

Sustainable Signals

The Asset Manager Perspective

Executive Summary

Sustainable investing has entered the mainstream, with two-thirds of asset managers surveyed now aiming to achieve competitive market-rate financial returns alongside positive social and/or environmental impact and with nearly nine in 10 familiar with the practice. This surge in activity has been spurred by rising investor demand and media coverage,¹ resulting in a proliferation of new products from specialist and mainstream asset management firms.

Sustainable Investing Trends at a Glance

Among 402 individuals surveyed at U.S. asset management firms:

89%

are familiar with sustainable investing

65%

practice sustainable investing

64%

believe its adoption will continue to grow

Yet:

62%

say proof of financial performance by sustainable investing products would increase firm's commitment

55%

say the field lacks credible data to inform decision-making

51%

are confident they can explain the non-financial impact of sustainable investing to clients

The perspectives in this issue brief are the result of a wide-ranging industry survey and in-depth interviews of more than 402 respondents at U.S. asset management firms; the survey was developed by Morgan Stanley Institute for Sustainable Investing and Bloomberg L.P. (see Methodology) between 2015 and 2016. The findings suggest that the asset management industry is seeing a mainstreaming of sustainable investing. Accordingly, we believe that this is an exciting and opportune time for asset managers and asset owners to assess how they can participate in the changing landscape of sustainable investing. What we heard from

asset managers in our study also suggests that the industry faces challenges that, if unaddressed, may hamper continued growth.

Interviewees frequently framed this moment as an inflection point in the industry. There is general excitement over growth amid complex change. Asset managers surveyed see diverse, shifting client demand and have varying opinions on what sustainable investing can deliver. Our analysis revealed that this is a moment that requires asset managers to make important decisions on the types of products to develop, how to size their sustainable investing practice and how to position themselves within the field.

Methodology

The Morgan Stanley Institute for Sustainable Investing and Bloomberg L.P. partnered to support the following analysis:

- In-depth interviews, conducted by staff of the Initiative for Responsible Investment (IRI) at the Hauser Institute for Civil Society at the Harvard Kennedy School, with employees at 17 asset management firms active in sustainable investing, primarily in the public markets. These firms were chosen because they have a historical track record of offering sustainable investment products, are new entrants to the sustainable investing field or have a noteworthy approach to sustainable investing. Interviews were conducted between July 13 and October 15, 2015.
- A quantitative survey, conducted by market research firm Edelman Intelligence, of 402 respondents at U.S. asset management firms that each manage at least \$50 million worth of assets. Respondents included employees from a range of professional roles, including C-Suite, senior executives, portfolio managers and analysts. The survey was conducted online and via phone from January 24 to February 17, 2016.

The interviews and survey utilized the following definition of sustainable investing: “The practice of making investments in companies or funds which aim to achieve market-rate financial returns alongside positive social and/or environmental impact.”

Throughout the report, “interviewees” refers to the group that was the subject of the qualitative work of the IRI team, while “survey” or “respondents” refers to the group that responded to the quantitative Edelman Intelligence survey.

We used these interviews and survey responses to inform our analysis of sustainable investing generally, participants’ institutional experience and their sense of opportunities, challenges and imminent changes in the field.

Note: This material was not prepared by the Morgan Stanley Research department and is not a Research Report as defined under FINRA regulations.

Our findings clarify the state of play, shed light on challenges to continued growth and provide actionable insights for asset managers and owners. The interviewees and survey respondents we engaged highlighted the following trends facing sustainable investing that inform the structure of this report:

				
Section 1	Section 2	Section 3	Section 4	Section 5
<p>Sustainable Investing and Asset Management: State of Play</p> <p>Investor demand and industry engagement to date</p>	<p>Responding to an Expanding Field</p> <p>The multifaceted nature of client and firm motivations to engage in sustainable investment, and what that means for asset managers</p>	<p>New Product Development: Opportunities and Challenges</p> <p>The development and marketing of new products that can both address client demand and signal credibility</p>	<p>Building an Effective Sustainable Investing Practice</p> <p>The key resource issues and capacity challenges facing firms looking to create, implement and expand a sustainable investment practice</p>	<p>Standardization and Scale in Sustainable Investing</p> <p>The financial industry's desire to standardize and scale investment products in a complex and evolving field</p>

In the conclusion, we offer insights and action steps for asset managers and asset owners based on our analysis.

Our findings (see summary below) confirm a rapidly growing appetite among asset owners for products that effectively and credibly deliver both financial and social returns. Together with our thought leadership partners, the Morgan Stanley Institute for Sustainable Investing aims for this brief to enhance industry

discussions on sustainable investing. For asset managers, we aim to help address this inflection point in the industry and leverage their strengths in bringing credible products to market. For asset owners, we aim to provide more clarity on current sustainable approaches and those in the pipeline, and to offer greater understanding of the ways asset managers are thinking about sustainable investing.

Key Findings

Industry engagement in sustainable investment is surging with a continued positive outlook.

The survey found that 89% of asset managers were familiar with sustainable investing, 65% currently practice sustainable investing and a further 19% work at firms actively planning to do so. Even among respondents at firms that don't practice sustainable investing, 52% believe adoption will increase in the next five years. Of respondents already engaged in sustainable investing, 54% plan new environmental, social and governance (ESG) strategies and 45% plan new sustainable thematic investment strategies in the next 12 months. This suggests to us

that many firms are thinking about this area in new ways and expect to see growth over the coming years.

Yet, as the field grows, firms are being forced to make decisions on their positioning within the market. Among asset managers interviewed, there was much discussion over the development of customizable products to address the diversity of client interests, demonstrating a spectrum of approaches ranging from styles that aim to be all things to all investors, to highly customized products.

Asset managers we engaged are divided on how they differentiate themselves to clients, an indicator that firms are wrestling with demonstrating credibility in sustainable investing.

