ESG
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ESG Global Study 2023

FOR PROFESSIONAL / QUALIFIED INVESTORS ONLY
Marketing communication

Contents

01 Executive summary

Global ESG adoption among global investors has reached a new high, according to this year's study. The proportion of adopters inched up by a single percentage point to 90%. This modest rise contrasts with the five-percentage-point increase in adoption recorded in our last report. Given that adoption is now so widespread, smaller increases should perhaps be expected.

This year's responses do, however, suggest some longstanding barriers are starting to diminish. For example, while investors continue to highlight data quality, regulatory complexity and fund disclosures as barriers to adoption, the level of challenge presented by each of these areas has declined.

Investors appear to be feeling more proactive and more empowered: The more they know about ESG, the more they are finding ways of dealing with its challenges themselves. For instance, investors are devising their own solutions to counter confusion around fund-labelling regimes. They are also taking proactive steps to decode data difficulties, including accessing ESG data from multiple sources, conducting their own analysis and leaning on asset managers' proprietary research.

Despite these positives, investors think greenwashing* is becoming more prevalent. This shifting perception may be indicative of wider media reporting and heightened regulatory action on greenwashing, rather than increased dysfunction.

Going forward, overcoming some of the confusion associated with ESG could help sustain ESG adoption levels. And the ability to articulate the ESG investment case will prove key if more non-users are to adopt ESG.

A significant majority of investors who have adopted ESG firmly believe that it has the potential to enhance returns. Nearly six in 10 (57%) say incorporating ESG analysis can uncover attractive investment opportunities. And nearly half (45%) think that integrating ESG is likely to improve long-term investment results. It is not surprising then that most investors favour active strategies, with nearly three-quarters preferring active funds to integrate ESG. More effective engagement and gaining a forward-looking view of company ESG profiles are the reasons most cited by investors for preferring active strategies. Potential alpha generation is identified as a further benefit.

This ties in to the potential investment benefits of targeting secular growth themes, of which environmental causes are top of mind. More than seven in 10 (71%) point to the green energy transition as the most important theme. This could reflect rising alarm at the pace of climate change and the impact of geopolitical events such as the Ukraine war.

Despite a bias toward environmental considerations, a significant percentage of investors want to support a broad array of causes across the sustainability spectrum. Around half of respondents flag "sustainable cities and communities" and "health and wellbeing" as two important themes they consider when selecting ESG funds. Furthermore, investors are alert to the potential risks of focusing solely on the climate aspect of the green energy transition: More investors this year are concerned about social issues being overlooked in the push for climate action.

Many investors therefore have an appetite for a diverse range of ESG themes. And this manifests in demand for funds aligned to the UN Sustainable Development Goals (SDGs). Nearly half say there is a need for multi-thematic ESG funds aligned to most of the SDGs. However, demand for these funds is not being met by an appropriate range of products. A significant number of investors point to a lack of suitable SDG-aligned equity, fixed income and multi-asset products.

The diversifying properties of multi-thematic funds also hold appeal for ESG investors looking to neutralize investment style biases. Four in 10 (40%) respondents think multi-thematic ESG funds are an effective means of diversifying risks related to style biases. And more than a third (35%) plan to raise allocations to more style-neutral ESG equity strategies over the next 12 months.

Investors also point to the importance of holding transitioning companies in portfolios. As well as accelerating the transition to a green future, investors think transitioning companies offer compelling investment opportunities. As such, they are shifting away from a singular focus on ESG leaders, with six in 10 saying strategies investing solely in leaders at the expense of transitioners will miss out on investment opportunities. Instead, they are looking to construct balanced portfolios synthesizing the different but complementary qualities of businesses whose products and services are aligned to ESG-related goals, alongside transitioners that are moving towards alignment. This blended approach offers the prospect of a broader opportunity set, greater diversification and the potential for enhanced investment results.

**Interpretations of what constitutes greenwashing can vary, but broadly the term relates to giving a misleading impression on the ESG or sustainability characteristics of a product, activity or organization.*

02 Methodology/ Sample breakdown

Methodology

The Capital Group ESG Global Study was commissioned for a third year to gather the views of 1,130 global investors on ESG via an online survey conducted by CoreData Research between March and May 2023.

The sample includes 565 global institutional investors (pension funds, family offices, insurance companies, sovereign wealth funds, endowments, foundations) and 565 global wholesale investors (funds of funds, discretionary fund managers, private banks, wirehouse broker-dealers, registered investment advisors, independent advisory).

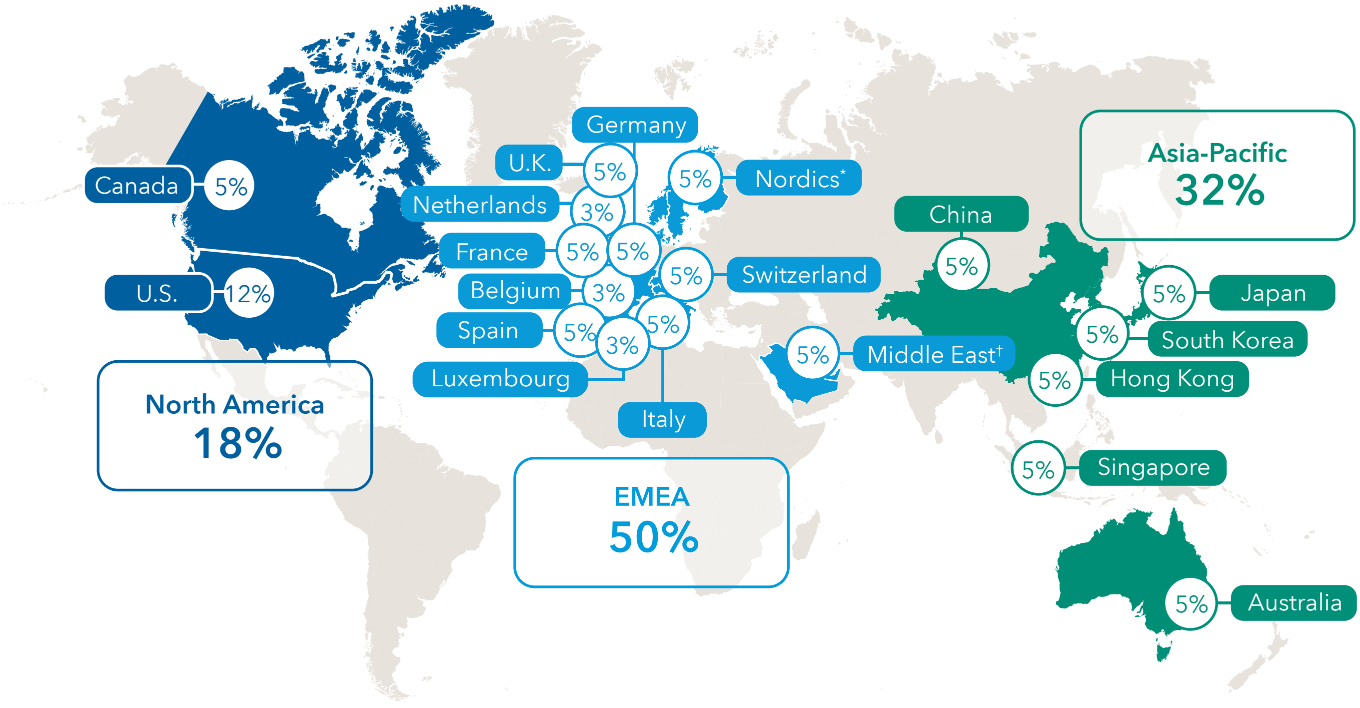
Investors were based in 25 different countries from Europe, the Middle East, and Africa (EMEA), Asia-Pacific and North America.

The sample also includes ESG users/adopters who have adopted ESG in their investment approach (90%) and ESG non-users/non-adopters (10%).

Sample breakdown

1,130 Global investors

25 different countries



Data may not total 100% due to rounding.
**Norway, Denmark, Finland and Sweden*
†Kuwait, Qatar, Saudi Arabia and UAE

Sample breakdown (continued)

Institutional | **Wholesale**

● 2023 ● 2022

Institutional 2023	Institutional 2022	Institutional	Wholesale	Wholesale 2023	Wholesale 2022
43%	48%	Pension fund	Funds of funds	17%	16%
30%	28%	Insurance company	Discretionary fund manager	9%	8%
5%	4%	Endowment	Private banks/Bank trusts	20%	18%
5%	4%	Foundation	Independent advisory/ Individual wealth manager	29%	31%
4%	3%	Sovereign wealth fund	Wirehouse broker/dealer	7%	6%
13%	13%	Family office	Registered investment advisor	17%	18%

Data may not total 100% due to rounding.
The Wholesale 2022 figures originally included a 3% allocation to "Investment division of insurance company" (not shown).
In 2023, this allocation is captured in the "Insurance company" category of the Institutional figures.

Institutional

	2023	2022
Chief investment officer	12%	17%
Portfolio manager/ Investment manager	45%	52%
Investment officer	9%	11%
Fund analyst/Fund selector	6%	4%
Investment director	13%	8%
ESG/Responsible investment specialist	4%	
Research analyst	3%	6%
Investment consultant	6%	1%
Other	2%	1%

Wholesale

	2023	2022
Chief investment officer	14%	22%
Director/Head of asset class	22%	18%
Investment team member	62%	55%
Other	2%	6%

Total AUM $52.9 Tr | $32.1 Tr

AUM	2023	2022
Less than $1 billion	17%	20%
$1 billion to less than $5 billion	24%	19%
$5 billion to less than $10 billion	13%	10%
$10 billion to less than $50 billion	18%	15%
$50 billion to less than $100 billion	9%	15%
$100 billion to less than $250 billion	7%	10%
$250 billion to less than $500 billion	5%	6%
$500 billion to less than $1 trillion	5%	3%
$1 trillion or more	3%	1%

Values in U.S. $

03 Tracking ESG adoption

Tracking ESG adoption

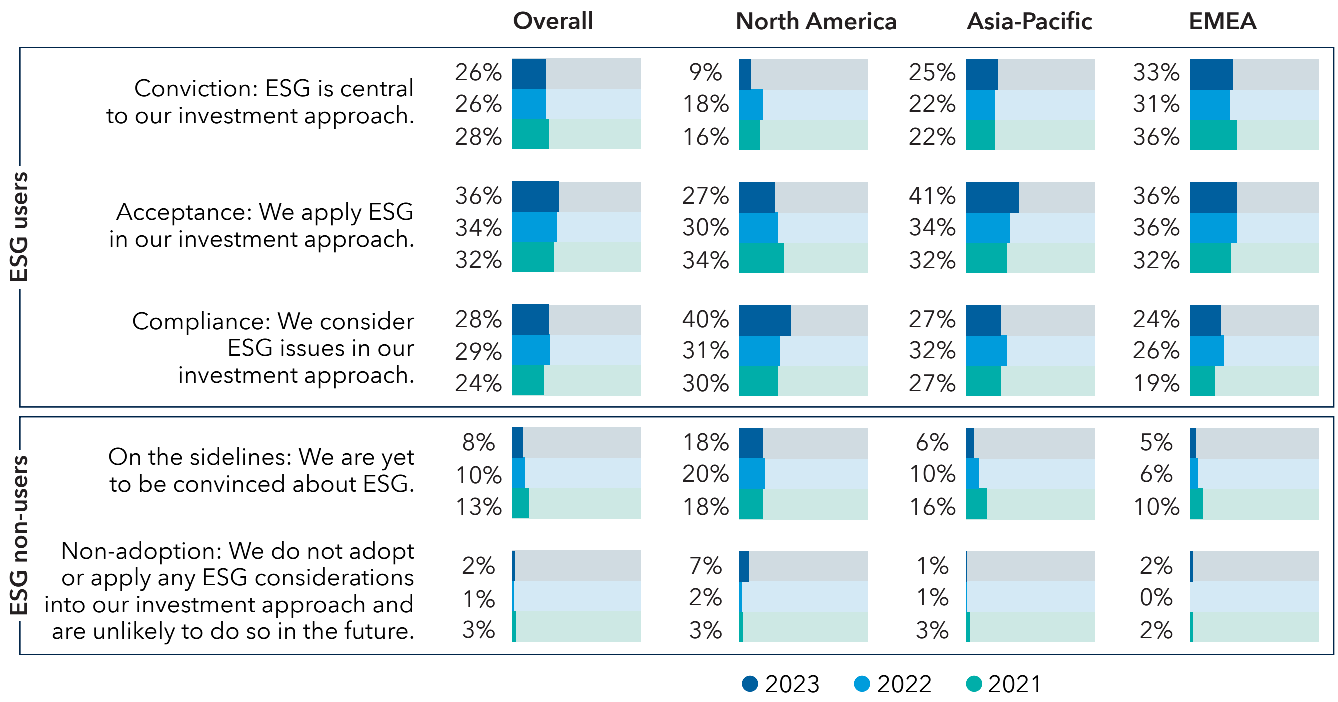
Global adoption reaches a new high, despite modest U.S. decline

The proportion of ESG users now stands at 90% – up from 2022 (89%) and 2021 (84%). Meanwhile, the percentage of "conviction" investors describing ESG as central to their investment approach remains static globally compared to last year (26%).

In contrast to the global trend, ESG adoption in North America has fallen from 79% in 2022 to 75%. This is due to a significant decline in the proportion of "conviction" investors, which has halved from last year (9% vs. 18% in 2022). The share of "conviction" investors elsewhere has increased: in EMEA (33% vs. 31% in 2022) and Asia-Pacific (25% vs. 22% in 2022).

