

Recent Trends in Sustainable and Responsible Investing in the United States

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Today, nearly one out of every eight dollars under professional management in the United States is invested according to strategies of sustainable and responsible investing (SRI), also known as socially responsible investing. More than 12% of all investment assets under professional management in the United States—\$3.07 trillion out of \$25.2 trillion at the start of 2010—are held by individuals, institutions, investment companies, or money managers that use one or more of three key strategies of socially responsible investing: 1) incorporation of environmental, social, and governance (ESG) issues into investment management, 2) filing shareholder resolutions on ESG issues, and 3) community investing.

These findings are based on surveys and research that the US SIF Foundation (formerly Social Investment Forum Foundation) commissioned in 2010.¹ Through this research process, the Foundation identified

- \$2.5 trillion in assets held by institutional investors or money managers to which various *ESG criteria* are applied in investment analysis and portfolio selection;
- \$1.5 trillion in assets held by institutional investors or money managers that filed or co-filed *shareholder resolutions* on ESG issues from 2008 through 2010; and
- \$41.7 billion in assets deposited or invested in community development banks, credit unions, venture capital funds, and loan funds that have a specific mission of *community investing*.

These three segments of assets, after eliminating for double-counting of assets involved in more than one of the three strategies, yield the overall total of \$3.07 trillion.

This article will provide a brief overview of sustainable and responsible investing in the United States, beginning with a review of its growth over the last 15 years. It will explain SRI as an investment discipline and identify key SRI strategies. It will then summarize how and why institutional investors and, in turn, money managers are practicing SRI today.

THE GROWTH OF SRI

Over the long term, SRI has shown steady growth in the United States. For example, in 1995, when US SIF Foundation published its first report on sustainable and responsible investing trends, \$639 billion—9% of the \$7 trillion in total assets under professional management in the United States—were identified as using SRI strategies. In 1999, the Foundation's research tracked continued rapid growth in sustainable and socially responsible investing, with SRI assets increasing to \$2.16 trillion. By 2005, the Foundation found that sustainable and responsible investing had kept pace with the broader U.S. financial market, growing to an estimated \$2.29 trillion in assets under management. And from the start of 2007 to the opening of 2010, a three-year period when such broad market indices as the S&P 500 Index declined and the broader universe of

professionally managed assets increased less than 1%, assets involved in sustainable and socially responsible investing increased more than 13%.

In cumulative terms, the SRI universe has increased 380% from 1995 to 2010, while the broader universe of assets under professional management in the U.S., according to estimates from Thomson Reuters Nelson, has grown 260%.

In the last several years, the pool of assets engaged in SRI strategies has grown more rapidly than the overall investment universe due to a number of factors, including net inflows into existing SRI products, the development of new SRI products, and the adoption of SRI strategies by managers and institutions not previously involved in the field.

SUSTAINABLE AND SOCIALLY RESPONSIBLE INVESTING DEFINED

Sustainable and responsible investing is an investment discipline that considers environmental, social, and corporate governance criteria to generate long-term competitive financial returns and positive societal impacts. Traditionally, responsible investors have focused on one or more of three strategies: ESG incorporation into investment analysis and portfolio construction, shareholder advocacy, and community investing. SRI practitioners include asset managers, investment advisors, and asset owners. Among the owners of investment assets, both individual and institutional investors are actively involved in SRI strategies, and the types of institutions taking ESG matters into account range widely, from foundations and endowments to hospitals and healthcare plans, from state and local governments to private corporations, from faith-based institutions to other nonprofit organizations.

There is no single approach to, or motivation for, socially responsible investing. Some investors embrace SRI strategies to manage risk and fulfill fiduciary duties. Others are driven by their personal values, their institutional mission, or the demands of their clients, constituents, or plan participants. Some are seeking hidden sources of alpha (financial outperformance); others are seeking long-term sustainable social and environmental impact. Many institutions and individuals mobilize SRI strategies for a complex combination of reasons.

Just as there is no single approach to SRI, there is no single term to describe it. Depending on their emphasis, investors use such labels as “sustainable investing,” “responsible investing,” “impact investing,” “mission-related

investing,” “ethical investing,” “values-based investing,” and “green investing,” among others.