Survey respondents reported three top factors as ways to differentiate themselves from their peers: a “strong firm reputation” (28%), offering customized “products tailored to the sustainability themes that matter most to clients” (28%) and offering “innovative and new sustainable investing products” (27%).

This pattern of responses highlights the differences we heard in interviews about what it means to develop a credible sustainable investing practice, complicated by varying opinions on what credibility along both financial and impact criteria means to clients, to internal colleagues and to external stakeholders.

Asset managers we engaged cite a wide variety of motivations behind their engagement in sustainable investing.

Client demand (29%) is clearly the leading motivator for sustainable investment, but far from a majority. Financial return potential (15%), personal values of leadership (10%), fiduciary duty (9%), global investment trends (9%) and portfolio risk management (8%) were also cited as leading motivating influences.

While client demand is not always the major driver behind asset managers' engagement in sustainable investing, for interviewees that saw this as a major motivating force, the diverse and

changing nature of client demand across all segments of the market was a significant source of debate. The variety in expressed client demand posed challenges not just for acting on existing demand, but also attempting to deduce future interests. Additionally, some interviewees pointed to an internal motivation to expand their sustainable investing practice tied both to financial opportunity and to a belief in the value of sustainable investing analysis.

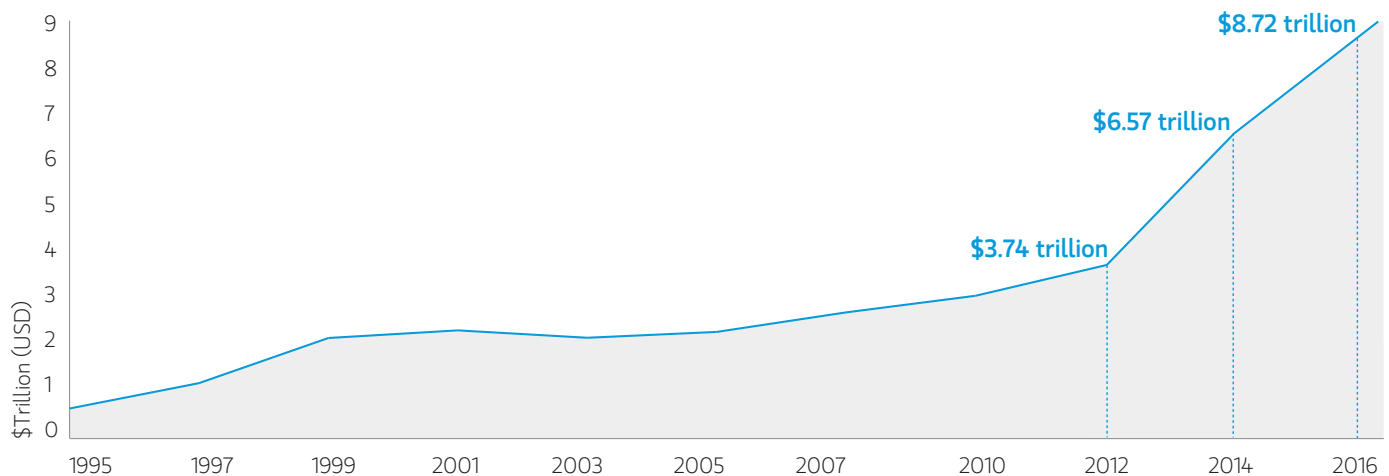
Sustainable Investing and Asset Management: State of Play

The past few years have seen a rapid rise in both institutional and individual investor interest and participation in sustainable, responsible and impact investing. Seven in 10 active individual investors (71%) are now interested in sustainable investing, according to a poll conducted by the Morgan Stanley Institute for Sustainable Investing,² with Millennials (84%) and women (76%) leading the way.

This trend is borne out by activity in the U.S. investment management sector where assets under professional management utilizing sustainable investing criteria grew 33% from the start of 2014 to \$8.72 trillion at the start of 2016, according to U.S. SIF: The Forum for Sustainable and Responsible Investment (see Figure 1).³

Professionally Managed U.S. Assets Utilizing Sustainable Investment Criteria

FIGURE 1



Note: U.S. SIF defines sustainable investment as “Sustainable, responsible and impact investing (SRI) is an investment discipline that considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact.”

How are asset management firms responding to this market transformation? Our analysis reveals a surge in the industry’s engagement in sustainable investing to meet client demand, with nearly nine in 10 (89%) respondents indicating they were familiar with the topic. This reveals the rapid progress the field has made in the past few years and the extent to which it has permeated mainstream asset management. Most asset

managers surveyed also believe that it’s important to implement sustainable investing practices (65%) and that adoption will continue to increase (64%). Even among survey respondents at firms that don’t currently practice sustainable investing, more than half (52%) believe its adoption will increase in the next five years.

How Familiar Are You With Sustainable Investing?

Interviewees described their firms as having significantly increased interest and paying greater attention to the field, which many considered to be at a turning point. Asset managers surveyed cited an influx of new players and intermediaries, with increasing coverage in the financial media of both sustainable investing and divestment campaigns as drivers. They also highlighted changes in client demand, from interest in product by previously disengaged clients to increasingly sophisticated questions about sustainable investing practices from engaged clients as well as and a simultaneous broadening of impact interest across ESG topics and deepening of interest in specific themes like water or human rights. In response, some

interviewees were looking to better integrate their boutique sustainable investing practices across their firms to take advantage of growing demand and to meet client needs. Others reported efforts to better communicate about how to reframe their existing products in the market.

Excitement over these market opportunities was tempered by concerns related to the field's rapid growth. Interviewees cited challenges in how to manage the internal growth necessary to take advantage of the expanding field, demonstrate real commitment to sustainable investing and signal financial sophistication and credibility in what is still perceived by many clients and peers as a new way of doing business.