The decline in North America is mostly attributable to the U.S., where adoption fell from 74% in 2022 to 69% this year. ESG adoption in Canada is far higher at 88%.

ESG adoption levels



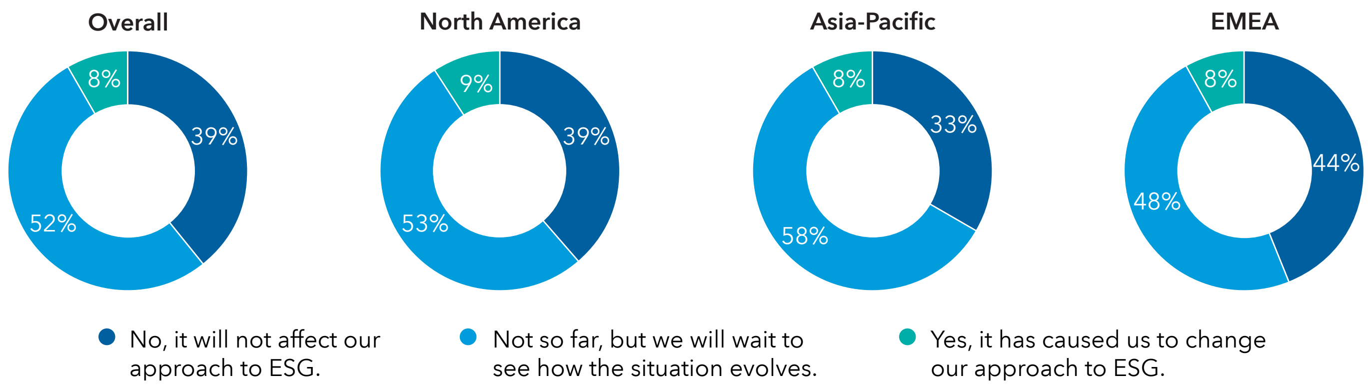
Data may not total 100% due to rounding.
Which of these statements best describes your organization's overall stance on ESG investing?

Although U.S. adoption levels have declined from last year, it's important to note that almost seven in 10 U.S. respondents still apply or consider ESG issues in their investment approach, even if fewer are putting it front and centre.

Arguably, the modest reversal recorded is not surprising. In the past year, some states have passed laws and implemented rules designed to curtail ESG in varied ways. More U.S. respondents say the increased scrutiny has changed their approach to ESG (9% vs. 7% Canada, 8% global). Additionally, more U.S. investors are monitoring the situation to see how it evolves (55% vs. 48% Canada, 52% global).

The more challenging environment for returns among dedicated ESG strategies may have acted as another potential headwind for ESG adoption. This year, fewer U.S. investors concluded that integrating ESG is likely to improve investment results.

Impact of policymaker scrutiny



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Has the increased scrutiny on ESG by some policymakers changed your approach to incorporating ESG in your strategies?

Divergent definitions

Going forward, the ability to overcome confusion and ambiguity over the definition of ESG may help raise global adoption levels. Some investors interviewed as part of this study's qualitative research point to the barrier created by the lack of a standardized ESG definition.

"The lack of a definition is a huge challenge," says a financial advisor at a U.S. registered investment advisor (RIA). "If ESG was truly defined and adhered to, then I would invest more in it."

A senior portfolio manager at a Canadian pension fund speaks of the complexities created by divergent definitions: "There is no one standard, but there are a group of different standards and different objectives that are starting to appear," he says.

The absence of an industry-wide, common definition is making it harder for investment firms themselves to define and describe how they approach ESG.

"I'm not sure whether, at an organizational level, we have a formalized definition of ESG," says a portfolio manager at a U.K. wealth manager.

04 Defining the ESG approach

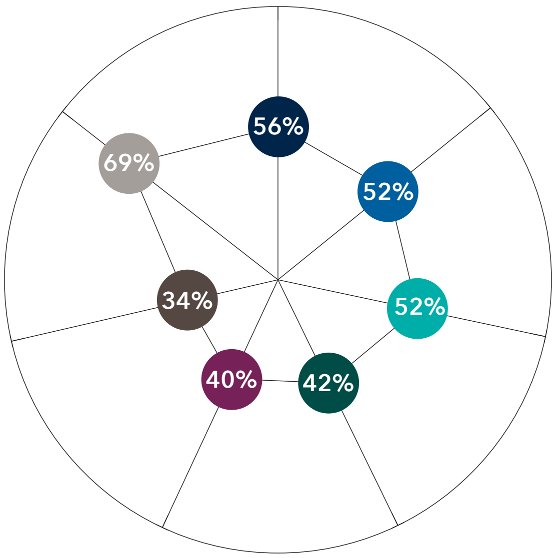
Defining the ESG approach

Regulatory compliance

Despite the lack of hard and fast definitions, investors share a common set of priorities when defining their approach to ESG. Regulatory compliance and risk management sit at the heart of that approach.

Seven in 10 (69%) investors say regulatory compliance is either 'absolutely central' or a 'significant part' of how their firm defines its ESG approach. This is followed by managing financially material ESG risks (56%).

How organizations define their ESG approach



% Significant (Absolutely central to our approach + significant part of our approach)
How significant are these in terms of how your organization defines its broad approach to ESG?

Avoiding reputational harm

"I think people are using ESG because of policymaker and regulatory expectations," says a portfolio manager at a Japanese insurance company.

The importance attached to regulatory compliance and managing financially material risks suggests investors primarily see ESG as a risk factor. They are prioritizing the need to avoid reputational damage from regulatory action and financial damage from ESG investment risks.

The pre-eminence of regulatory compliance also reflects the raft of new ESG rules that investment firms now need to get to grips with. In Europe, these include the EU Taxonomy, Corporate Sustainability Reporting Directive (CSRD) and the latest versions of the Sustainable Finance Disclosure Regulation (SFDR) and MiFID II; and in the U.K., the Financial Conduct Authority (FCA) is rolling out its Sustainability Disclosure Requirements (SDR). Meanwhile the U.S. Securities and Exchange Commission (SEC) has proposed new ESG fund disclosure rules; and in Asia-Pacific, the Australian Treasury is currently finalizing the climate-related disclosure framework for financial institutions and corporates, while Singapore, Hong Kong and Japan have established rules for ESG funds and have made public statements that they will be adopting International Sustainability Standards Board (ISSB) standards as part of their climate-related disclosure frameworks.

"I think people are using ESG because of policymaker and regulatory expectations," says a portfolio manager at a Japanese insurance company. "Obviously the clients are demanding it, but there's a strong push from the top to align to those standards."

A patchwork of confusing labels

The task of regulatory compliance is made more difficult by an evolving patchwork of different fund-labelling and fund-disclosure standards.

A majority of institutional (52%) and wholesale (54%) respondents say regional variations in fund labelling make it harder for investors to remain true to their ESG objectives.

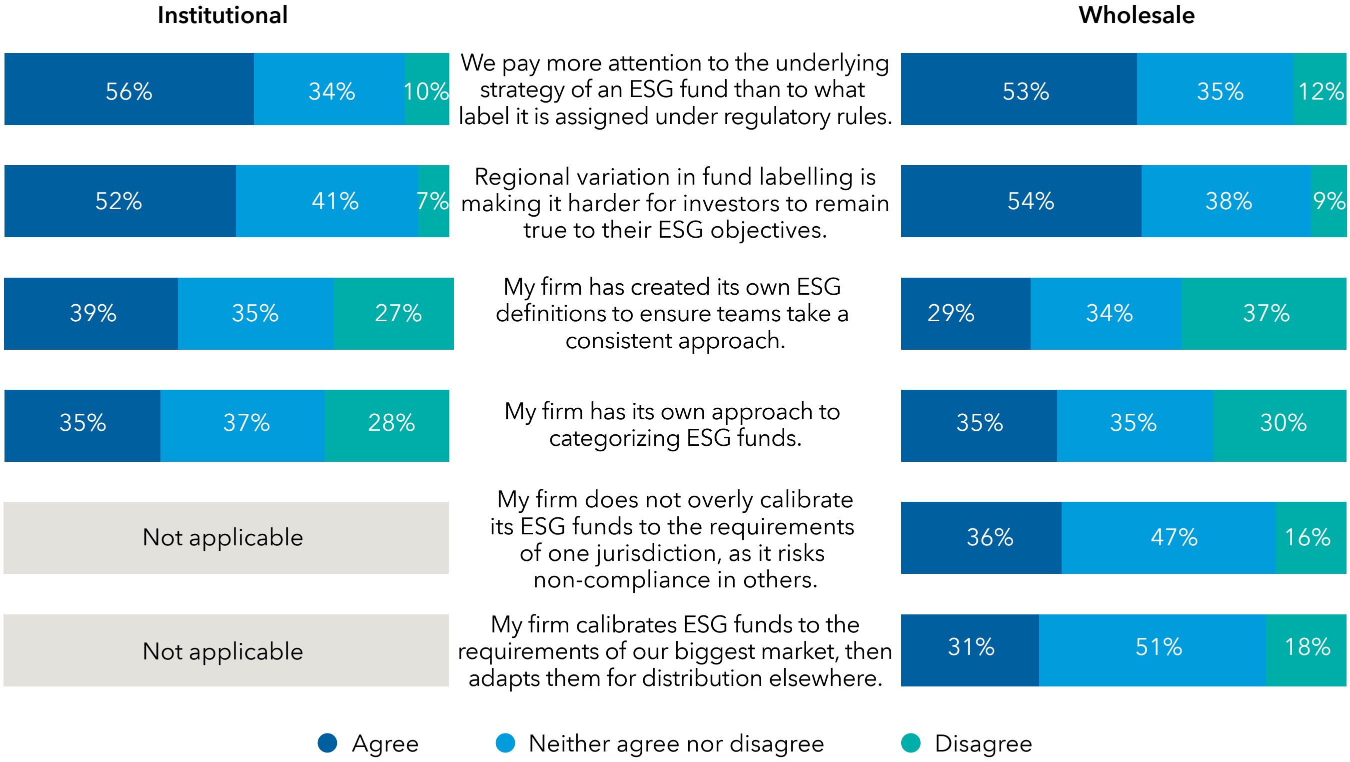
Countering the confusion

Investors are developing their own approaches in a bid to counter the confusion over different fund-labelling standards across regions. For instance, about four in 10 (39%) institutional investors have created their own set of ESG definitions to ensure teams are taking a consistent approach. And more than a third (35%) have developed their own in-house approach to categorizing ESG funds.

Meanwhile, a majority of investors are largely overlooking regulatory labels and focusing on the fundamentals of the underlying fund. More than half of institutional (56%) and wholesale (53%) investors say they pay more attention to the underlying strategy of an ESG fund than its regulatory label.

Investors are also taking steps to avoid a situation whereby complying with one set of standards means contravening rules in other regions. Nearly a third of wholesale investors (31%) say their firm calibrates ESG funds to the requirements of their biggest market and then adapts them for distribution elsewhere. And 36% say they do not overly calibrate their ESG funds to the requirements of one jurisdiction as it risks non-compliance in others.

Views on different fund-labelling standards across regions



Data may not total 100% due to rounding.

05 Catalysts for adoption

Catalysts for adoption

Converting non-adopters into ESG users

The ability of the industry to articulate and evidence the investment case for ESG will prove critical in raising adoption levels. Among non-ESG users, 62% say more convincing evidence showing a positive relationship between ESG and investment performance would most encourage them to start adopting ESG.

Questions about the ability of ESG to deliver investment returns are thus a key stumbling block for non-users. They crave more convincing evidence of a positive relationship between ESG and investment results.

"The number one thing stopping me from focusing more on ESG would be performance," says a financial adviser at a U.S. RIA who invests in a renewable energy fund but is not a strong advocate of ESG.

Non-users also want compelling proof that ESG is a risk mitigator. Evidence that integrating ESG reduces portfolio risk and volatility (46%) is the second-biggest factor that would incentivize non-users to enter the fray.

Non-users are therefore primarily motivated by the investment factors of risk and return. While still important, in comparison to non-users, ESG users attach relatively less weight to these drivers. Fewer than four in 10 (39%) say evidence linking ESG and performance would spur them to increase their focus. This suggests ESG users already accept the long-term investment case for ESG.

Which of these factors would encourage your organization to increase its ESG focus or to start adopting ESG if you haven't yet done so?
(Up to three answers allowed. Most popular ESG adoption drivers are shown from a longer list of responses.)

Deepening the dedication of ESG users

Current ESG users identify greater transparency and consistency in ESG fund reporting frameworks and data availability (43% vs. 23% non-users) as the top driver that would increase their focus.

In addition, a significantly greater percentage of ESG users cite the need for a more supportive regulatory environment (31% vs. 6% non-users). This suggests the regulatory burden is weighing heavily as a rising tide of regulations sweep across the ESG landscape. This is particularly the case in Europe, where investors must be conversant with the EU's SFDR Level 2 and MiFID II ESG amendments.

Investors need a balanced and flexible regulatory approach that mitigates risk without stifling innovation and progress.

06 Overcoming barriers to adoption

Overcoming barriers to adoption

Making broad progress

Breaking down longstanding adoption barriers could help unlock sustainable capital and increase ESG uptake. Investors are making progress as they strive to overcome these obstacles.

"I would say the deeper Scope 1 carbon data is becoming much more reliable," says a senior portfolio manager at a Canadian pension fund.