Far from being a static enterprise, SRI is an evolving form of finance, and the proliferation of approaches underscores this basic dynamism. As the United Nations Principles for Responsible Investment have highlighted, “[t]here is a growing view among investment professionals that environmental, social, and corporate governance issues can affect the performance of investment portfolios.”² As an investment discipline, SRI strategies can be mobilized across asset classes within portfolios, and increasingly, investors are applying ESG investment techniques not only to public equity investments, but also to real estate and alternative investments, such as private equity and venture capital.

What unites these diverse investment approaches—and what ultimately distinguishes them from the broader universe of assets under management in the United States—is precisely the explicit incorporation of ESG issues into investment decision-making, fund management, or shareholder activities. The specific ESG factors and the way they are used may differ widely from investor to investor, and tactical and technical considerations are often specific to an institution or fund manager. But the basic strategies of SRI share sufficient features to be observed and measured.

SOCIALLY RESPONSIBLE INVESTING STRATEGIES

Socially responsible investing strategies work together to promote responsible business practices and to help provide social and environmental benefits across the economy.

ESG incorporation involves the application of explicit ESG factors into the investment process. In sustainable investing, asset managers frequently complement traditional, quantitative techniques of analyzing financial risk and return with qualitative and quantitative analyses of ESG policies, performance, practices, and impacts.

As an investment discipline, ESG incorporation can be a process of identifying and investing in companies that meet certain standards of corporate social responsibility (CSR) or that reflect the values or mission of the investor. This may include issues such as environment, health, and safety; diversity and human resources policies; and human rights and the supply chain.

Asset managers and asset owners may incorporate ESG issues into the investment process in a variety of ways. Some may screen their portfolios by excluding or

avoiding companies with poor CSR track records or by positively filtering a portfolio for companies that have stronger CSR policies and practices. Others may incorporate ESG factors to benchmark corporations to peers or to identify “best in class” investment opportunities based on CSR issues. Still other responsible investors integrate ESG factors into the investment process as part of a wider evaluation of risk and return.

Shareholder advocacy involves actions sustainable investors take as asset owners. These efforts include communicating with companies on ESG issues of concern. For owners of shares in publicly traded companies, shareholder advocacy can also take the form of filing and co-filing shareholder resolutions on ESG issues and actively voting their proxies in support of such resolutions. Proxy resolutions on ESG issues generally aim to improve company policies and practices and to promote the long-term concerns of shareholders and other stakeholders. Some sustainable investors also speak out for legislative and regulatory changes that will lead to greater corporate accountability and disclosure on ESG issues.

Community investing directs capital responsibly from investors and lenders to communities that are underserved by traditional financial services. It provides access to credit, equity, capital, and basic banking products that these communities would otherwise lack. In the U.S. and around the world, community investing makes it possible for local organizations to provide financial services to low-income individuals and to supply capital for small businesses and vital community services, such as affordable housing, child care, and health care. In recent years, the term “impact investing” has gained currency as a broader term to encompass community investing and other investments—mostly through private placements—in businesses that create social or environmental benefits alongside financial returns. Many SRI practitioners assert that community investing (and impact investing) does not represent a separate strategy of SRI so much as an array of alternative asset classes that merit consideration for inclusion in many investors’ portfolios.

ESG INCORPORATION AND SHAREHOLDER ADVOCACY BY INSTITUTIONAL INVESTORS

Institutional investors dominate the \$3 trillion in assets in the U.S. market implementing sustainable and socially responsible investing strategies.³ A wide range of institutions, including public employee retirement plans, government-sponsored college savings plans, philanthropic foundations, educational endowments,

hospital and healthcare plans, and faith-based investors, are the primary owners of \$2.03 trillion in assets to which they apply a wide spectrum of environmental, social, and governance factors. Institutions incorporate different kinds of ESG criteria in various ways. Many avoid or exclude companies that do not meet certain ESG standards, while others proactively seek investments that generate positive social or environmental impacts. Still others incorporate ESG factors to manage risk and pursue more sustainable investment outcomes. Increasing numbers of institutional plan sponsors are also making SRI options more commonly available to plan participants, particularly in defined-contribution retirement and college savings programs.

Additionally, many institutional investors are active shareholder advocates, pressing managements of portfolio companies to improve disclosure or management of corporate political spending, environmental policy (especially with regard to climate change), and overall sustainability. They have urged portfolio companies to adopt governance reforms so that directors and executives act in the long-term interests of the companies, shareholders, and other stakeholders. The institutional investors that filed or co-filed shareholder resolutions on ESG issues from 2008 through 2010 control more than \$858 billion in assets.