“The landscape is changing rapidly. More people are getting educated in the space. Financial Advisors are saying ‘you can have a portfolio of this stuff!’ when before, no one even knew what ‘this stuff’ was or could speak intelligently about the issue. There’s been a proliferation of various kinds of product and specific products on specific themes — it helps in some ways, but hurts in others.”

– **Portfolio Manager**

“More mainstream players are broaching the topic. Players in the ESG space haven’t really articulated their objectives, but they know they need to be in the space. That’s the shift. It’s not more confusion, but [there is] less of a fervent niche interest that was clear, crisp and defined.”

– **Vice President**

Sustainable Investment Approaches

The financial services industry is meeting growing and varied demand by investors for sustainable investment vehicles with a wide range of sustainable investment products. These products can be organized into the following categories, among others:

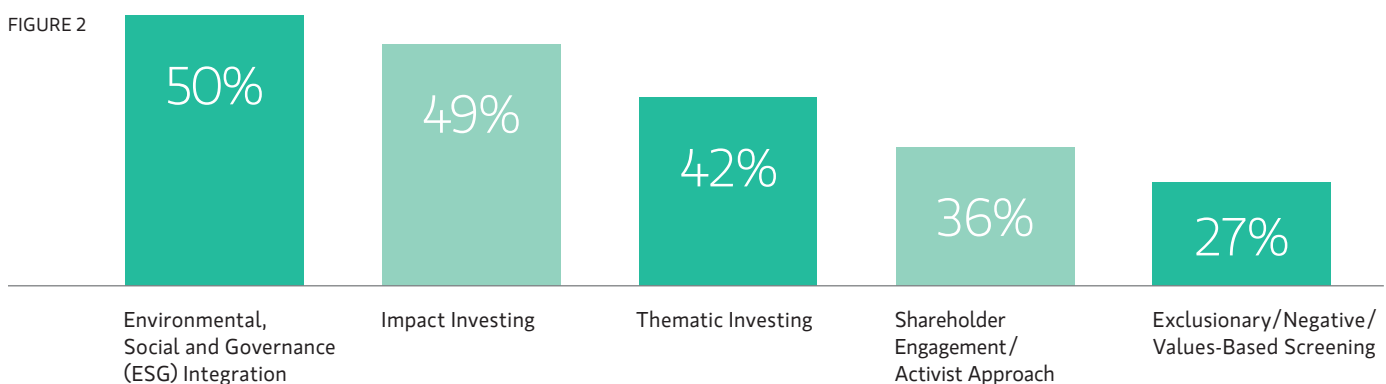
Values-Based/ Exclusionary Screening	Environmental, Social and Governance (ESG) Integration	Thematic Investing	Impact Investing
Managing exposures by intentionally avoiding certain investments, based on specific criteria.	Proactively considering ESG criteria alongside financial analysis to identify opportunities and risks during investment process.	Pursuing strategies that address sustainability trends, such as clean energy, water, agriculture, community building.	Seeking to make investments in funds or companies that intentionally generate measurable positive social and/or environmental impact.
Shareholder Engagement Voting proxies, signing shareholder resolutions or other shareholder activities that engage with corporations on ESG and sustainability issues.			

Our findings confirm that this broad, fragmented product landscape is reflected across the sample of U.S. asset management firms we engaged (see Figure 2). Among the 402 survey respondents, they indicated that their firms define sustainable investing products in different ways and provide a range of reasons for engaging in the field. Motivations given by interviewees ranged from using ESG analysis in order

to improve investment performance to creating sustainable investment products that signal commitment to values in line with those of potential clients. As Figure 2 illustrates, many respondents use more than one sustainable investing approach. ESG strategies, impact investing and thematic approaches are the most popular among all asset management firms and sustainable investing specialists surveyed.

Which of the Approaches Does Your Firm Currently Implement?

FIGURE 2



Drivers and Challenges

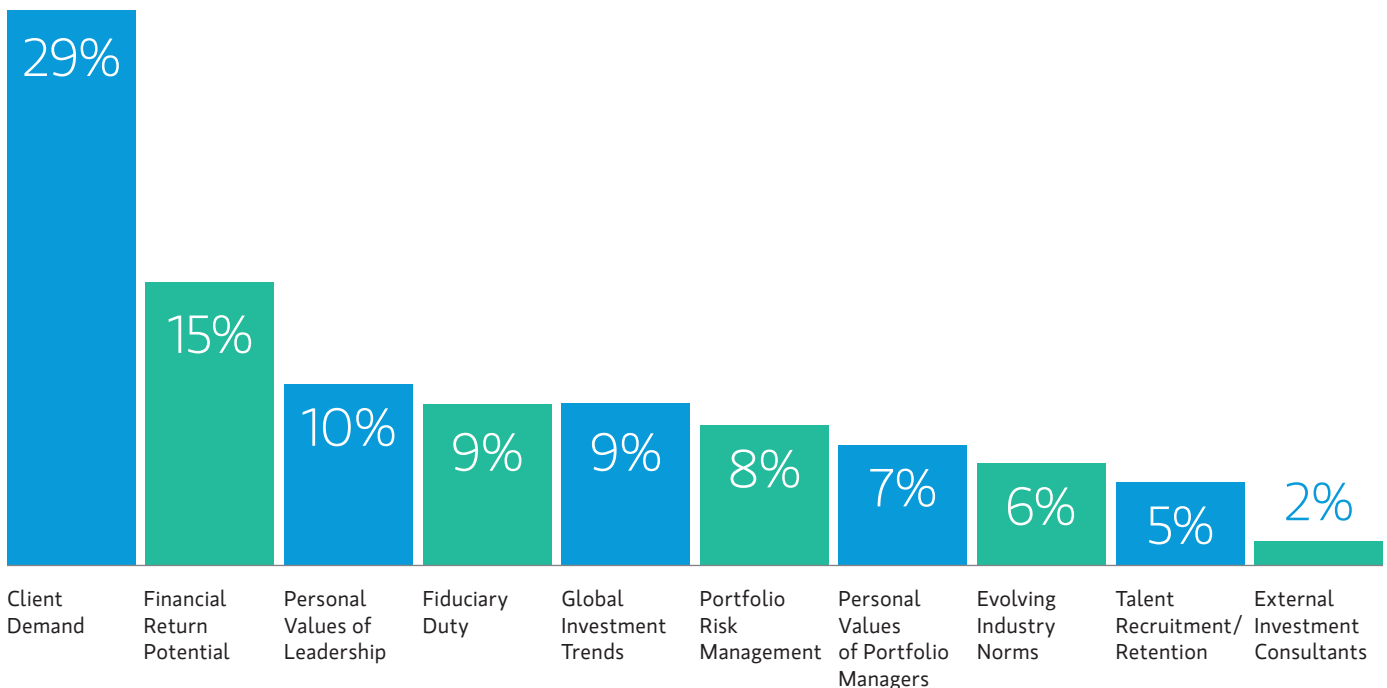
Several factors are behind the rapid mainstream adoption of sustainable investing (see Figure 3). First and foremost comes client demand, cited by almost one-third of respondents surveyed. But respondents also indicated that financial return potential, the personal values of company leaders, fiduciary

