Sustainable Investing

BlackRock

Capital at risk.

The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

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The environmental, social and governance ("ESG") considerations discussed herein may affect an investment team's decision to invest in certain companies or industries from time to time. Results may differ from portfolios that do not apply similar ESG considerations to their investment process.

What is sustainable investing?

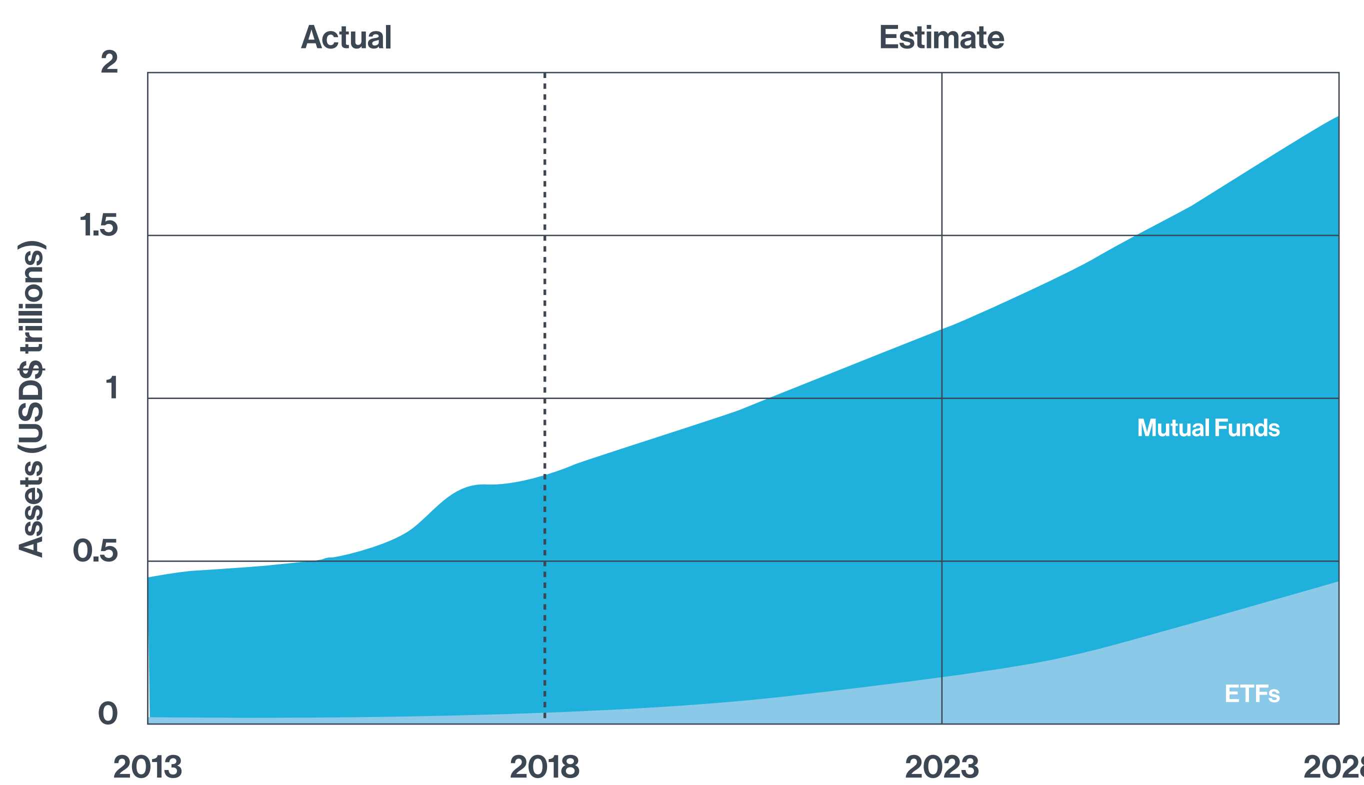
Sustainable investing is about investing in progress, and recognising that companies solving the world's biggest challenges can be best positioned to grow. It is about pioneering better ways of doing business and creating the momentum to encourage more and more people to opt into the future we're working to create.

