Responsible investing: from a niche strategy to a global trend
The consideration of environmental, social and governance (ESG) risks and performance is becoming increasingly crucial to investment analysis and decisions with the aim of realising full potential. Investments that include ESG criteria are often called responsible investments. Responsible investing is therefore about how to invest money in order to create both financial and non-financial value. Non-financial value is generated through achieving a positive impact on society and environment. Managing investments in such a way that the impact is positive for both the company and society presents a win-win situation. While the link between ESG issues and value creation has turned out to be difficult to measure, there is clear evidence of a growing demand from private (i.e. high net worth individuals (HNWI)) and institutional investors (i.e. pension funds, insurance, etc.) for responsible investment. As well as this, there is an increase in initiatives engaging with responsible investment.

**The following examples illustrate this trend:**

- The Dow Jones Sustainability Indices (DJSI) – a Swiss innovation with global relevance – have become well-established benchmarks for a growing number of investors that consider good ESG performance essential to their investments. Each year, over 3,000 of the world’s largest companies are invited to participate in the RobecoSAM Corporate Sustainability Assessment (CSA). Today more than 830 of the biggest companies from 42 different countries are participating. This number has been growing year by year as the chart below illustrates:

![Increasing participation of companies in DJSI over the years](chart.png)

CAGR: + 7.4%
Another well-founded and established financial market index is the CDP, which has two sets of indices: the Climate Disclosure Leadership Index (CDLI) and the Climate Performance Leadership Index (CPLI). The CDP indices are ratings showing, transparently, the carbon emissions and the performance related emission reduction activities of a company. In 2015 more than 822 institutional investors, representing in excess of 95 trillion USD in assets, supported CDP in engaging with companies worldwide to disclose and ultimately manage climate change issues in order to create and sustain long term value for shareholders and society.

Also well recognised is the FTSE4Good index series. It was created to measure the performance of companies which implemented strong ESG practices. The FTSE4Good criteria is applied to the FTSE Developed Index series, which covers 23 markets and over 2,000 potential constituents.

The Green Bond Index (GBI) is designed to identify the fixed income market’s funding projects and initiatives with direct positive environmental impacts. The issuance of green bonds amounted to almost 40 billion USD worldwide in 2014.

Clear evidence of a growing trend can also be seen in the evolution of various initiatives to increase the quality of existing definitions and indices and strive for more transparency. The best known are the UN Principles for Responsible Investment (UN PRI), the OECD Declaration on International Investment and Multinational Enterprises, the Environmental and social principles of the European Investment Bank, the Equator Principles, UNEP FI Guide to Banking and Sustainability, the Green Bonds Principles, and the Natural Capital Declaration. The UN PRI – as the most relevant of them – had 1,262 signatories from more than 30 countries in October 2014, 62 thereof are Swiss signatories (i.e. Suva, Nest Sammelstiftung, City of Zurich Pension Fund (PKZH), etc.). The PRI represents 45 trillion USD of assets under management.

Strong interest but still low market share

Despite the strong interest in responsible investment, the market share is still relatively small but shows significant potential for growth. Whereas in the United States the growth in sustainable assets under management (AuM) has been relatively gradual over the past 15 years, Europe has shown considerable momentum in this respect. The Forum für Nachhaltige Geldanlagen (FNG) describes the increasing interest in and potential of sustainable financial products in Europe. In 2013 they show that in Germany, Austria and Switzerland there was an overall increase of 12 percent to a volume of 135 billion EUR (approx. 166 billion CHF). In Switzerland they show a volume of 56.7 billion CHF. Since 2005, the volume has increased by 23 percent per year on average. In 2014 it increased by a volume of 17%.

The trend shown is accompanied by a growing number of green financial products such as green loans, sustainable project finance, green, ethical or social funds, microcredits, micro insurance, etc. It is assumed that this trend will continue and according to the FNG study, financial institutions predict an increase in the volume of responsible investments in Switzerland of 20 to 50 percent for the next three years.

However, the volume of responsible investments overall is still quite low compared to total investment volume with a share of approximately 4 percent. Even with the optimistic growth scenario of 50 percent over the next three years, experts believe that the share of the overall investment volume of responsible investments will most probably not reach the 6 percent threshold.

1 (Credit Suisse, 2012, p. 2)
2 (Dittrich, Kunzlmann, Tober, & Vögele, 2014, pp. 35–36)
Corporate responsibility and sustainable investments are relatively new trends. As is always the case with new trends a healthy debate about relevance and definitions is ongoing. The ultimate need for action does not only rest with the actors in the financial market but also with the regulating or aligning bodies who may have a role in setting the level playing field.