duty and global investment trends are key drivers. In addition, interviewees singled out the fossil fuel divestment movement in response to climate change as a major catalyst for recent conversations with both institutional and high net worth clients and as an issue that has raised overall awareness of the field.

Rank the Following Factors by How Important Each is in Driving the Adoption of Sustainable Investing at Asset Management Firms

FIGURE 3

Showing % who ranked each as No. 1



Responding effectively to this array of drivers creates challenges as well as opportunities as firms seek to capitalize on the sustainable investing boom. In interviews, some individuals reported struggling to position their firms effectively in a fragmented field, given the range of client demands and

approaches. Others cited the lack of clarity within asset management firms on what their clients are looking for as a major obstacle. Overall, interviewees reported widespread internal and external debates over what demand looks like, and what kind of products meet investor needs.

“It’s hard to meet what clients are asking for because homogeneity of demand isn’t there. How do you define impact? If we take everyone’s point of view into consideration, we can’t invest in anything anymore. We can’t make individual funds for everyone.”

– Senior Vice President

Responding to an Expanding Field

Meeting the increased client demand widely identified by individuals in our survey and interviews hinges on firms offering or devising investment products that clients find credible from both a financial and a social impact perspective. According to survey respondents and interviewees, credibility in this field means different things to different asset owners—beyond which type of products are offered. Our interviews showed that some clients value the ability to tailor a bespoke product to match their individual values. Others look for a firm that combines expertise in sustainability and social issues with a legacy of delivering on impact. Still others want to work with a large or mainstream financial firm that emphasizes financial return alongside strong sustainability integration across its portfolio. So, how can asset managers address this range of client demand?

Market Differentiation

In our view, asset management companies can best position themselves and their products by demonstrating credibility uniquely tied to the identity of their firm. When asked how asset management firms differentiate themselves in the sustainable investing market, survey respondents were almost evenly split into three main areas:

- “Has a strong firm reputation” (28%)
- “Offers customized sustainable investment products tailored to the sustainability themes that matter most to clients” (28%)
- “Offers innovative and new sustainable investing products” (27%)

Respondents identifying themselves as focusing exclusively on sustainable investing highlighted “demonstrates expertise in the sustainable investing market through in-house research” (25%) as one of their main differentiators.

We believe these responses reflect the complexity of the field, both in the variation of firm motives as well as firm interpretation of client interests.

“Demand for credibility is just emerging ... The financial community moves in a pack. It’s used to new products breaking into the market and everyone all of a sudden needing to have one ... This is a different model—it’s been around for a while, but now everyone has to have one.”