Investors continue to grapple with challenges around data, regulation, disclosures and performance. But crucially, these persistent problems are less pronounced than two years ago.

The quality of ESG data remains the biggest concern. More than half of investors say consistency and reliability of data (54%) is a very challenging issue for their ESG adoption today. But a higher proportion (62%) say this was very challenging two years ago – showing that progress is being made.

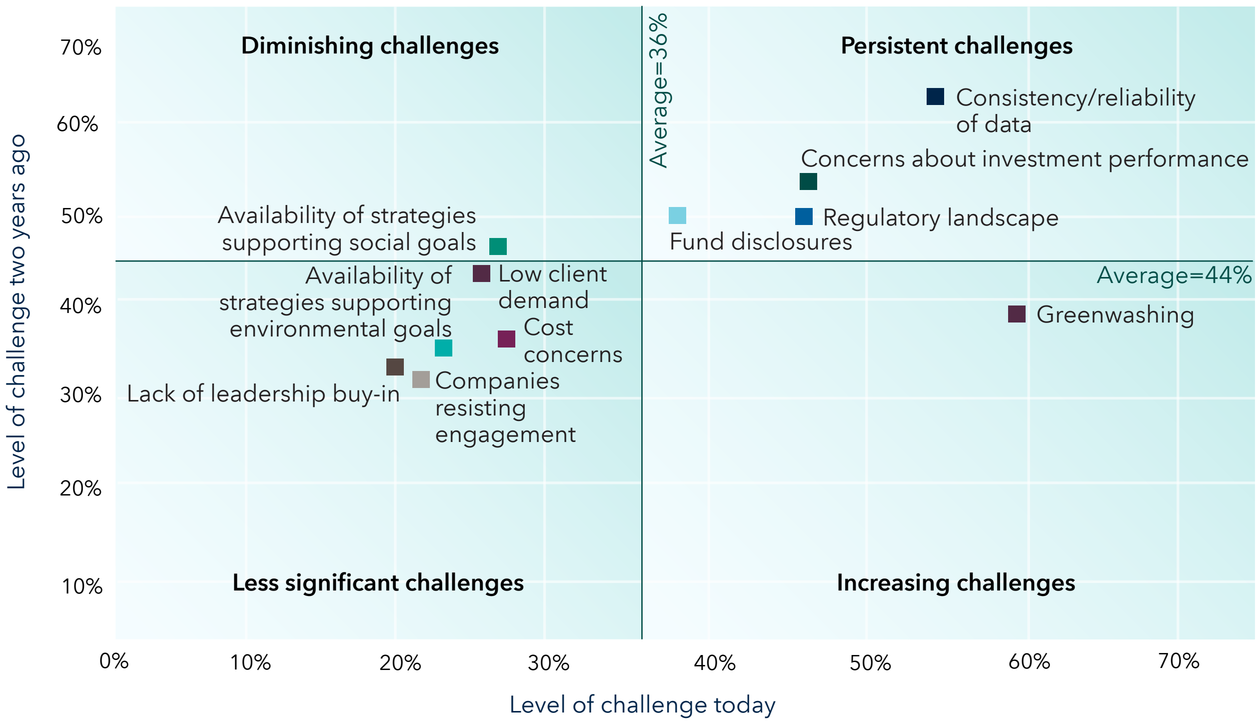
"I would say the deeper Scope 1 carbon data is becoming much more reliable," says a senior portfolio manager at a Canadian pension fund. "I would also say in terms of governance, the data is becoming more readily available and less biased." Scope 1 emissions are direct greenhouse emissions from sources that are controlled or owned by an organization (for example, emissions associated with fuel combustion in boilers, furnaces and vehicles).

Similar progress is evident on other fronts. For example, less than half (46%) of investors today have concerns about how ESG may impact investment performance compared to more than half (54%) two years ago. And while 50% think ESG fund disclosures were very challenging two years ago, fewer (39%) say this represents the same level of challenge today.

Meanwhile, slightly fewer investors say the complex regulatory landscape is very challenging today compared to two years ago (47% vs. 50%).

These findings suggest the industry is beginning to address and manage some of the ongoing issues that have acted as barriers to ESG adoption. They also indicate that, as investors become more familiar with ESG, they are understanding the nature of these challenges better and becoming more adept at handling them.

Evolving nature of challenges



% Challenging (7-10)

To what extent were these issues a challenge for your organization's adoption of ESG two years ago? And what level of challenge do they represent for your organization's adoption of ESG today?

(Please rate on a scale of 0-10 where 0=Not a challenge, 5=Moderate challenge, and 10=Very significant challenge.)

Decoding data difficulties

"We decided two years ago to switch to two data providers to get a better mix between the different opinions," says a portfolio manager at a Dutch insurer.

The easing of data challenges can partly be attributed to incremental improvements in company disclosure regimes. But investors are also taking proactive and positive steps.

Investors are primarily looking to overcome data challenges by accessing ESG data from multiple sources (52%). This illustrates how they are trying to circumvent problems stemming from different ratings providers issuing inconsistent scores based on subjective criteria.

"Sometimes one data provider is pointing up and another provider is pointing down, so you have different opinions on the governance of a company," says a senior portfolio manager at a Canadian pension fund.

Rather than relying on one provider, whose ratings may diverge from others, investors are assessing different vendors to achieve a collective consensus or establish an average score.

"We decided two years ago to switch to two data providers to get a better mix between the different opinions," says a portfolio manager at a Dutch insurer.

ESG ratings agencies have come under criticism for having overly complex and opaque methodologies. Critics also say ratings providers tend to focus on the quantity of information submitted by companies rather than the quality and integrity of the data.

Another key issue is that ESG ratings agencies are unregulated. However, the U.K. has proposed bringing these agencies under the regulatory umbrella. In Asia, Japan and Singapore have either developed or are in the process of finalizing a code of conduct for ESG data providers and ratings agencies. Japan's Financial Services Agency is expected to announce which providers follow the code of conduct and expects fund managers to use providers that are following their standards.

Active research

"Active managers have got the resources, inherent interest in underlying businesses and the access to carry out any due diligence they feel is necessary," says an investment manager at a U.K. family office.

Investors seeking more robust data are also tapping into the research resources of asset managers. Two in five (40%) say they are addressing data difficulties by relying on managers to undertake deep proprietary research. This indicates strong support for active management and its ability to unlock more insightful data through fundamental research and rigorous analysis.

"Active managers have got the resources, inherent interest in underlying businesses and the access to carry out any due diligence they feel is necessary," says an investment manager at a U.K. family office.

Active managers can also leverage their research resources to provide investors with more forward-looking data, thus overcoming the limitations of providers that rely on historical numbers.

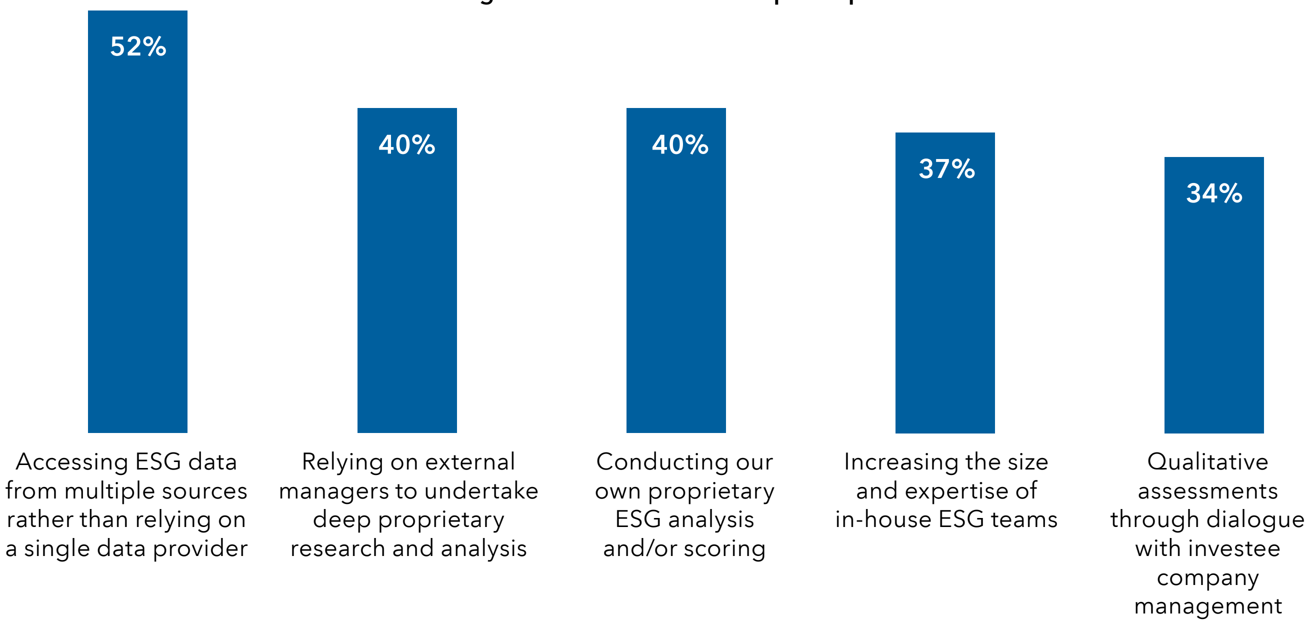
"When we got carbon data earlier this year, we received the sovereign data for 2020 and the corporate data for 2021, which was very much lagging," says a portfolio manager at a Dutch insurer. "As an investor, you don't look back. You look ahead at what's going to happen at the forward-looking indicators."

Building internal expertise

As well as seeking help from external managers to manage data challenges, investor organizations are looking to develop their internal skillsets and capabilities. Four in 10 (40%) of those surveyed are conducting their own proprietary ESG analysis, while a similar percentage (37%) are expanding the size and expertise of their in-house ESG teams.

Investors are, therefore, looking to diffuse data difficulties through a pragmatic and flexible approach that utilizes their own resources and harnesses the expertise of active managers. This supports the notion that the more investors know about ESG, the more they are finding ways of dealing with its challenges.

Dealing with data difficulties – top 5 responses



Multiple answers allowed

Given that ESG data challenges are not going away anytime soon, what approaches is your organization using to overcome and work around them?

07 The evolving ESG landscape

The evolving ESG landscape

The greenwashing problem

While some of the major challenges historically confronting ESG investors pose less of a barrier today, the greenwashing issue shows no sign of abating.

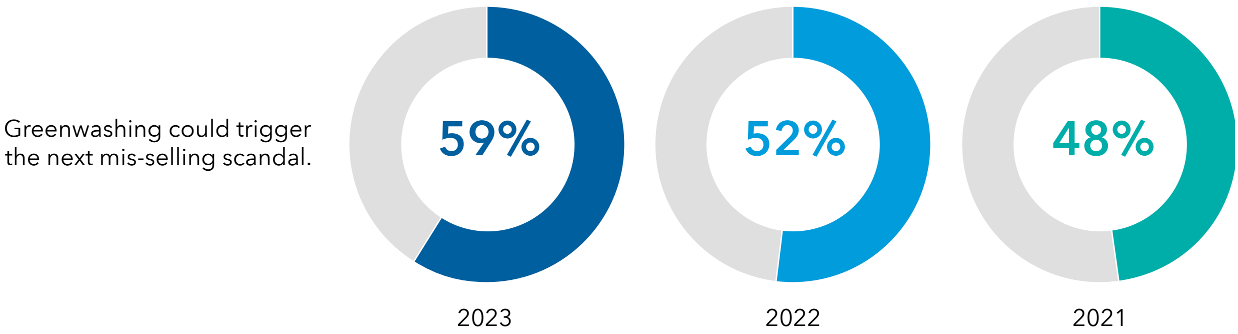
"In my opinion, greenwashing is an issue at the investee company level rather than the asset manager level," says the CIO of an Italian advisory firm.

Indeed, investors think it now presents a greater obstacle. While about two in five (39%) say greenwashing was very challenging two years ago, a far higher proportion of nearly six in 10 (59%) see it as a grave challenge today.

Other findings reinforce the escalating nature of the challenge. More investors than last year think greenwashing is prevalent in the asset management industry (50% vs. 48% in 2022). And a higher proportion think greenwashing could trigger a mis-selling scandal (59% vs. 52% in 2022).

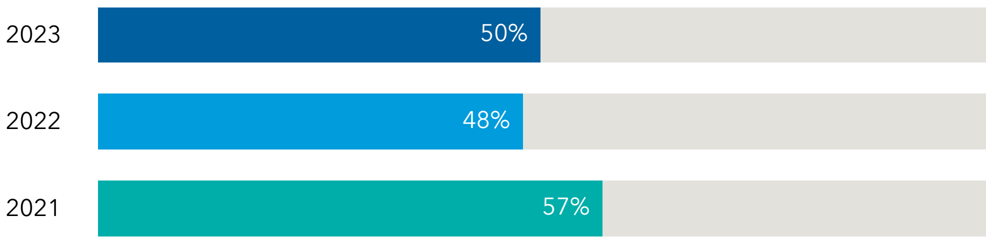
"The greenwashing issue is bad," says the chief investment officer (CIO) of an Italian independent advisory firm. "But in my opinion, greenwashing is an issue at the investee company level rather than the asset manager level. A lot of companies only present positive numbers."

Greenwashing and mis-selling risk



% Agree

Prevalence of greenwashing



% Prevalent (7–10)

How prevalent do you think greenwashing is within the asset management industry?

(Please rate on a scale of 0–10 where 0=Not prevalent at all and 10=Extremely prevalent.)