The combined assets of institutions that either incorporate ESG criteria or engage in shareholder advocacy by filing shareholder resolutions amount to \$2.3 trillion, or 75% of the total SRI assets identified by US SIF Foundation in its 2010 survey and research.

Among institutional investors, *public funds* managed for federal, state, county, and municipal governments, including public employee pension plans and other publicly pooled portfolios, incorporate ESG criteria across \$1.46 trillion in ESG assets, the largest share of institutional assets.

Investment criteria related to Sudan have displaced tobacco as the most prominent ESG factor incorporated into institutional investment policies, in asset-weighted terms, pulling ahead of the dollar value of assets affected by anti-tobacco policies. U.S. student and civic campaigns to oppose the genocidal policies of the Khartoum government have resulted in legislative mandates in states and cities and targeted divestment by dozens of educational endowments. Philanthropic foundations and faith-based investors have also incorporated Sudan-related investing criteria into investment policy. In total, US SIF Foundation identified \$1.34 trillion in institutional assets as subject to Sudan criteria.

ESG INCORPORATION AND SHAREHOLDER ADVOCACY BY MONEY MANAGERS

The US SIF Foundation's 2010 survey also identified \$569 billion in 493 funds that incorporate ESG criteria. Key trends in the growth of ESG incorporation by money managers include the following:

- 250 *mutual funds* from 65 fund families and with \$316.1 billion in total net assets at year-end 2009 were identified as incorporating some form of ESG criteria into investment management. The overall number of mutual funds incorporating ESG has increased 45% since 2007, while the total assets affected by ESG criteria in mutual funds have risen 11%. (These figures include \$176.9 billion in assets underlying variable annuity portfolios, most of which represent the assets of annuity funds and accounts managed by TIAA-CREF, which, in addition to its separate annuity funds incorporating multiple ESG criteria, divested from companies with business operations in the Sudan across its entire firm.)
- 26 *exchange-traded funds (ETFs)* that incorporate ESG criteria were identified with \$4.0 billion in assets at the end of 2009. This represents a 76% increase in assets from the eight ETFs, with \$2.25 billion in total net assets identified in 2007.
- 177 *alternative investment vehicles*, ranging from social venture capital and double- and triple-bottom-line private equity funds to hedge funds and responsible property funds, had estimated assets and capital commitments totaling \$37.8 billion at the beginning of 2010. This is up dramatically from the 46 alternative investment funds with \$5.3 billion in the ESG space tracked for the first time in 2007. These private investments are providing dynamic growth within the universe of investment vehicles that incorporate ESG issues into portfolio management, often on very highly targeted themes such as clean technology, responsible property investment, or sustainable community impact. Given the much more limited disclosure available in the alternative investment space, this \$37.8 billion figure represents a conservative estimate of the assets managed via hedge funds, private equity, and property investment vehicles.

In addition to the funds summarized above, the research process identified for the first time more than 232

distinct ESG *separate account vehicles* with more than \$122 billion in assets, managed by 85 investment advisors.

A number of money managers with substantial aggregate assets also practice shareholder advocacy in addition to, or instead of, ESG incorporation. US SIF Foundation identified 26 asset managers with assets of \$637.9 billion in assets that filed or co-filed shareholder resolutions on ESG issues from 2008 through 2010. (More than three-quarters of these firms also consider ESG criteria in the portfolio selection process.)

The Leading ESG Criteria Incorporated by Money Managers

Across the full spectrum of ESG investment vehicles, including separate accounts, Sudan-related investment criteria have replaced tobacco as the most prevalently incorporated ESG factor, in asset-weighted terms. *Sudan* policies affected 269 vehicles with more than \$446 billion in assets at the beginning of 2010. Managers have applied Sudan-related criteria in a variety of ways and for various reasons. Some managers are registering human rights concerns about the genocide in Darfur, while others are managing the risk associated with doing business in a region marred by civil strife and authoritarianism. Still others are simply responding to client demand and helping institutional plan sponsors in particular meet Sudan-free mandates.

Tobacco is the second most frequently incorporated ESG factor and second in asset-weighting as well, affecting 361 funds with more than \$235 billion in assets.