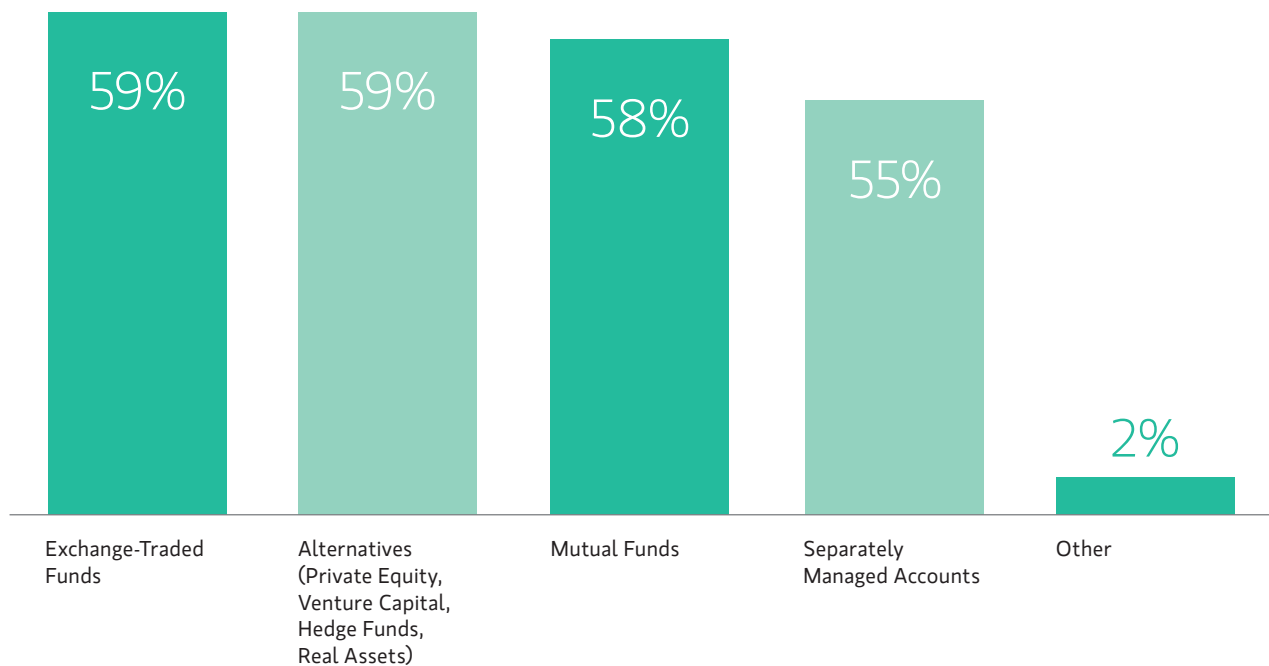
– Partner

New Product Development: Opportunities and Challenges

We believe our survey and interview results confirm that the field of sustainable investing is expanding across asset management firms, with 68% of all survey respondents identifying sustainable investing as a business-building strategy. Respondents already engaged in sustainable investing indicated plans to create more products, deepen existing strategies and publicize their sustainable investment activity. Some 57% of all respondents anticipated offering new sustainable products in next 12 months, with ESG (45%), thematic (38%) and impact investing (38%) being the top three approaches. Several interviewees highlighted products targeting new interests and themes, especially climate change, while some reported pivoting from niche products to integrate sustainable investment into their firm's broader strategy.

What Products Do You Offer?

FIGURE 4



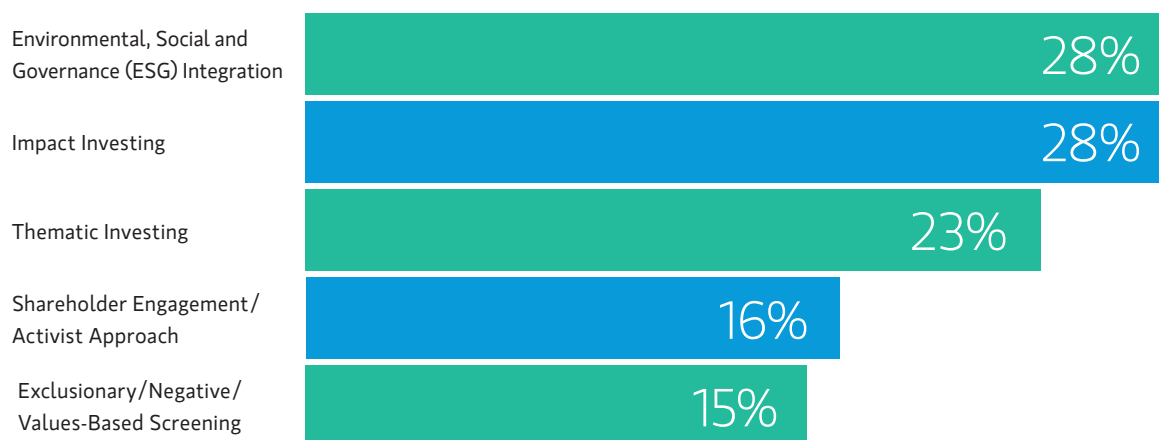
New Entrants' Product Focus

Among respondents not currently engaged in sustainable investing, 59% said they would begin implementing such approaches in the next 12 months. These “new entrants” plan to follow strategies that mirror the diversity of those already

engaged in sustainable investing (see Figure 5). While enhancing the number of offerings available for asset owners, this trend, in our view, could cause more confusion to the field if new products are not clearly defined and targeted.

Among New Entrants, Which of the Following Products is Your Firm Considering Offering in the Next 12 Months?

FIGURE 5



Challenges in Meeting Demand and Expectations

As they go about creating new sustainable investing products, asset managers we engaged reported concerns and challenges in meeting investor expectations. On the one hand, many interviewees believe that the developed market of existing products offers the right vehicles to draw in new investors. In contrast, they reported a desire to develop new products that meet investor expectations for financial and social returns in a way that investors themselves recognize and can buy into. They described this tension over whether to create new products manifesting in their firms in three ways:

- As a communications challenge
- As a more fundamental inquiry into the transparency of goals and approaches taken by investment managers
- As a practical question about how to help clients make informed decisions about new products

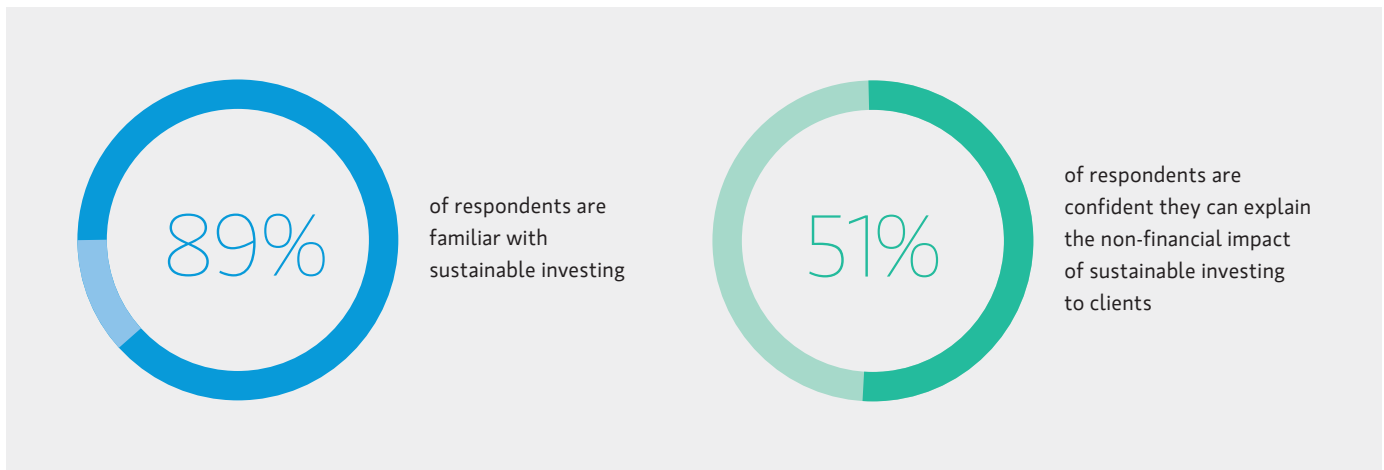
Avoiding a Lowest Common Denominator Approach