Greenwashing perceptions

"It's like everyone is accusing each other of greenwashing," says a portfolio manager at a Japanese insurance company.

The rise in greenwashing concerns does not necessarily mean the problem is getting worse. It may reflect the heightened visibility of the issue amid increasing regulatory scrutiny and media reporting.

A portfolio manager at a Japanese insurance company thinks there is a difference between appearance and reality when it comes to greenwashing.

"I wonder whether it's actually as big of an issue as people make out," he says. "It's like everyone is accusing each other of greenwashing."

A number of factors are shaping perceptions of greenwashing. These include press coverage of high-profile cases of alleged greenwashing, anti-ESG commentary and the reclassification and downgrading of ESG funds.

The Great Reclassification

The noise around greenwashing and the growth in ESG regulatory enforcement is impacting the actions of asset managers. Last year, for instance, a significant number of asset managers downgraded SFDR Article 9 funds to Article 8 in what came to be known as The Great Reclassification. The downgrades were triggered by concerns that funds could be falling foul of the Article 9 definition of "sustainable investment."

Green hushing

This caution has given rise to a new phenomenon coined "green hushing," where companies deliberately downplay their green credentials for fear of being accused of greenwashing.

A senior portfolio manager at a Canadian pension fund has noticed how companies are adopting a more careful and tentative approach.

"I've seen a step towards a situation where people are trying to be very clear about what they do and what they don't do and not trying to push themselves as ESG leaders," he says.

Fund flows

Flows from EMEA into so-called "dark green" Article 9 funds have slowed in the wake of The Great Reclassification. Four in 10 (40%) EMEA respondents are currently invested in Article 9 funds – down from 52% in 2022. The proportion investing in "light green" Article 8 funds has consequently increased from 51% in 2022 to 54%, while the percentage investing in Article 6 has grown from 35% to 39%.

Despite the decline in Article 9 investment, appetite for these funds remains relatively strong. More EMEA investors than last year would consider investing in these vehicles (43% vs. 34%). This could suggest investors are confident that current ambiguities around SFDR definitions will be resolved.

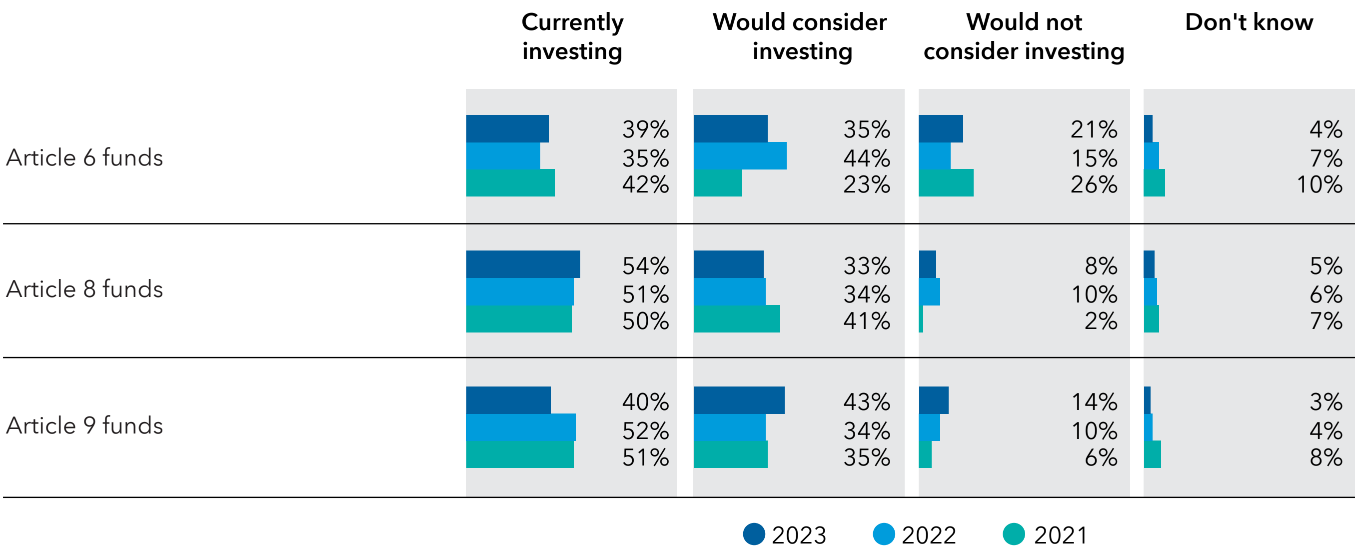
Note on EU SFDR fund classifications: Put simply, Article 9 funds focus on sustainable investments and include sustainable investment as an objective; Article 8 funds promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices; Article 6 is a classification that includes funds that don't focus on ESG or sustainability.

The SFDR Classification is related to the European Union's regulation and is not equivalent to approval or recognition as an ESG fund by regulators in Asia Pacific.

Global reach

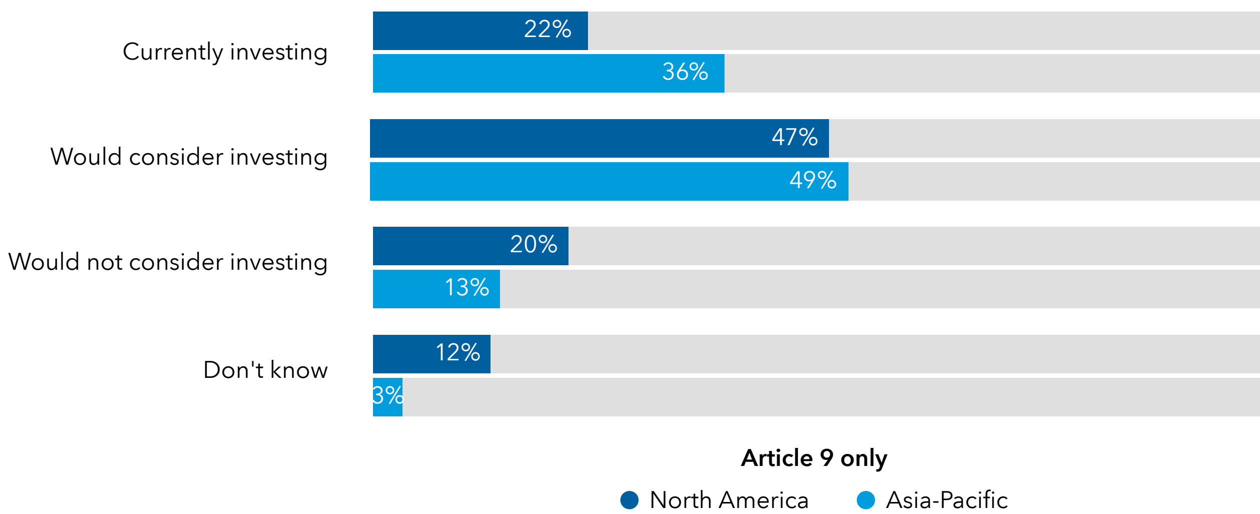
There is also strong appetite for Article 9 funds beyond Europe. While fewer investors outside EMEA currently invest in these products, a higher proportion of North American (47%) and Asia-Pacific (49%) investors would consider investing. This demonstrates how the appeal of SFDR funds extend beyond their regulatory borders, indicating that some investors are increasingly adopting a global approach to ESG.

Investing in SFDR funds – EMEA investors



Are you currently investing, or would you consider investing, in these three categories of funds as classified under the EU's Sustainable Finance Disclosures Regulation (SFDR)?

Investing in Article 9 SFDR funds – North America and Asia-Pacific



Data may not total 100% due to rounding.

Are you currently investing, or would you consider investing, in these three categories of funds as classified under the EU's Sustainable Finance Disclosures Regulation (SFDR)?

08 Investment attitudes and strategies

Investment attitudes and strategies

Linking ESG with performance

Many investors firmly believe ESG can enhance investment returns. A majority (57%) of global respondents think incorporating ESG analysis can uncover attractive investment opportunities. And nearly half (45%) said they agreed with the claim that integrating ESG is likely to improve long-term investment performance.

"The main reason we integrate ESG is to improve risk-adjusted returns," says a portfolio manager at a Japanese insurance company.

"The main reason we integrate ESG is to improve risk-adjusted returns," says a portfolio manager at a Japanese insurance company. "I think ESG is an alpha source and that non-financial factors are a very good source of that."

A portfolio manager at a U.K. wealth management firm speaks of the investment benefits of targeting secular growth themes. "There are ESG themes that present a multi-decade investment opportunity that, purely from an investment point of view, align with our clients' long-term horizons."

However, fewer U.S. investors think incorporating sustainability analysis can identify investment opportunities (46% vs. 58% Canada) and that integrating ESG improves investment performance (29% vs. 33% Canada). These findings may help explain the lower levels of ESG adoption in the U.S.

"I don't have a lot of my clients asking for ESG, so I don't tend to bring it up," says a financial adviser at a U.S. RIA.

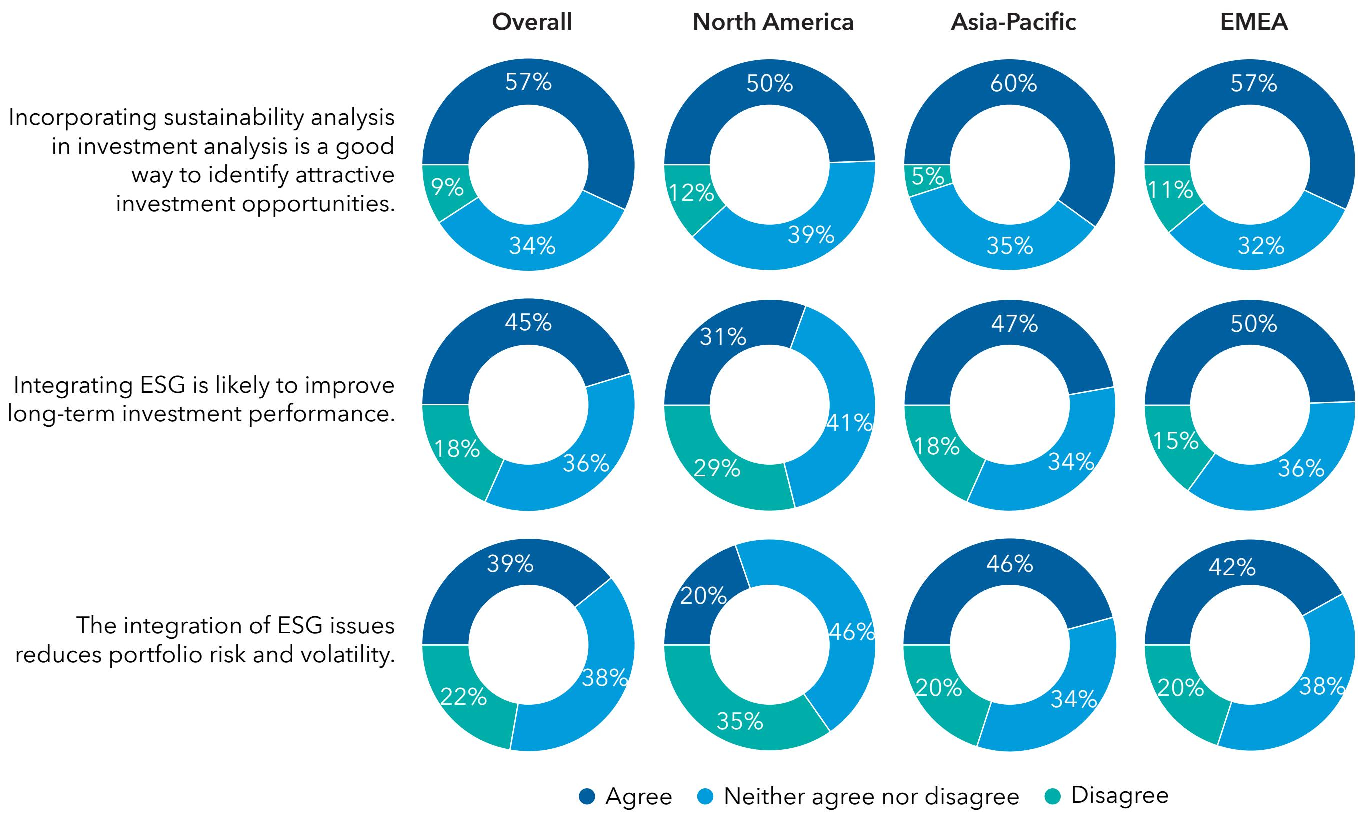
High conviction

"We would like to see more high conviction products," says a portfolio manager at a U.K. wealth manager.

Concentrated ESG portfolios containing a small number of conviction stocks are also seen as a way of boosting investment returns.

"We would like to see more high-conviction products," says a portfolio manager at a U.K. wealth manager. "We like holding funds where the managers are only holding 20 to 30 stocks. We think over time you have lower turnover, lower transaction costs and arguably better performance."

ESG and investment performance



Data may not total 100% due to rounding.

ESG investment approaches

"There's a difference between impact investing and investing with impact," says a portfolio manager at a Dutch insurer.