Through the combination of traditional investment approaches with environmental, social and governance (ESG) insights, investors ranging from global institutions to individuals are taking a sustainable approach to pursuing their investment goals.

Growth of sustainable investing

Assets in dedicated sustainable investing strategies have grown at a rapid pace in recent years, and this trend is showing no signs of slowing.

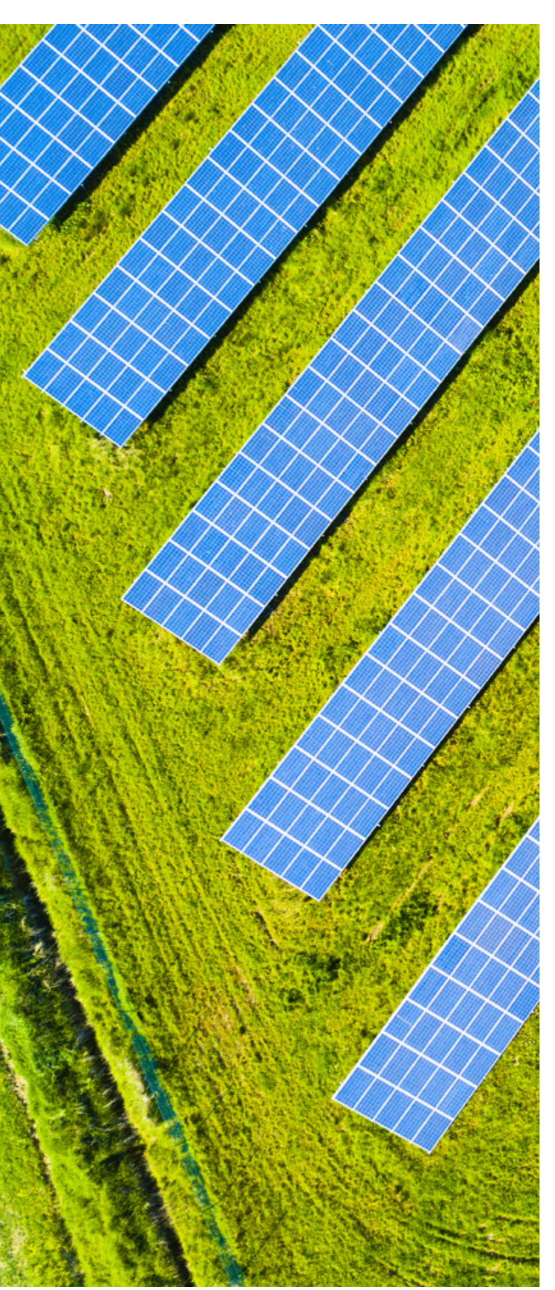
Sustainable Swell
Assets of sustainable mutual funds and ETFs, 2013-2028



There's no guarantee that forward-looking estimates will come to pass.

Sources: BlackRock, with data from Broadridge/Simfund, June 2018. Notes: The chart shows the total assets under management in ESG mutual funds (MFs) and ETFs globally. The 2019 to 2028 figures are based on BlackRock estimates, assuming a 5% annual growth rate in the underlying markets. Other assumptions: MF asset growth starts at 5% in 2019 and declines by 0.5% annually through 2022, then at a zero to-0.5% rate annually thereafter. ETF asset growth starts at 45% and decreases by 5% annually through 2022, with a zero-to-3% pace thereafter.

What is driving the growth of sustainable investing?



The number and diversity of investors looking for sustainable opportunities are on the rise for several reasons:

1. Future financial decision-makers are asking more of companies and are seeking more sustainable investment solutions.

2. Regulators and governments are expanding their focus on incorporating sustainability into investment information and decision making.

3. There is growing recognition that ESG research and analysis can potentially identify investment risks and generate excess returns.

How to invest sustainably

We draw a clear distinction between dedicated sustainable investing products and the process of integrating sustainability-related data or insights into existing investment processes.

Sustainable solutions

There is a wide range of products available to investors looking for dedicated sustainable investment solutions. At BlackRock, we distil client motivations into a spectrum from Avoid to Advance.

- "Avoid" strategies involve the elimination of certain companies or sectors that are associated with increased ESG risk or which violate the asset owner's values.
- "Advance" strategies focus increasing exposure to positive ESG characteristics to align capital with certain behaviours or target specific positive social or environmental outcomes.