Many interviewees who focus on public market strategies expressed skepticism about the need for more highly tailored, bespoke funds addressing specific topics of interest to clients. The rise in technology-enabled financial market products, such as exchange-traded funds (ETFs), make it easy for asset managers to serve interested clients in this way at a low cost. But our interviewees viewed the proliferation of ETFs and rise of robo-advisors with concern, questioning the quality of the impact standards governing those products. Our assessment indicates that downward pressure on fees, the high costs of developing new products and diverse client demand could drive some firms to define a lowest common denominator for a new sustainable investment product or to simply repackage an existing offering.

Taking such an approach could clearly harm the credibility of the products' sustainability impact in the eyes of discerning clients. Our analysis suggests that firms would benefit from clearly signaling a product's goals and value proposition to asset owners by providing some methodological detail beyond a simple label like "sustainable" or "impact" or "responsible" investing. Providing this kind of clarity would not only demonstrate transparency and enhance credibility, but should also help address the challenge of differentiated demand by allowing clients to better identify the product that meets their needs and interests.

Building an Effective Sustainable Investing Practice

Given the opportunities and challenges described above, how can asset management firms best prepare to create or expand an effective sustainable investing practice? Beyond the issues of product choice and market positioning, what institutional factors are most important to success? Our study points to two major issues: the use and quality of business-relevant sustainability research and information, including data and analysis from a range of sources, and the internal capacity to run a sustainable investing practice.



Use of Business-Relevant Sustainability Research and Information

Our analysis demonstrates a clear challenge around quality sustainability research, potentially impacting firms' credibility with clients.

The individuals at the firms we surveyed took different approaches to research on sustainability—from buying a single third-party data set to building an in-house sustainable investing research team. Among the nearly half of respondents who use sustainability data, the top analytical resources in use were: third-party providers (49%), in-house research (48%) and third-party rankings or indexes (42%) (see Figure 6). Among those who turn to third-party specialists for sustainability data, 92% reported they were happy with their information providers. Yet 55% of all survey respondents believe there isn't enough

credible data and available research for asset managers to make informed decisions about sustainable investing. This is seen as a critical gap to fill. Almost half of respondents (48%) stated that better research/tools would boost their firms' commitment to sustainable investing.

Respondents from boutique sustainable investing firms viewed the issue as more critical, with 58% believing that better research and tools are the most important factor in further growing the field. These findings were reinforced in interviews with specialist asset managers who revealed that the third-party research being sold is not strong enough to support their practice. They also expressed concern over gaps in available data on sustainability.

Among the Nearly Half of Respondents Who Use ESG Data in Their Analysis, 49% Use Third-Party Providers, 48% Use In-House Research and 42% Use Third-Party Rankings or Indexes

FIGURE 6

Which of the following sources do you use?	
Third-Party Data Providers (e.g., Bloomberg, Thomson Reuters)	49%
In-House Research	48%
Third-Party Ratings, Rankings and/or Indexes	42%
Government or Agency Data	38%
Direct Company Engagement (e.g., Phone Calls, Questionnaires)	35%
Other Third-Party Research (e.g., Specialty ESG Research Firms)	35%
Sell-Side Research	26%

What Resources Does Your Firm Dedicate to Sustainable Investing?

FIGURE 7

What resources does your firm devote to sustainable investing?	
Employees trained to consider ESG risks and opportunities	42%
Some time is required from employees whose responsibilities are broader than sustainable investing	40%
All employees are required to consider sustainable investing	35%
Dedicated employees who focus only on sustainable investing	34%
Third-party consultant	25%
No current resources/employees committed, but intend to implement/hire in the next 12 months	13%
No commitment of resources	4%

Using Resources to Differentiate Sustainable Investment Offerings

Our analysis also highlights two significant internal capacity challenges among asset management firms looking to excel at sustainable investing:

- The ability of smaller, specialized firms to absorb new capital investments
- The knowledge and staff capacity required to carry out this work

Interviewees revealed that the ability to absorb new capital was a major concern for boutique sustainable investing firms, and also highlighted the struggle they face in handling substantial new inflows of investment with appropriate staffing. This presents a challenge when determining how to appropriately align their firms' growth to the expansion of sustainable investing overall. Across all individuals surveyed, 34% reported having dedicated employees who focus only on sustainable investing and 35% reported that all employees were responsible for considering sustainable investment (see Figure 7).

Our analysis also reveals evidence of a confidence gap. While 89% of respondents indicated they were familiar with sustainable investing, only 51% felt confident they could explain the non-financial impact of sustainable investing to their clients. Asset owners detecting a lack of confidence from asset managers could flag the discomfort as a warning sign. This suggests that further market growth may run into capacity roadblocks. In our view, firms have an opportunity to more closely assess the resources needed to take advantage of the growing sustainable investing market. For some firms, this might be adding dedicated sustainable investing staff, while others may need better knowledge of ESG issues to be integrated across existing investment management teams.