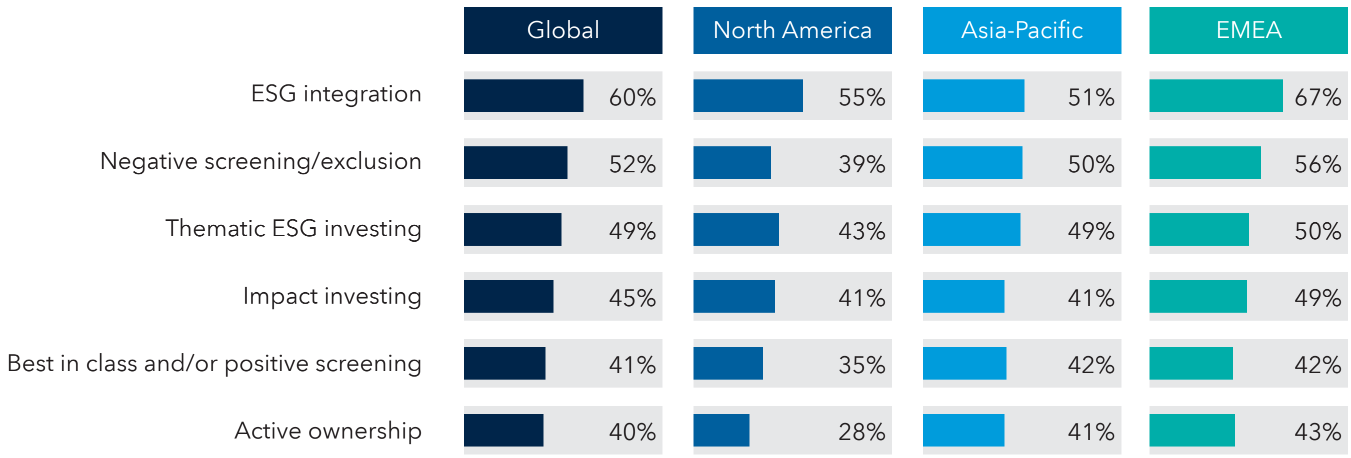
We have seen that almost half of global investors think integrating ESG improves long-term investment performance. In line with this, ESG integration, cited by six in 10 (60%) investors, remains the most used ESG approach. EMEA respondents have the highest preference for integration (67%).

Meanwhile, more investors this year use negative screening (52% vs. 40% in 2022), which has become the second most popular approach.

Elsewhere, just under half deploy thematic ESG investing (49%) and impact investing (45%), while two in five use best-in-class (41%) and active ownership (40%). Impact investing is most popular in EMEA (49%), reflecting the more developed European impact market.

"There's a difference between impact investing and investing with impact," says a portfolio manager at a Dutch insurer. "A lot of investments have an impact, but impact investing is really that highest level."

ESG approaches



Multiple answers allowed
What approaches to ESG do you use?

Structural growth themes

"The most important themes for us are clean water and environmental protection," says the CIO of a Chinese insurance company.

The popularity of thematic investing, the third most-used ESG approach, ties in with how investors are looking to gain exposure to long-term structural growth themes. And environmental themes are uppermost in their minds.

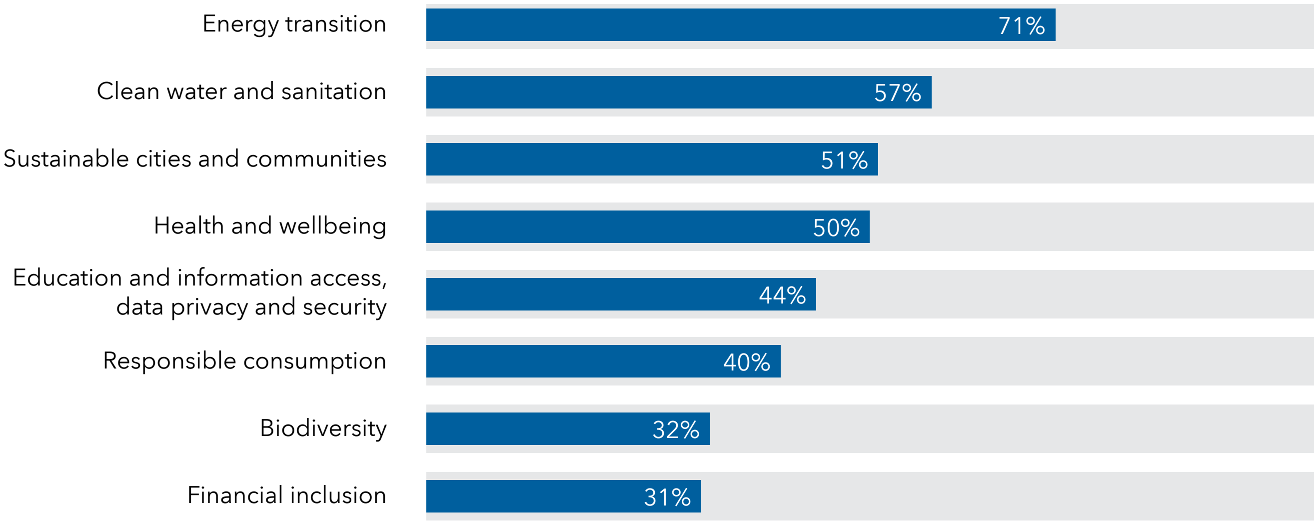
Seven in 10 (71%) respondents say the energy transition is the most important theme when selecting ESG funds. This is followed by clean water and sanitation (57%).

"The most important themes for us are clean water and environmental protection," says the CIO of a Chinese insurance company. "Low pollution consumption is important because in China the government is pushing much more for a green economy."

The importance attached to the energy transition also reflects the impact of political and geopolitical currents that have powered renewable energy and energy security to the top of the agenda. In the U.S., for instance, the 2022 Inflation Reduction Act (IRA) has boosted investment in renewable energy. And in Europe, Russia's invasion of Ukraine has amplified concerns about energy security and, in turn, reinforced the need to use alternative sources of power.

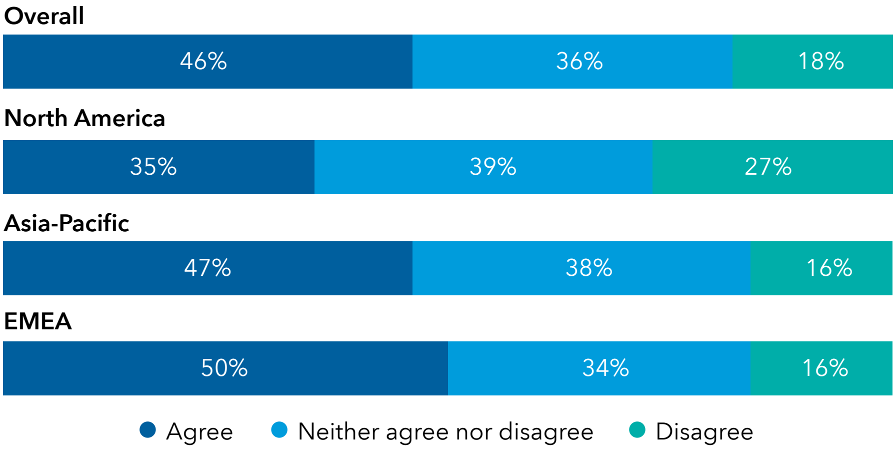
Nearly half (46%) of global investors agree the Ukraine war and resulting energy crisis have strengthened the need to support the low-carbon transition. More investors in EMEA agree (50%).

Most important ESG themes



% Important (7–10)
How important do you consider these investment themes when selecting ESG funds/strategies?
(Please rate on a scale of 0–10 where 0=Not at all important, 5=Moderate importance, and 10=Extremely important.)

The impact of Russia's invasion of Ukraine



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Russia's invasion of Ukraine and the global energy crisis have reinforced the importance of investors supporting the low-carbon transition.

Capturing multiple themes

Beyond these environmental themes, half of investors point to the importance of sustainable cities and communities (51%) and health and wellbeing (50%) when selecting sustainable funds. And about four in 10 say education and information access (44%) and responsible consumption (40%) are core components of the fund selection process.

Investors are therefore looking to capture multiple ESG themes and support a broad array of causes across the sustainability spectrum. Despite a bias towards environmental considerations, there is growing recognition that many ESG issues are interconnected. Income inequality, for example, is connected to poor education, poverty and food insecurity, with the latter increasingly linked to climate change and biodiversity loss.

Supporting a just transition

Indeed, a significant percentage of investors are more alert to the dangers of a climate-only green transition leaving behind social issues. Nearly half (47%) are concerned that social issues are being overlooked in the push for climate action – up from 41% in 2022. Investors appear to be indicating that they want a just transition whereby the benefits of a greener economy are distributed equally and equitably and in a way that respects workers' rights.

"Just because someone is reducing their carbon footprint, [it] doesn't give them a free pass on modern slavery," says the CIO of an Australian wealth manager.

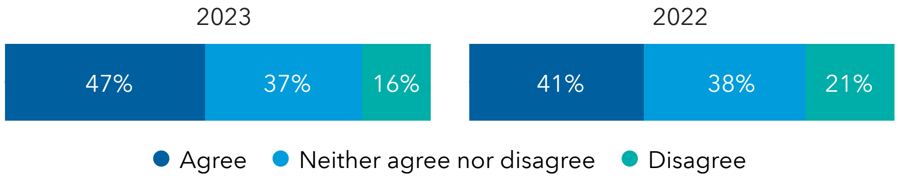
"We want to participate in net zero, but when there are competing ESG interests we'll always go towards the human aspect," says the CIO of an Australian wealth manager. "Modern slavery, for us, is a bigger issue, and just because someone is reducing their carbon footprint, [it] doesn't give them a free pass on modern slavery."

A portfolio manager at a U.K. wealth manager echoes the importance of these social themes.

"From a long-term point of view, a reduction in inequality, improvement in labour standards, and improvement in supply chain standards are probably more important in terms of risk reduction."

The importance of social issues

Social issues are being overlooked in the debate on climate change.



Emerging themes

Investors are also attracted to emerging themes they think will become more important. One such example is biodiversity, which is gaining more visibility amid growing concern about the erosion of natural capital. This is being fuelled by international initiatives such as the Taskforce on Nature-related Financial Disclosures (TNFD), which is set to unveil finalized recommendations in September 2023. The TNFD, similar in structure to the Task Force on Climate-related Financial Disclosures (TCFD), will provide a global framework for nature-related risk management and disclosures.

"When we look to invest in funds, there is greater discussion and awareness of biodiversity and natural capital," says a portfolio manager at a U.K. wealth management firm.

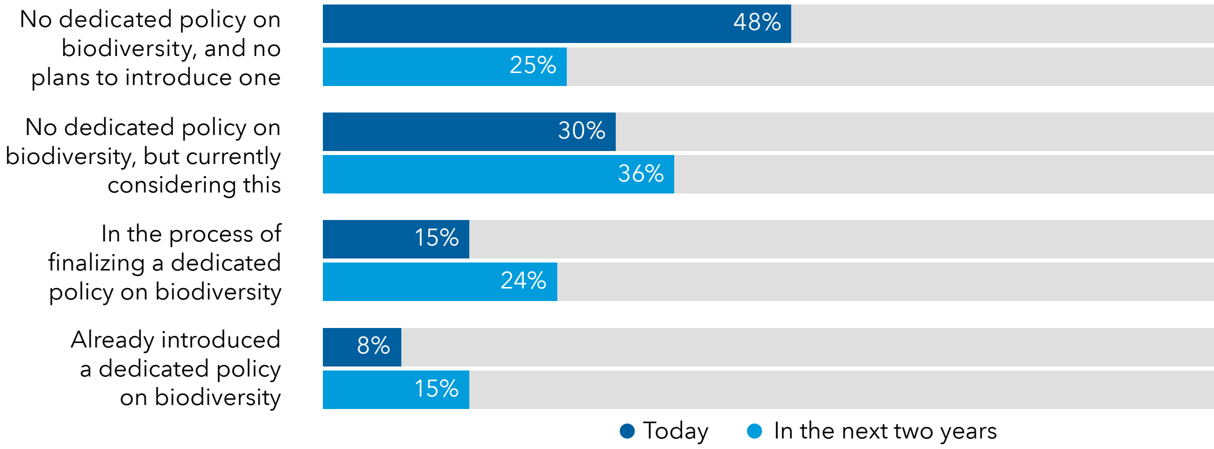
Momentum behind biodiversity is accelerating as investor organizations look to launch targeted strategies. The percentage of investors introducing a dedicated policy on biodiversity is set to nearly double to 15% (from 8% today) over the next two years.

"I think biodiversity is getting more prominent," says a portfolio manager at a U.K. wealth management firm. "When we look to invest in funds, there is greater discussion and awareness of biodiversity and natural capital. We've seen, over the past year, multinational bodies placing more focus on these issues."

Interviewees also draw attention to other emerging ESG themes gaining more relevance in the modern world. A portfolio manager at a Japanese insurance company says his firm has started to integrate cybersecurity into its ESG process.

"Digital infrastructure needs protecting just like physical infrastructure," he says. "I think the market and especially businesses and policymakers are really coming to see cybersecurity and the measurement of cybersecurity performance as a key factor that is very important and very meaningful in terms of risk and loss. And the market needs to start pricing this in, just like we've learnt we need to price carbon."

Biodiversity policies



What is your organization's current approach to addressing biodiversity within its investment policy?
And what do you expect its approach will be in the next two years?