ESG Integration

ESG integration is the practice of incorporating ESG information into investment decisions to help enhance risk-adjusted returns, regardless of whether or not a strategy has a sustainable mandate. There is no one-size-fits-all approach but at BlackRock we see it as being about making research, data and insights available to all of our portfolio managers and working with them to identify potential process enhancements across all investment activities.

There is increasing awareness that material environmental, social and governance (ESG) factors can be tied to a company's long-term performance. As such, more and more investors are looking to integrate sustainability insights and data into their traditional investment processes. By expanding access to data, insights and learning on material ESG risks and opportunities in investment processes across the board, we can become better overall investors.

What is ESG?

ESG is often conflated or used interchangeably with the term "sustainable investing." We see sustainable investing as the umbrella and ESG as a data toolkit for identifying and informing our solutions.

ESG data is most often categorised as "non-accounting" information because it captures components important for valuations that are not traditionally reported. The valuation of companies has become more complex, with a growing portion tied up in intangible assets. ESG metrics provide insights into these intangibles, such as brand value and reputation, by measuring decisions taken by company management that affect operational efficiency and future strategic directions.

Environmental (E)

Covers themes such as climate risks, natural resources scarcity, pollution and waste, and environmental opportunities

Social (S)

Includes labour issues and product liability, risks such as data security, and stakeholder opposition

Governance (G)

Encompasses items relating to corporate governance and behaviour such as board quality and effectiveness

The ESG considerations that are material will vary by investment style, sector/industry, market trends, and client objectives.

ESG integration is about using research, data and insights to inform investment decisions.

Sustainability issues can contribute to a company's long-term financial performance, and thus further incorporating these considerations into the investment research, portfolio construction, portfolio review and stewardship processes can help enhance long- term risk adjusted returns.

ESG integration is...	...and is not
Arming portfolio managers with tools and information to identify risks and opportunities within portfolios	A value-based exercise
Enhancing the investment process and implementing this across all our portfolios	Addressing stakeholder concerns by applying exclusionary screens based on immaterial ESG information
Making investment decisions that take financially material ESG information into account	Simply developing ESG versions of existing products while leaving processes unchanged

Sources: BlackRock Sustainable Investing and BlackRock Investment Institute, December 2019.
Note: The table is for illustrative purposes only

ESG integration at BlackRock

Our activities to integrate sustainability considerations into the investment process mirror the diversity of clients we serve, as well as the range of investment strategies and asset classes we offer. Across BlackRock, we provide all of our investment teams with data and insights to keep them well informed of sustainability considerations.

Each of our investment teams is responsible for implementing ESG approaches in line with its investment mandate and is required to have a formal ESG integration statement to underpin its respective approach. Our portfolio managers are able to bring useful ESG information into their investment processes, discounting or emphasising this information as they would any other financial input.

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any financial instrument or product or to adopt any investment strategy.

Sam Tripuraneni
Responsible Investing, BlackRock

A word from our author

Sustainability in Defined Contribution: Implementing for the long term

When I started writing this blog, I was determined not to talk about COVID-19. On reflection, that was a fruitless effort. Not mentioning the pandemic would have been comparable to denying that we're living through extraordinary times.

And yet, for all the focus on the responses to the crisis, it has not gone unnoticed to me that we're also witnessing an increased interest in sustainable investing amongst UK pensions investors (Source: BlackRock DC Pulse 2021).

For someone working in sustainable investing, COVID-19 has inadvertently given me the chance to step back and look at "ESG (Environmental, Social and Governance)" with fresh eyes. We have seen how the temporary (and, hopefully more permanent) reduction in carbon emissions, has cleansed the riverways of Europe and reduced the air pollution levels in the cities of India and China. We have also noticed that our collective increased scrutiny of how companies have been treating and interacting with their workforce during the crisis– allowing us to reflect on "purpose" and the little brother in the room - the "S."

The way we invest is being directly impacted by all this.

In the case of UK Defined Contributions (DC), things have moved even faster.