- Although all responsible investment vehicles have in common that they include to a certain extent environmental, social and governance (ESG) criteria, there is no universal definition available of what a responsible, sustainable or green investment is and what disclosure requirements have to be fulfilled. Research has identified that many responsible investment initiatives lack clear and transparent disclosure and communication.

- There is a wide range of initiatives for responsible investing, sustainability standards, labels and indices for the financial market, yet they differ in how they incorporate ESG criteria. Most of them are phrased rather vaguely and allow room for interpretation. The sustainable financial products also lack definitions and criteria and should therefore be analysed regarding their actual impact. Aspects of that issue may also lead to ambiguous statistics as only clear and unambiguous definitions allow appropriate tracking of their development.

- Investment funds are some of the most promising vehicles for responsible investment. However, the complex tax structure in Switzerland, especially the withholding tax and stamp duty, creates a disincentive for the establishment of sustainable funds. Furthermore, due to complex regulations setting up a fund in Switzerland takes much more time than, for example, in Luxembourg. This causes challenges for the Swiss financial market in staying competitive when specifically addressing responsible investment objectives.
Responsible investment and return on investment

One of the key issues in the sustainability debate is the link between responsible investment and its financial return. The empirical evidence is clear: by investing responsibly there is no sacrifice in financial return, on the contrary, recent research shows that long-term financial returns are less volatile and above average. Evidence is delivered by two meta-studies, one conducted by Mercer and one by Deutsche Bank. The Mercer study called ‘Shedding light on responsible investment: Approaches, returns and impacts’ concludes that out of 36 studies examined, 20 studies show evidence of a positive relationship between ESG factors and financial performance and only three show evidence of a negative relationship.\(^3\)

The Deutsche Bank study which surveyed more than 100 studies on sustainable investing around the world states that sustainable companies are more stable in value and less prone to crises. They correlate with superior risk-adjusted returns at a securities level. Companies which perform well in sustainability and ESG ratings have lower costs in terms of debt (loans and bonds) and equity. This is due to the fact that these companies are identified as low risk. The study also shows that sustainability and financial performance correlate from a market as well as from a balance sheet perspective. Normally, during the last financial crisis sustainable companies exhibited a better performance than non-sustainable ones (better down-side-performance).\(^4\)

However, a meta-study (including 162 studies) published by the University of Zurich states that the impact of corporate social responsibility in regard to return on investment is in effect neutral but there is a bias in the related reporting about it. A so called positive bias towards or overestimation of the efficiency.\(^5\) A recent study published by Credit Suisse finds that investments in financial vehicles, which integrate certain ESG criteria, have a positive impact on economic return. The study states however, that it would be presumptuous to claim that they have superior performance compared to conventional investments at all times. These studies disprove the widespread assumption that sustainable investments are not profitable or create an exposure towards additional risks.\(^6\)

PwC conducted a study in 2015 among 60 investors from 14 countries on ‘aligning the responsible investment interests of limited partners and general partners’. We concluded that 88% of limited partners believe that there is added value in responsible investment and nearly all believe it will increase in importance over the next two years.\(^7\)

Yet another PwC study was conducted in 2013, called ‘Putting a price on value’ looking at private equity (PE) and its approach to ESG issues. The link between ESG issues and value creation proved to be difficult to measure. Even the most sophisticated private equity (PE) houses see the challenge in understanding, quantifying and communicating the value that good ESG management can deliver, not only the risks that can be mitigated.\(^8\)

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\(^3\) (Mercer, 2009, p. 2)
\(^4\) (Deutsche Bank, 2012, p. 5)
\(^5\) (Rost & Ehrmann, 2015)
\(^6\) (Credit Suisse, 2012, p. 3)
\(^7\) (PwC, 2015)
\(^8\) (PwC, Putting a price on value, 2013)
Conclusion

Even though the positive impact on financial and non-financial value of responsible investing needs to be investigated further and there are no clear and common definitions in place for many ESG aspects, the resulting market is growing. The potential for investment principles to support sustainable development is not yet being fully realised and the jungle of definitions, initiatives, studies and products needs to be untangled in order to achieve more transparency. Given that there is still a growing interest and increasing activity in the responsible investment market, there is, first of all, a need to analyse which of these responsible investment products already has the biggest positive financial and non-financial impact on financial performance and society. Then consideration should be given to which measurements would be adequate for this product. This should be followed by diligent and accurate research of all the existing guidelines, principles and standards for that product. In any given case an alignment of those indicators/products and guidelines is only achievable when the different companies and associations communicate about the competitive advantages and advance together in one direction. This is best done in coordination with one of the existing standard setters. An overarching standard would then serve as leverage for other products internationally.

PwC services

- Responsible investment strategy and policy development
- ESG due diligence in transactions
- CDP and DJSI coaching
- Total impact measurement and management
- Responsible investment portfolio management
- Green bonds creation and development
- Sustainability assurance services
Bibliography


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