09 Product preferences

Product preferences

Sustainable Development Goals

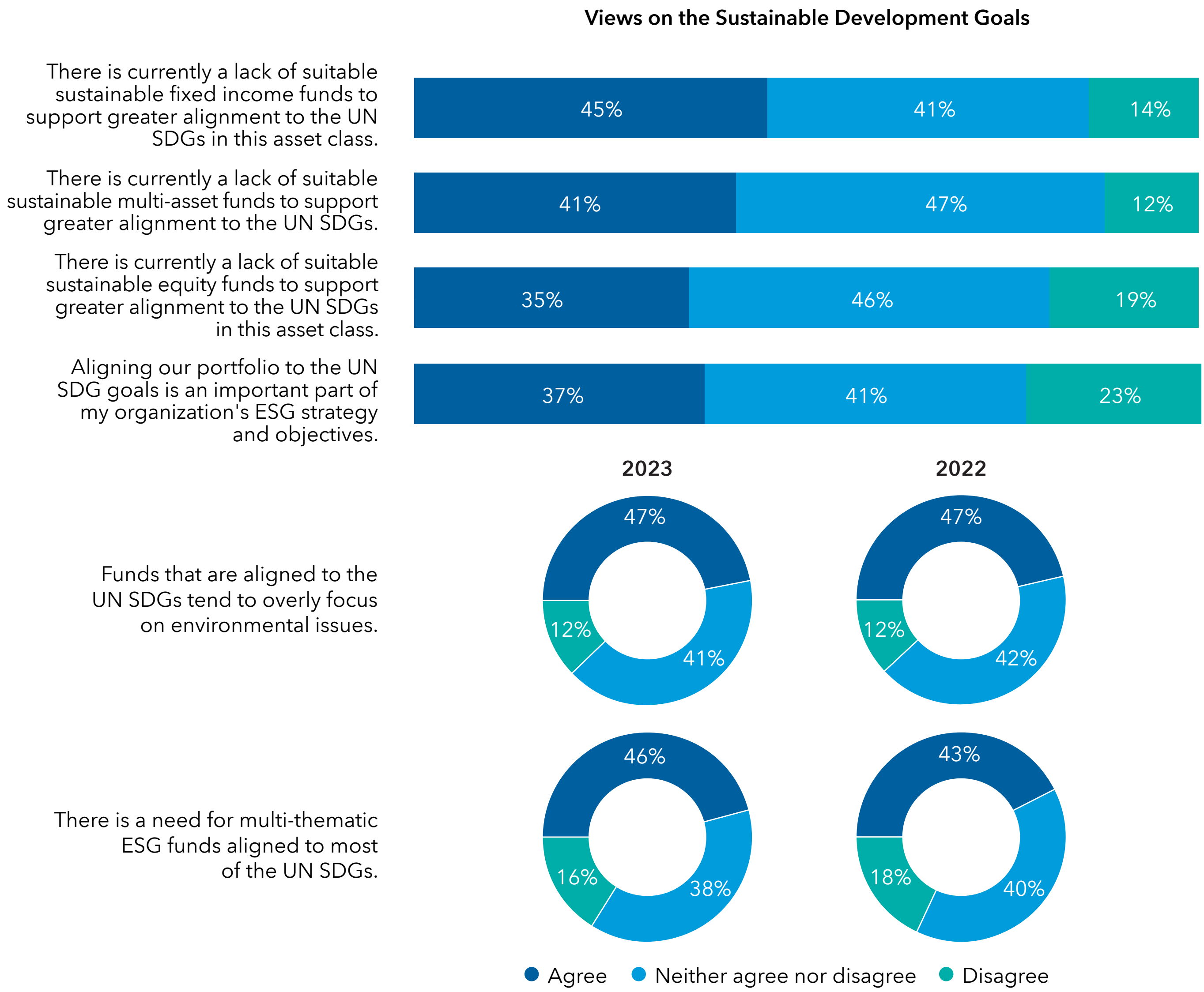
Investor appetite for a broad range of themes also manifests in demand for funds aligned to the UN Sustainable Development Goals (SDGs). These goals encompass a diverse range of causes spanning the economic, social and environmental spheres – including climate change, hunger, poverty and inequality.

Investing in funds targeting a variety of SDGs therefore provides an effective and efficient way of gaining exposure to multiple ESG themes. The wide reach of these funds also helps investors construct diversified and balanced portfolios better able to mitigate sector and style biases.

These benefits are well understood by many global investors. Nearly half say there is a need for multi-thematic ESG funds aligned to most of the SDGs (46% vs. 43% in 2022).

However, demand for these funds is not being met by an appropriate range of products. More than four in 10 investors say there is a lack of suitable SDG-aligned fixed income (45%) and multi-asset (41%) funds. And more than a third (35%) agree there is a dearth of sustainable equity products supporting greater alignment to the SDGs.

Other investors point to deficiencies in existing products. Almost half (47%) think funds that are aligned to the SDGs overly focus on environmental issues.



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"The SDGs are the simplest, clearest guidelines the world's got," says an investment manager at a U.K. family office.

These product gaps are therefore frustrating investor efforts to gain exposure to multiple SDGs. And these frustrations perhaps explain why only a minority consider SDG-alignment core to their approach. Less than two in five (37%) agree that aligning portfolios to the SDGs is an important part of their ESG strategy and objectives.

This muted enthusiasm also hints at imperfections inherent in the SDG framework itself. For example, the SDGs do not explicitly measure ESG risks, and not all topics, communities and groups are explicitly referenced in the SDGs. But despite these limitations, the SDGs, which launched in 2015, can be a useful framework for investors to measure impact and track progress.

"The SDGs are the simplest, clearest guidelines the world's got," says an investment manager at a U.K. family office. "I think they provide a broad spectrum and give us sensible benchmarks to think about those areas we should always be looking to integrate into our investment process."

A portfolio manager at a Japanese insurance company echoes this view, describing the SDGs as "a roadmap for high-priority impact investment."

Neutralizing style biases

The diversifying properties of multi-thematic funds also hold appeal for ESG investors looking to neutralize style biases. Four in 10 (40%) respondents think multi-thematic ESG funds are an effective means of diversifying risks related to style biases. And more than a third (35%) plan to raise allocations to more style-neutral ESG equity strategies over the next 12 months.

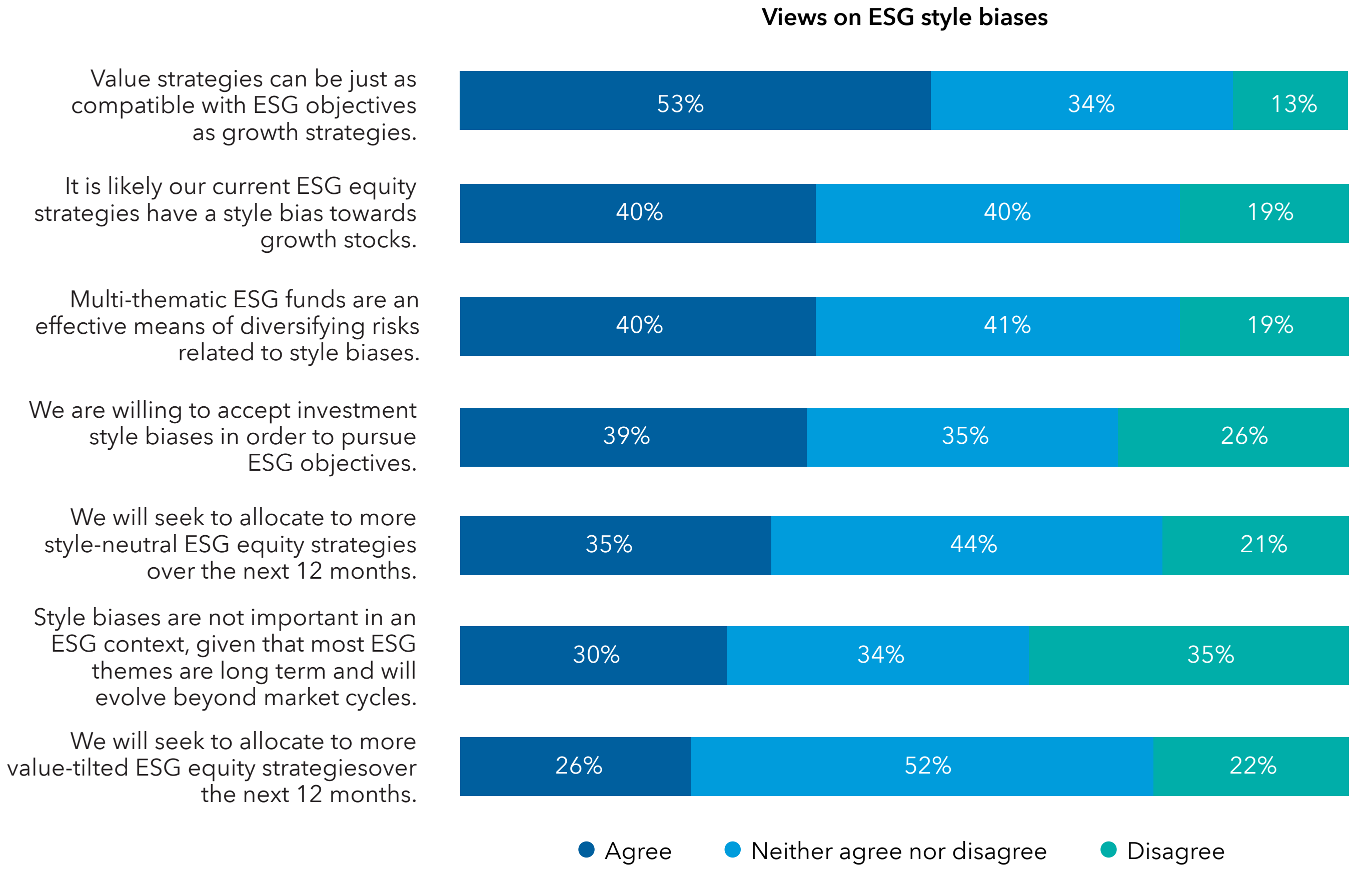
"There has been a big growth bias in ESG and we now see how that is not something that performs throughout the entire investment cycle," says a portfolio manager at a Japanese insurance company.

These style-related risks came to the fore during the market rotation from growth to value in 2022. This contributed to short-term performance issues for some ESG equity funds with a growth tilt, which comprise a significant portion of strategies. Indeed, four in 10 (40%) investors agree their ESG equity strategies have a bias towards growth stocks. This compares to just 19% who disagree.

"There has been a big growth bias in ESG and we now see how that is not something that performs throughout the entire investment cycle," says a portfolio manager at a Japanese insurance company.

Seeking value

The performance issues affecting some growth-oriented ESG funds last year have seen increased interest in value strategies. More than half of investors (53%) think value can be just as compatible with ESG objectives as growth strategies. This is compelling some investors to adjust portfolios accordingly. More than a quarter (26%) are looking to balance to more value-tilted ESG equity strategies over the next year.



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Overlooking style biases

As some investors look to allocate more to value, others are overlooking style biases as they focus on long-term ESG themes. Nearly two in five (39%) say they accept style biases in pursuit of ESG objectives and 30% say such biases are irrelevant given the enduring nature of ESG themes.

A significant portion of investors therefore recognize that ESG is about investing in durable themes and sustainable causes that will outlive market rotations and macro "gyrations."

Active preferred to passive

Nevertheless, these short-term macro and market challenges can be effectively navigated by active managers. And active management is also seen as most compatible with ESG.

Investors clearly favour active strategies, with three-quarters (74%) preferring active funds to integrate ESG. This compares to 18% favouring passive funds and just 8% opting for hybrid instruments. EMEA investors are most likely to use active strategies (77%), while North Americans are least inclined (63%).

"We tend to avoid ETFs [exchange-traded funds] or passive investments in this space because we don't want to be bound by the rules of the index provider," says the CIO of an Italian independent advisory firm.

The CIO of an Australian wealth manager also thinks active management and ESG go hand in hand.

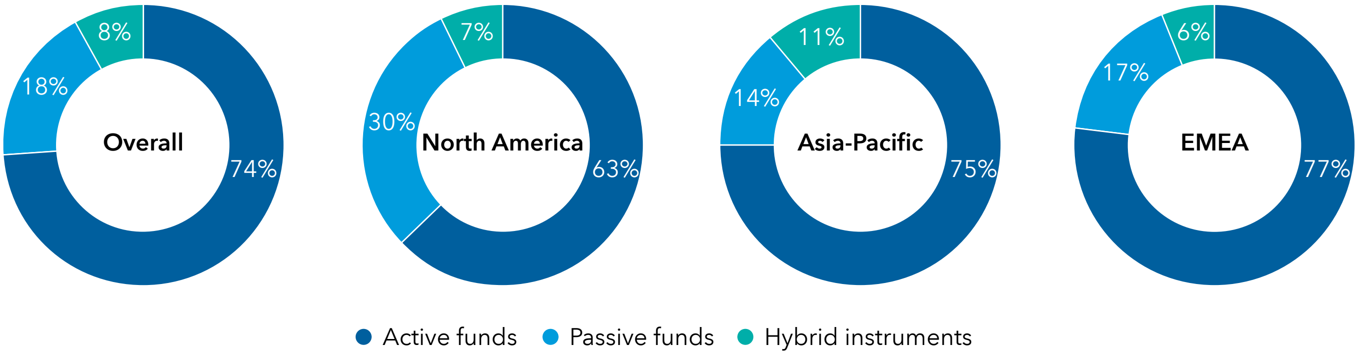
"If you're a well-resourced manager, you should be able to add genuine value through active management in the ESG space," he says.

"If you're a well-resourced manager, you should be able to add genuine value through active management in the ESG space," says the CIO of an Australian wealth manager.