When building out a sustainable investment practice, asset managers view resources, research and staff essential to creating a credible investment product. Specifically, interviewees viewed credibility as a positive differentiator for both sound financial management and social and/or environmental impact. As described above, many firms use third-party research to integrate sustainability into investment decisions. However, simply adding widely available third-party data may limit the perceived differentiation of a firm's approach to sustainable investing. Asset managers can now access raw data from companies, utilize increasingly available sell-side equity research that integrates ESG data into valuations and rely on supplementary analysis from internal analysts and portfolio managers dedicated to understanding sustainability issues. In our view, asset managers who can articulate the value they derive in the portfolio management process from using a full spectrum of sustainable investing analysis tools will be at an advantage.

Standardization and Scale in Sustainable Investing

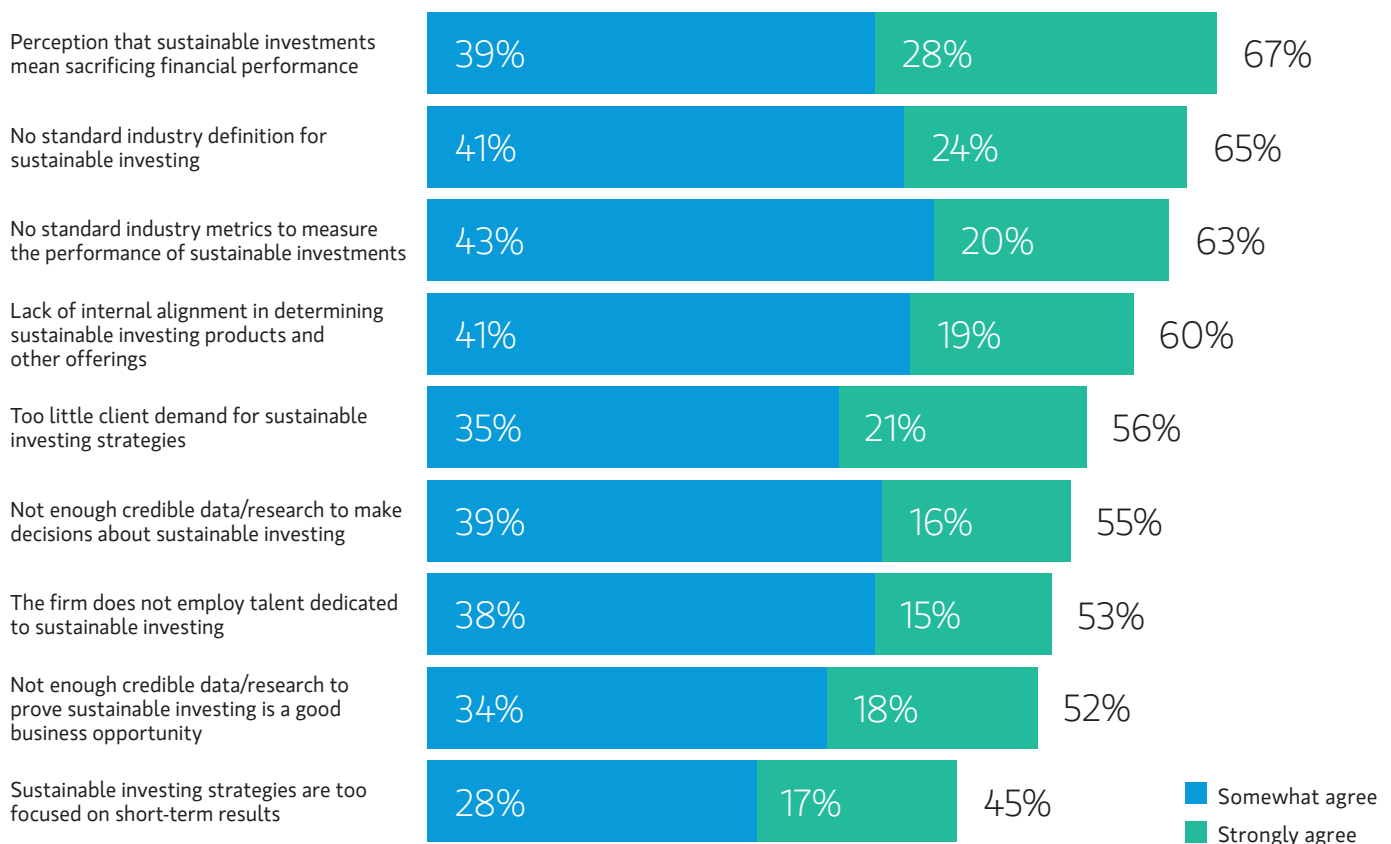
While sustainable investing appears poised to continue its growth, our study confirmed three commonly cited barriers to reaching standardization and scale in the field. Survey respondents highlighted the following overarching challenges:

- The persistent perception that sustainable investments mean sacrificing financial performance
- The lack of a standard industry definition for sustainable investing
- The lack of industry metrics to measure performance

Challenges Preventing Firms From Adopting Sustainable Investing Practices

FIGURE 8

To what extent do you agree that each of the following factors are challenges preventing firms from adopting sustainable investing practices?



Various efforts have aimed to address these long-standing barriers in recent years. They include performance meta-studies, coalition-promoted definitions of sustainable investing and multi-version, stakeholder-elaborated standards for metrics.

These efforts have been met with limited success, as evidenced by their persistence.⁴ Our analysis sheds light on why these barriers remain and how asset managers can address them.

