration, lack of sustainable-related products or reporting procedures that haven't fully developed. A few firms in this category don't have responsible investing as a primary part of their investing ethos, which may result in a half-hearted and unfocused engagement. As these firms continue to build their sustainable investing platforms, add resources and develop sophisticated analytical and scoring capabilities, we believe they are capable of improving their ratings to Strong.

A common refrain in the sustainable investing community is that European asset managers are ahead of their US peers when it comes to this approach to investing. Our analysis confirms this observation. More than half of our European-based managers achieved a Strong rating versus fewer than 20% of their North American counterparts. Similarly, European-based managers comprise nearly half of our Strong category, but account for less than one-quarter of the managers evaluated.

ESG Rating by Geography



Source: SEI

At the other end of that analysis, North American-based managers account for 85% of Weak ratings, particularly US-based managers (which also account for the bulk of Weak ratings across the entire platform). Within this segment, certain managers made it clear that they currently have no interest in sustainable investing. These managers are typically US-based boutique firms with limited resources and a fundamental belief that ESG integration does not have a positive effect on performance results. Some managers have shown an interest in moving towards ESG integration, but have not committed to developing personnel or products at this stage.

SEI Manager Research's Sustainable Investing Analysis

Beyond participation in the UN PRI, our analysis looks at each manager's sustainable investing profile, resources and practices.

Profile

We have found that the smallest number of managers achieved top ratings for their sustainable investing profile. When assessing profiles, we consider the content of the firms' sustainable investing policies, which vary in breadth and depth: some simply restate the UN PRI, while others expound for more than 50 pages.

We have found that comprehensive policies—those that outline ESG integration for multiple asset classes, engagement procedures, and reporting requirements—tend to be indicative of solid sustainable investing practices. While most policies articulate the manager's philosophy for sustainable investing, many fail to provide detail on engagement practices and neglect to set reporting guidelines.

Resources

The largest number of managers achieved top ratings for their dedicated internal resources to sustainable investing. The strongest managers have created specialist teams that spearhead ESG integration practices using sophisticated data collection and analysis.

Despite limited personnel, some smaller firms also managed to perform well in this category—usually due to their proprietary ESG research, as well as from in-house training of portfolio managers and analysts.

Practices

When assessing each manager's sustainable investing practices, we found it difficult to ascertain if managers exhibited a competitive advantage. Given the recent emergence of sustainable investing at some of these firms, we look forward to continuing to examine each manager's approach as the practice matures.

We saw several managers pioneer exciting new practices, particularly regarding the analysis and risks associated with climate change. A few managers joined third-party groups (such as universities and think tanks) to advance their understanding of climate change and its impact on companies, issuers and portfolios. In addition, some managers are building out other analytical capabilities, adopting frameworks such as climate value at risk (VaR), evaluating the impact of carbon taxes, measuring decarbonisation efforts and developing methodologies to monitor scope 1, 2 and 3 emissions.

Looking Ahead

Sustainable investing has seen tremendous expansion in recent years for two reasons. First, an increasing number of managers have discovered that ESG integration may enhance investment outcomes. Second, investors have become more aware of the impact of their portfolios.

The managers with whom we interact are preparing for continued growth in this arena: nearly 90% report that they are at least considering expanding their sustainable investing platforms over the next three to five years.

Given the omnipresent threat of climate change, regulatory focus and the risks and opportunities that COVID-19 has uncovered, we expect managers and investors alike to expand their awareness of (and interest in) sustainable investing. We look forward to seeing these exciting developments and continuing to provide the most comprehensive range of sustainable investing solutions for our investors.

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