Investors cite more effective stewardship and engagement (47%) and gaining a forward-looking view of company ESG profiles (47%) as the factors driving the preference for active strategies. The relative importance of engagement shows that a significant number of investors recognize that active managers have the resources and opportunities to share and encourage industry best practices directly with the companies in which they invest, which should help deliver long-term investment results.

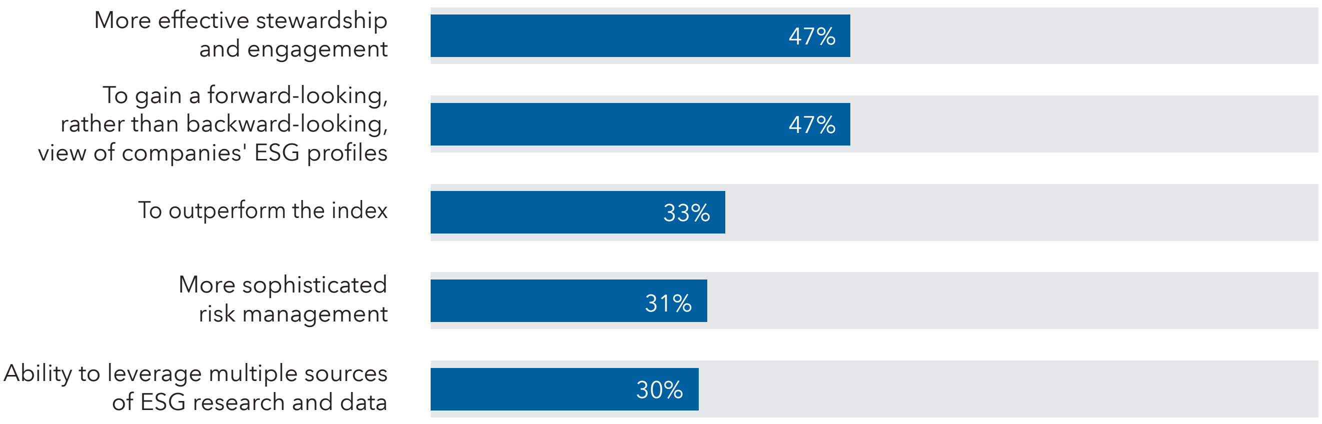
Investors additionally cite the ability of active managers to generate alpha and reduce risk. About a third point to outperforming the index (33%) and more sophisticated risk management (31%) as reasons to use active strategies.

Preferred approaches when integrating ESG



What is your preferred approach when integrating ESG?
(Select one answer only.)

Reasons for favouring active strategies – top 5 answers



What are the main reasons why your organization prefers active strategies when integrating ESG?
(Select up to three answers.)

An active transition

"A passive index takes a snapshot of the present, but with transitioning companies you really need to forecast the future; and active managers are better able to do that," says a senior portfolio manager at a Canadian pension fund.

"It's about finding those companies on an improving track where that's not yet priced in or where the market awareness is not there yet," says a portfolio manager at a Japanese insurance company.

Investors also think active managers have a distinct advantage when it comes to finding transitioners – companies looking to transition their business models to a sustainable future. Two-thirds (65%) agree that fundamental research – a key component in the active management tool box – is critical to identifying companies with credible transition plans.

"A passive index takes a snapshot of the present, but with transitioning companies you really need to forecast the future; and active managers are better able to do that," says a senior portfolio manager at a Canadian pension fund.

Global investors think transitioners play a decisive role in the evolution towards a sustainable planet. And they are aware that the transition toward this green future cannot be achieved solely by backing today's ESG leaders (companies that, according to some specified ESG criteria, are regarded as among the best in class).

Four in 10 (38%) say investors need to focus more on transitioners than leaders to achieve the SDG goals. And a third (32%) think funds solely investing with leaders at the expense of transitioners are doing more harm than good.

Furthermore, investors think transitioning companies offer compelling financial rewards. Six in 10 (59%) say strategies investing solely in leaders at the expense of transitioners will miss out on investment opportunities. And nearly half (44%) think transitioning companies are undervalued by the market.

"It's about finding those companies on an improving track where that's not yet priced in or where the market awareness is not there yet," says a portfolio manager at a Japanese insurance company.

A senior portfolio manager at a Canadian pension fund also comments on the upside potential of transitioners. "Where we see value in ESG is where we see the transitioners and say we will take these companies – whether chemical, oil or utilities – and transition them to a better profile."

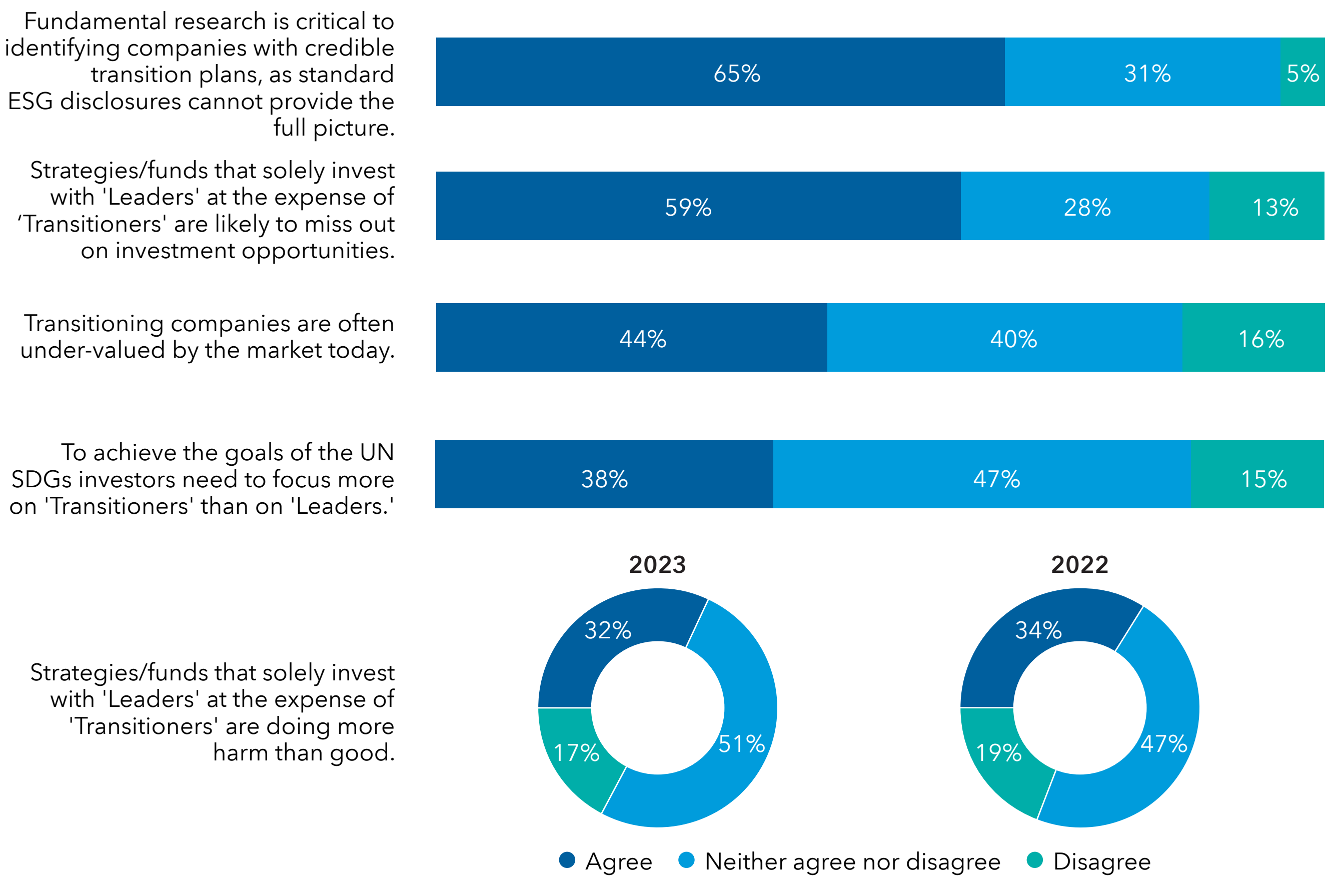
However, the CIO of an Italian advice firm notes the growing difficulties of identifying transitioners. "There is a lot of interest in transitioners and a lot of analysts looking at the space, so it's difficult to find companies that are underfollowed and therefore undervalued."

Reconfiguring portfolios

Global investors recognize the need to invest in a combination of leaders/adopters and transitioners and are reconfiguring portfolios away from a sole focus on leaders. The proportion focusing on a mix of leaders and transitioners two to three years ago stood at 23%, but this has doubled to 46% today. And this is expected to rise to 54% over the next two to three years.

Investors are therefore looking to construct balanced portfolios that synthesize the different but complementary qualities of leading businesses that have adopted ESG practices and transitioners that are moving towards them. This blended approach offers the prospect of a broader opportunity set, greater diversification and the potential for capital appreciation by owning undervalued companies.

Views on transitioners and leaders



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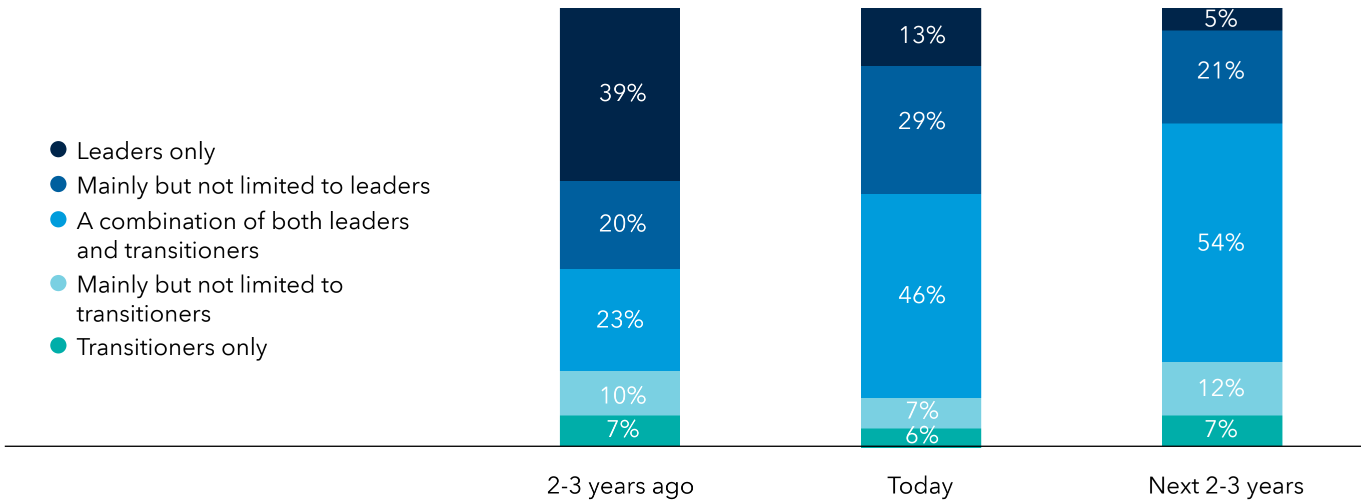
Allocations to leaders and transitioners



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Which of these types of companies (Leaders vs. Transitioners) do you mainly focus on when allocating to ESG today? How does this compare to 2-3 years ago, and how do you expect it to change over the next 2-3 years?

10 Implementing ESG

Implementing ESG

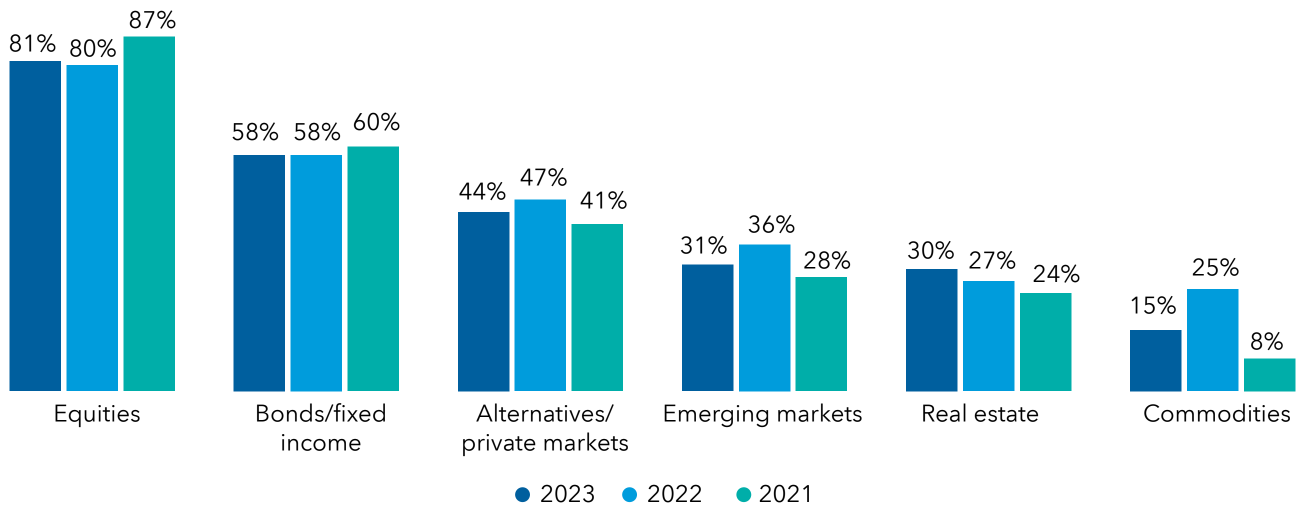
Equities remain dominant asset class

Equities remain the most popular asset class for implementing ESG (81% vs. 80% in 2022).