There is an increased understanding, and desire, to move closer to a framework that Nordic pension schemes have operated at for the past 10 years. For UK DC, the time to make the move to ESG appears to be now.

However, I want the conversation to move away from the well-trodden "what ESG methodology" should a UK DC scheme use. That is something specific to each scheme, and there are many screened and ESG index options available in the market for people to choose from. What to me would be more pertinent to focus on are the considerations around long-term investing.

The time is nigh – how to do it?

At BlackRock we believe that investors should choose ESG when they believe it will deliver better risk adjusted returns over the long term.

What has been really interesting to realise in my conversations with large UK DC schemes and default providers over the past 6 months, is that we are seeing "active views" being taken – where clients move past the more general "ESG" concept and start taking specific views on climate change as an investment risk, or overweighting their investments with strong governance ratings.

This reveals an investment conviction in the materiality of risks and opportunities.

The Department for Work and Pensions (DWP) requirements for the consideration of non-financial material factors has driven the need for the consideration of what trustee's believe are E, S and G risks and opportunities in their portfolios.

Sustainable funds (particularly optimised ESG indexes favoured in the UK) have now had their first market crisis with which to score them – and crucially, for the most part, have performed as we expected them to – i.e. they have demonstrated a resilience akin to the quality and minimum volatility factors we have long known and have had a positive correlation to ESG ratings.

But it is not easy moving allocations – particularly as the focus remains (and will do so for the time being) on the large global passive equity exposures that make up growth phases (Source: BlackRock as at June 2020).

There is, of course, a cost implication to this. In terms of investment products, nothing is as cheap (management fee) nor as efficient (additional expenses) as a Market Cap index – in some cases, the fees associated with investing in an ESG index fund might be two or three times higher than the traditional market cap parent index.

This is where having conviction in ESG is important – why pay more if you don't believe in ESG or at the very least if your members are not asking for it? The DWP are certainly not forcing it (yet!).

What we have seen over this cycle is that additional cost may be rewarded in performance (or through minimising the downside). When you take the longer term horizon of DC members in growth phases, more and more of these E, S and G risks begin to manifest. We have been through this process ourselves when deciding that our UK target date range, LifePath, was ideally suited to the long-term view of an ESG fund to deliver its global equity exposure.

We did not want to make one large transition, as that would have incurred high costs. So, we decided to allocate over time using the new flows from contributions and building the allocation that way. It was a long-term investment view and therefore by approaching it that way LifePath members receive the benefit of the research led investment, whilst not being impacted by the higher cost.

Conclusion

My suggestion to investors is for them to consider if they believe that E, S and G risks are material enough for them to do something about it.

Understanding why they are investing in a specific ESG fund makes the implementation easier. It does not all have to be on day one. Allocation through contributions can reduce cost and ESG can pay for itself through performance, if investors are willing to consider the long-term. It is with a simple investment premise of understanding the materiality of E, S and G risks that BlackRock are dedicating our research to.

We believe that in these extraordinary times, there will be change and, if now is the time to invest in ESG, then we can help our clients navigate that change as smoothly as possible.

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BlackRock DC LifePath UK Risks

Credit Risk: The issuer of a financial asset held within the Fund may not pay income or repay capital to the Fund when due.

Equity Risk: The values of equities fluctuate daily and a Fund investing in equities could incur significant losses. The price of equities can be influenced by many factors at the individual company level, as well as by broader economic and political developments, including daily stock market movements, political factors, economic news changes in investment sentiment, trends in economic growth, inflation and interest rates, issuer-specific factors, corporate earnings reports, demographic trends and catastrophic events.

Derivative Risk: The Fund uses derivatives as part of its investment strategy. Compared to a fund which only invests in traditional instruments such as stocks and bonds, derivatives are potentially subject to a higher level of risk.

Liquidity Risk: The Fund's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Fund may not be able to realise the investment at the latest market price or at a price considered fair.

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss. Tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

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Email: PMIQualifications@Pensions-pmi.org.uk
Twitter: https://twitter.com/pmipensions
LinkedIn https://www.linkedin.com/company/pensionsmanagementinstitute
Website www.pensions-pmi.org.uk

Registered office:

Devonshire House
60 Goswell Road
London
EC1M 7AD

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