Perception of Limited Performance Potential

The perception that sustainable investment means sacrificing performance is based on long-standing financial theory that narrowing the investable universe lowers returns. While there is research that counters this assumption,⁵ there is also a perception that it is not digestible or clear for the investment industry.⁶ This creates a significant barrier to convincing mainstream asset managers to engage in an unfamiliar investment approach. In fact, 42% of our survey

respondents agreed with the statement “investing sustainably means sacrificing investment returns.” Overcoming this cultural assumption inside asset management firms cannot be achieved by more return studies alone. Instead, in our view, communicating product development and performance in the terms and forms that managers themselves use might help turn the tide on this misperception.

Lack of Standard Definitions

The lack of a common industry definition for sustainable investing reflects both the challenges and the complexity of navigating client demand. There is a presumption that a clear, accepted definition will make it easy for firms to understand which investments do and don't meet sustainable investment criteria. However, our findings show that the market's complexity reflects the variety of asset owner motivations rather

than confusion over defining the field. This, in turn, suggests that a lowest common denominator approach won't adequately satisfy the range of investor demand. Instead, we believe asset managers should be clear and transparent about each specific sustainable investment product, thus allowing clients and consultants to navigate the market effectively.

Standard Industry Metrics

Concern over industry-standard metrics is an indicator of the credibility challenge. Widely used, comparable metrics for sustainability and impact provide an easy measurement for asset owners looking for reassurance that the underlying investment product has credible impact. At the same time, our analysis demonstrates that individual investors tend to be more interested in stories and themes that deliver the impact of their sustainable investment performance. In other words, rigorous, industry-standard metrics are valuable for the signal of credibility and trustworthiness they send to investors. However, it is the narrative of impact that can help signal alignment with investors' sustainability goals. Asset managers should be aware

of the difference between resonating with an investor's values and articulating how a focus on sustainability adds value to the investment thesis.

Overcoming these three core challenges, and building credibility in the market, will involve continued innovation and transparency by asset management firms. Our analysis suggests that neither more elaborate metrics, nor additional performance studies or even a campaign for shared definitions will be enough. For the field to continue to grow and deepen, asset managers must wrestle with these challenges in the context of each firm's management, culture and investment style.

Conclusion: What Comes Next?

Our analysis indicates that sustainable investing is at a turning point. Industry excitement and engagement in the field are at record levels. Yet, asset managers surveyed and interviewed worry that continued challenges, including navigating increasingly varied client demand and credibility, may impact the field's long-term growth.

So, what comes next? What should asset managers do differently in light of our survey findings? What can asset owners learn from the insights in this paper and how can they act on them?

A key takeaway for asset managers is that the best approach in the sustainable investing market is to leverage their firm's strengths and focus on its unique value proposition in designing the products they bring to market. To maximize opportunities and develop credible products, both mainstream and boutique firms might also need to invest more resources in growing their sustainable investing business. With the trend of market growth in their favor, any investment of resources will likely be rewarded as sustainable investing continues to grow.

Asset owners are facing a multifaceted and potentially confusing market. It can feel as though there are many sustainable investment products (in general) and not enough (given each asset owner's unique perspective/structure) at the same time. In our view, the ideal starting point to navigating the many and varied products on offer is for asset owners to clearly identify their sustainable investing and/or impact objectives. Asset owners can then work with consultants and current investment managers to map these priorities across their asset classes to find the right options on the market. If the products they seek are not immediately available, asset managers should engage with industry partners and closely monitor the rapidly growing and changing field for new product developments.

Deeper Insights for Asset Managers and Asset Owners

Meet persistent barriers identified as holding back mainstream adoption of sustainable investing head on.

Many asset owners new to the field are unclear about the sustainable investment approaches they are looking for. Asset managers can attract assets if they address this directly. Those who can provide clarity on the following issues will also help their firms target the type of client best suited to their offering(s):

- Defining their firm's approach to sustainable investing and how a focus on sustainability is adding value to the investment process

- Displaying the strategy's performance against appropriate asset-class benchmarks (both traditional and ESG-specific indexes)
- Explaining how nonfinancial data is being used as an input during the portfolio management process

Develop client support mechanisms to address the confidence gap that exists among asset managers in practicing sustainable investing.

Asset managers need strong support in their interactions with clients, leadership and peers—including education, tools, case studies and proof points—to build their confidence in and comfort with sustainable investing. Asset owners seek both metrics that demonstrate credible impacts of the products they

invest in and thematic stories that help them understand this impact in the world. Asset managers should become fluent in delivering these indicators of credibility to clients in the context of their firm's management, culture and investment style.

Break down internal barriers to support sustainable investing—even at firms that embrace it—so it is no longer a siloed activity.

Firms can drive integration of sustainable investing strategies into company culture and portfolio manager activity through a combination of incentives, knowledge-building and messaging, based on growth areas and proof points. Recruiting and training

dedicated and integrated expert staff are also factors in future growth. Asset owners are more likely to view this dedicated, integrated focus as value-add for both sustainability and financial performance.

Which of the Following Best Describes Your Firm When It Comes to Practicing Sustainable Investing?

FIGURE 9

65% of respondents work at firms that practice sustainable investing



As sustainable investing market infrastructure continues to evolve, we look forward to tracking how asset managers choose to fit their investment strategies into this spectrum of engagement (see Figure 9). Looking ahead, we believe that the sustainable investment space will see continued growth and

adoption across asset management firms of all sizes and types. Firms that can authentically leverage their strengths to achieve competitive market-rate financial returns alongside positive social and/or environmental impacts will be well positioned to thrive in a rapidly changing asset management landscape.

Notes

- 1 "The Rise of Sustainable Investing," U.S. News & World Report, September 15, 2015 (<http://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2015/09/15/the-rise-of-sustainable-investing>; accessed on July 12, 2016) "The Growth of the Responsible Investment Industry," *International Banker*, April 11, 2016 (<http://internationalbanker.com/finance/growth-responsible-investment-industry/>; accessed on July 12, 2016)
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