However, *environmental factors* are now the most frequently incorporated criteria, in numerical terms, affecting 390 vehicles with more than \$101 billion in assets under management. Factors related to climate change or clean technology are applied in 297 funds with \$66 billion in assets. This makes them the smallest ESG funds, on average, reflecting the growing "cleantech" trend among smaller venture capital and private equity funds within alternative asset classes. Toxics and pollution are criteria incorporated into the management of 207 funds with more than \$52 billion in assets, while other environmental issues affect the management of more than \$75 billion in 277 funds.

Money Managers' Motivations for ESG Incorporation

A subset of 107 managers with more than \$552 billion in ESG assets under management provided insights on

their motivations for the incorporation of ESG factors by responding to additional questions in the 2010 survey. The vast majority cited demand from clients, but at least half also saw ESG incorporation as a way to manage portfolio risk or improve long-term performance. Specifically,

- 91 managers (85% of this subset), with more than \$530 billion in ESG assets, cited client demand.
- 60%, with \$443 billion in ESG assets, pointed to the desire to help bring about societal and environmental benefits as a reason for incorporating ESG factors.
- 58%, representing \$446 billion in assets, said they assessed ESG criteria in order to help fulfill their institution's or client's mission.
- 53%, representing \$524.4 billion, said they consider ESG criteria in investment analysis in an effort to manage risk.
- 50%, with \$522.5 billion in assets, said they review ESG issues in order to enhance financial returns.

OUTLOOK

As the US SIF Foundation's surveys over the years have demonstrated, interest in sustainable and responsible investing issues is not a passing phenomenon, but one that has gathered adherents and assets over the last 15 years. Indeed, sustainable and responsible investing has gradually taken market share from the conventional investment universe. Money managers are increasingly incorporating ESG factors into investment analysis, decision making, and portfolio construction because their clients are demanding it. Institutions are incorporating ESG factors partly because of legislative requirements. At the same time, mission-driven institutional investors are increasingly seeking impact investing opportunities. Managers are consequently rising to meet this demand, particularly with alternative investment vehicles. Environmentally themed investment products and services are growing at a particularly rapid pace and becoming more targeted in their approaches. Frustration with mainstream banks has also encouraged increasing interest in community development financial institutions.

Several trends suggest that this growth will continue. One motivation is academic literature pointing to links between ESG factors and corporate financial performance. A recent assessment of 36 academic papers published between 1995 and 2009 concluded that 20—more than half—found evidence of a positive rela-

tionship between ESG factors and financial performance, and only three found evidence of a negative relationship.⁴ In addition, numerous high-profile corporate scandals in recent years have underscored that lax corporate ethical and environmental practices can damage shareholders financially. The challenges of climate change and growing population pressures on world resources are motivating many investors to assess their portfolios to identify companies and sectors best positioned to manage these risks and to offer innovative solutions.

ENDNOTES

¹This article is excerpted and adapted from the *2010 Report on Socially Responsible Investing Trends in the United States*, published by US SIF Foundation. Available at <http://ussif.org/resources/pubs/trends/>. The 2010 report is the eighth edition of a series that the Foundation began publishing in 1995.

²The United Nations Principles for Responsible Investment (UNPRI) have been developed as an investor initiative in partnership with the UN Environment Programme Finance Initiative and the UN Global Compact. More than 870 asset owners, investment managers, and other investment service providers from around the world, with combined global assets of \$25 trillion, have become signatories to the UN PRI. See www.unpri.org.

³For the purposes of this report, an institutional investor is any asset-owning institution or investment plan sponsor, in contradistinction to individual investors, whether retail or high-net-worth individuals, and asset management firms. Although the capital of asset management firms is sometimes considered to be "institutional" within the financial services industry, ESG incorporation by money managers is analyzed separately in this article. The main types of institutional investors analyzed are pools of investment assets sponsored by corporations, faith-based institutions, foundations, endowments, hospital and healthcare plans, labor unions and Taft-Hartley pension plans, and public authorities, such as public employee retirement systems, college savings plans and other government-sponsored pools, as well as other nonprofit organizations. Institutions that did not respond to information requests or do not make their assets or ESG criteria publicly available are not captured in these figures.

⁴"Shedding Light on Responsible Investment: Approaches, Returns and Impacts." White Paper, Mercer Consulting, November 2009: <http://www.mercer.com/surveys/1363935>.

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