This is followed by fixed income (58% vs. 58% in 2022) and alternatives (44% vs. 47% in 2022).

While there is little regional variation within equities, a higher proportion of EMEA investors use fixed income (61%) to implement ESG compared to peers in North America (43%). And Asia-Pacific investors are more likely to deploy alternatives (54% vs. 44% global).

Favoured ESG asset classes



Multiple answers allowed
For which asset classes and sectors have you implemented ESG?

Fixed income ESG approaches

"I feel integrating ESG into fixed income is actually easier than in equities," says a portfolio manager at a Japanese insurance company.

Negative screening is the most widely used approach when investing in fixed income. Respondents favour negative screening when investing in high yield (39%), developed market sovereign (36%) and emerging market (35%) debt.

However, those using investment grade bonds (rated BBB/Baa and above in the U.S., for example) prefer ESG integration (47%), just ahead of negative screening (46%).

"I feel integrating ESG into fixed income is actually easier than in equities," says a portfolio manager at a Japanese insurance company. "As fixed income investors, we are very much focused on the downside risks and ESG risks are often downside in nature."

He adds that a divide has opened up in the way European investors integrate ESG into fixed income compared to their global counterparts.

"There has been a shift where, in Europe, they're very focused on green bonds because they want a very pureplay instrument," he says. "But I think in the rest of the world it's more of a focus on sustainability bonds, which are kind of both green and social."

ESG approaches in fixed income

	Investment grade corporate debt	High-yield corporate debt	Developed market sovereign debt	Emerging market debt	Strategic bonds/ Unconstrained strategies
Negative screening	46%	39%	36%	35%	29%
Best-in-class	37%	32%	25%	21%	22%
ESG integration	47%	39%	33%	26%	29%
Thematic ESG	26%	23%	18%	20%	22%
Impact investing	27%	23%	20%	22%	17%
Engagement	24%	21%	16%	22%	19%
Allocation to green bonds	25%	15%	23%	12%	15%
Allocation to social bonds	18%	12%	15%	8%	12%
Allocation to sustainability-linked bonds	18%	14%	14%	10%	14%
Don't know	7%	11%	18%	14%	15%

Multiple answers allowed
What ESG approaches does/will your organization favour when investing in these fixed income sectors?

Macro factors

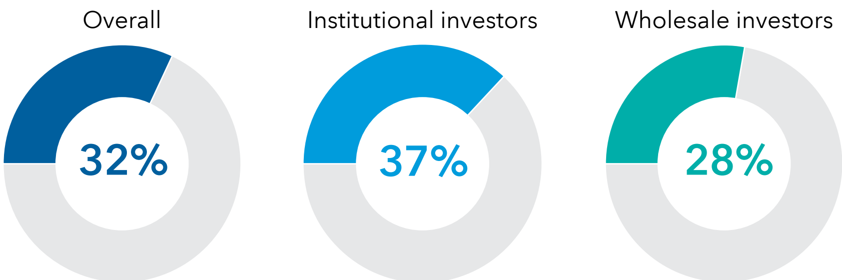
"Fixed income will definitely be coming back on the menu," says a portfolio manager at a Japanese insurance company.

Investors are planning to adjust their fixed income strategies in expectation that interest rates will start to fall as central banks bring down inflation.

Nearly a third (32%) plan to increase allocations to ESG bond funds when inflation falls, with this figure rising to 37% of institutional investors. More than twice as many EMEA as North American investors are set to raise ESG bond allocations as inflation comes down (37% vs. 17%).

"Fixed income will definitely be coming back on the menu," says a portfolio manager at a Japanese insurance company. "The rise in interest rates and volatility in 2022 was quite negative for the ESG bond space."

My organization is likely to increase allocations to ESG bond funds as inflation falls.



% Agree

Fixed income hurdles

"If there is no common or objective metric of measuring things, then there might be scope for greenwashing, among other issues," says a co-manager of a private credit portfolio at a U.K. pension fund.

"Unless you are dealing with primary market origination then you are going to have very little say. It's not like equity, where you have potential to feed into board decisions via shareholder feedback," says a portfolio manager at a U.K. wealth management firm.

Investors flag a number of challenges when integrating ESG within fixed income. A lack of standardization for integrating ESG risks into credit ratings, cited by 46% of global investors, is seen as the predominant barrier.

A co-manager of a private credit portfolio at a U.K. pension fund speaks of the challenges created by ratings agencies using different scoring methodologies when incorporating ESG into bond ratings.

"If there is no common or objective metric of measuring things, then there might be scope for greenwashing, among other issues," he says. "I think a common universal language is paramount."

He adds: "A way forward is to create an ecosystem of green investments that will have measurable, tangible outcomes; and this will attract more investors because they can easily compare apples to apples and everyone will speak the same language."

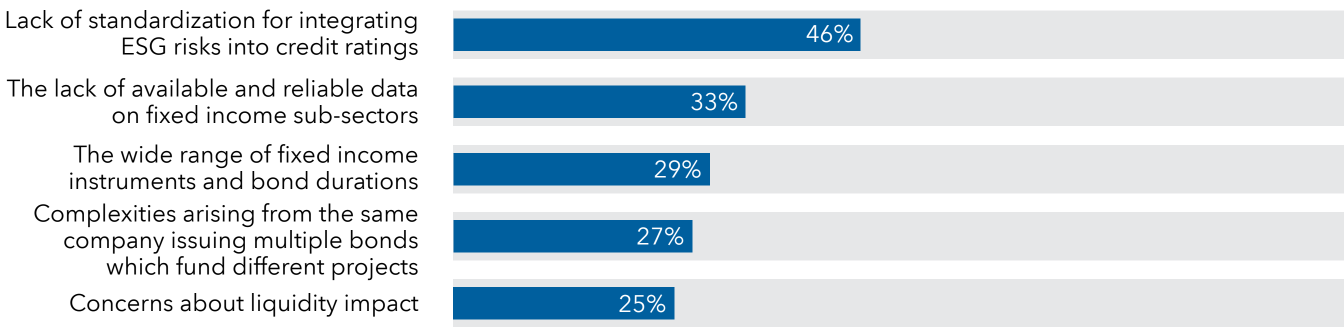
The second-biggest barrier when integrating ESG within credit portfolios is a lack of available and reliable data on fixed income sub-sectors (33%). This is followed by the wide range of fixed income instruments and bond durations (29%).

Investors also highlight complexities stemming from the same company issuing multiple bonds funding different projects (27%), along with concerns about liquidity impact (25%).

Meanwhile, a portfolio manager at a U.K. wealth management firm comments on the lack of engagement opportunities when buying fixed income securities in the secondary market.

"Unless you are dealing with primary market origination then you are going to have very little say. It's not like equity, where you have potential to feed into board decisions via shareholder feedback."

ESG fixed income barriers – top 5 answers



Multiple answers allowed
What are the main barriers when integrating ESG issues within fixed income?
(Select up to three answers.)

11 Making sense of regulation

Making sense of regulation

Seeking harmony

Given the difficulties posed by differing regional rules, it is unsurprising that investors crave a joined up and synchronized set of global standards above all.

Harmonizing global regulatory standards, cited by 48% of investors, is seen as the primary priority for policymakers developing ESG frameworks. This is followed by the provision of guidelines for consistent disclosure of ESG risks (40%) and developing guidelines for comparable ESG reporting (39%).

Regulatory priorities – top 5 answers

Overall 2023	Overall 2022	Overall 2021		Region North America	Region Asia-Pacific	Region EMEA
48%	45%	45%	Harmonizing global standards, taxonomies, metrics	36%	48%	52%
40%	42%	43%	Providing guidelines for consistent, objective, quantified disclosure of ESG-related risks	49%	40%	37%
39%	44%	38%	Developing guidelines for material, comparable ESG reporting for investors	54%	40%	34%
38%	24%	25%	Avoiding frequent regulatory changes	36%	35%	40%
37%	28%		Enforcement, tackling greenwashing	41%	33%	38%

● 2023 ● 2022 ● 2021 ● North America ● Asia-Pacific ● EMEA

Rank 1 + 2 + 3
What should policymakers prioritize as they continue to develop ESG regulatory frameworks?

Knowledge and relevance

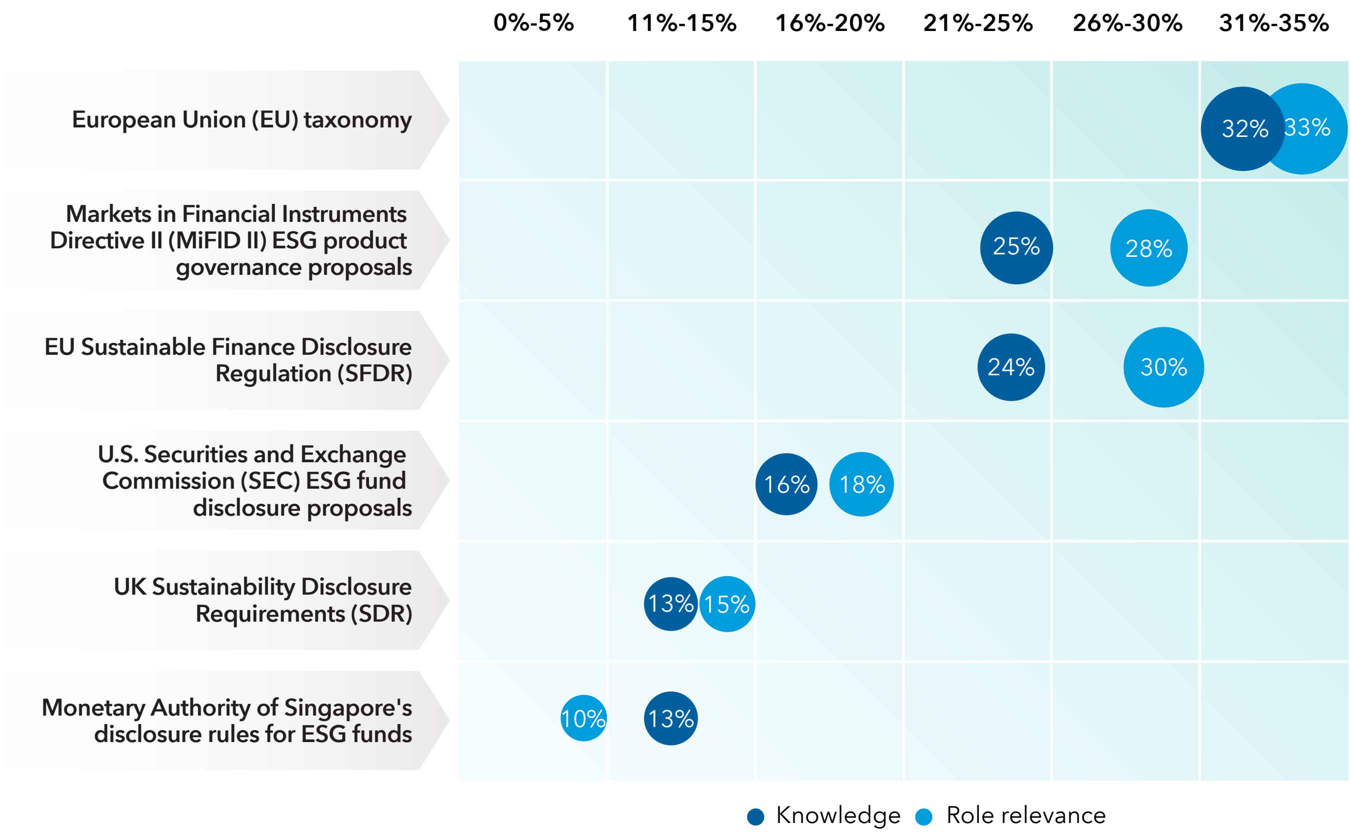
Keeping up with the complex assortment of different ESG regulations is proving challenging for investors.

For all regulations under review, only a minority of global investors claim to have strong knowledge. However, there is close correlation between levels of knowledge and relevance to job roles. For instance, global investors are most familiar with the EU taxonomy, with a third (32%) rating their knowledge as strong. And a near equal percentage (33%) say the EU taxonomy is important or relevant to their role.

Likewise, a quarter (25%) claim to have strong knowledge of MiFID II ESG product governance proposals and a similar proportion (28%) say it's relevant to their role. The same trend is seen with the EU SFDR (24% strong knowledge, 30% role relevance) and U.S. SEC proposals (16% strong knowledge, 18% role relevance).

Investors are therefore adopting a pragmatic approach based on focusing on those rules they need to understand to conduct their roles.

Regulatory knowledge and relevance



% Strong (Somewhat strong + very strong).
How would you rate your knowledge of these regulations, regulatory proposals and frameworks?
% Important (High importance + very high importance).
And how important/relevant are these regulations to your role?

12 Conclusion

Our study shows a significant number of investors are making progress overcoming a range of ESG hurdles. This is evident on the regulatory front, where they are devising their own ESG definitions and categorizations to counter confusion and complexity around fund labelling.

Progress is also being made in the data arena where investors are looking to circumvent the challenges of inconsistency by accessing multiple sources.

Many investors are breaking down longstanding ESG barriers through a pragmatic and flexible approach that utilizes their own resources and harnesses the expertise of asset managers.

And they overwhelmingly favour active managers as they seek effective engagement, alpha generation and opportunities to invest in transitioners as well as a broad range of ESG themes offering compelling financial and non-financial rewards.

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