Remaking markets one portfolio at a time

Janine Guillot September 24, 2019

As an investor, the goal is to manage your portfolio to meet specific risk and return objectives. As a responsible investor, that goal takes on an additional facet: achieving your desired risk-return profile in a way that improves the resilience of your portfolio—and of financial markets—over the long term. After all, who says today's returns have to come at the expense of tomorrow's?

However, although interest in sustainable investing has grown rapidly, markets have been slower to develop the basic tools — let alone the structural underpinnings — needed to fully support this type of big-picture, long-term approach to investing. The good news? Recent market innovations indicate those shortcomings may soon be a thing of the past.

The evolution of ESG

For years, active asset managers have led the way in integrating environmental, social, and governance (ESG) considerations into the investment process, seeking attractively priced issuers with strong financial and sustainability fundamentals. For example, at the Sustainability Accounting Standards Board (SASB), the earliest users of our standards included a number of fundamental managers, who applied SASB's framework to their analysis of equity and fixed income issuers. Similarly, active fund managers were among the first investors to license SASB standards and intellectual property for use in their investment processes. Long before ESG was a mainstream buzzword, these investors helped move the needle by facilitating the allocation of capital to companies with clear strategies for long-term value creation — and they continue to do so today.

Meanwhile, index fund managers have increasingly joined the charge, further expanding the options available to investors who want to pursue an integrated ESG strategy across multiple asset classes. For example, State Street Global Advisors (SSGA), which has licensed the SASB framework since 2017, recently used it to develop R-Factor™, a unique ESG scoring system designed to address market concerns about ESG data quality, availability, and relevance to investors. Similarly, by building on the work of SSgA, SASB, and others, Bloomberg this week launched an innovative family of equity and fixed income indices that enable investors to apply SASB's financial materiality-based framework to passive ESG strategies.

Tomorrow's investment tools today

By employing focused, transparent methodologies that "offer companies a roadmap" on how to benchmark ESG performance and disclose their ESG practices, these emerging products move ESG forward in an important but often overlooked way: they incentivise corporate performance on a market-informed subset of business-critical, industry-specific ESG factors. As such, they're terrific examples of the market bringing materiality-based ESG investing to life. Indeed, we have always viewed SASB standards as important market infrastructure that can help investors integrate ESG factors into decision making in a rigorous, scalable way.

It goes without saying that the SASB Foundation, our governing body, has an interest in any capital market infrastructure that may incentivise companies to more effectively measure, manage, and report on the financially material ESG factors identified by the 77 SASB industry standards. These new tools are purposefully designed to both enhance corporate disclosure practices and incentivise improved performance on SASB metrics. For example, State Street shares R-Factor scores with companies through its stewardship program, creating positive feedback loops, while the Bloomberg SASB ESG indices explicitly incorporate specific SASB performance metrics into their methodologies. From transparency to performance and back again, the intended result is a virtuous cycle of improved market efficiency.

It is for these reasons that, since 2014, the SASB Foundation has licensed its standards and related resources to power a variety of investment strategies, platforms, and products. In addition to those mentioned above, examples include investment strategies from Russell Investments, services from TruValue Labs and RepRisk, and indices developed by ET Index. The Bloomberg SASB ESG family of indices is the latest addition to a growing array of SASB-powered tools available to all types of investors.

Sustainability at scale

Collectively, the expanding array of SASB-based investment tools presents a unique opportunity to advance SASB's mission. Our purpose is not just to create disclosure standards for their own sake, but as a mechanism for building more resilient and efficient capital markets that can support sustainable economic growth.

We believe the recently announced Bloomberg SASB ESG indices, along with the R-Factor scores that underly them, will help accelerate corporate reporting on key sustainability factors and, by extension, improved corporate performance on those factors. Furthermore, they will enable us to reach even more companies and investors to invite them into our standard-setting process, thereby ensuring the standards retain their technical rigor and continue to reflect a broad, balanced range of market perspectives.

The SASB standards are designed to facilitate a simple but powerful idea — that the key to unlocking sustainable, long-term value creation is viewing ESG through the lens of financial materiality. Academic research has shown the SASB approach can help companies enhance business outcomes, including their return on sales, sales growth, return on assets, and return on equity, in addition to improved risk-adjusted shareholder returns.

But the promise of SASB standards will only be realised if they are just that: widely used market standards. Incorporating SASB standards into an array of investment tools and products helps establish the standards as an essential tool for companies to communicate ESG performance to their investors. The Bloomberg SASB ESG indices are not the first step along that path, and they won't be the last. This is because widespread use of SASB standards incentivises not just ESG transparency, but ESG performance — which is ultimately what benefits companies, investors, and society at large the most.

Transforming markets together

At SASB, we believe 21st century challenges call for innovative solutions. For too long, sustainability disclosure has been viewed as a burden for companies — with companies unclear as to whether and how investors use sustainability information. With financial materiality as their North Star, today's forward-thinking investors are exploring the common ground where sustainability and finance intersect, unlocking value for active, passive, and hybrid portfolios and portfolio companies alike.

Indeed, as the research shows, when sustainability efforts are well-aligned with corporate strategy, they can deliver benefits for all types of investors, across all asset classes, and over a range of investment horizons. And when sustainability investment tools are well-designed — with appropriate transparency and clear links to financial outcomes — they have the power to transform not only individual portfolios but the global capital markets in which they operate.