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PURCELL COMMUNICATIONS

Values-Based Investing Terminology – An Overview of Usage

CONCLUSIONS

- The largest asset managers are coalescing around two preferred terms when discussing values-based investing: "Responsible Investing" and "ESG."
- There is room for both terms. Responsible Investing is seen as a top-down label for strategies that incorporate personal values, or constructive social outcomes, into their investment decisions, while ESG describes the data that is used to make those investment decisions.
- Advisors and wealth managers remain reluctant to talk about values investing in any systematic way.
- While the top asset managers talk a lot about "responsible investing" and "ESG" in their marketing, they don't consistently provide clear follow-through in later reporting.

We talked in our recent paper that the No. 1 communication problem for values-based investing (the generic term that we use to describe these strategies) is the complex, confusing terminology surrounding it. In personal conversations, stakeholders from many parts of the industry argue passionately for different terms and definitions.

We wanted to get a clearer picture of what investors see when they explore investing options that fit with their values. To do that, we conducted an overview of public-facing websites and other data sources to determine *who* is saying *what*, and what conclusions we could draw from those trends.

Tackling the Communication Challenges of Values-Based Investing — A Series

Murky Terminology | Evolving Context | Stubborn Perception

This is the first in a series of three reports we are creating, looking at the three biggest communications challenges for values-based investing.

To receive more reports like this one, email us at admin@purcellcom.com and we'll add you to our contact list.

WHAT THE LARGEST ASSET MANAGERS ARE SAYING

One thing we've noticed about the values-based investing industry is that it includes a lot of different stakeholders, such as nonprofits and institutional investors, who don't have a long history of talking to one another. These separate domains have developed their own language preferences.

But we suspect that it will be the major asset managers who ultimately drive the terminology in this industry. Money talks, and when BlackRock (the world's largest asset manager) talks about responsible investing, people pay close attention to the language the company uses.

We thought it would be beneficial to look at the largest asset managers to see what terminology trends emerge. Interestingly, even a few years ago, this wouldn't have been possible. Until recently, there wasn't enough values-based investing discussion among traditional asset managers to merit the study. How times have changed! Now, almost all of the top 100 asset managers[1] are addressing values-based investing (see **Figure 1**).

As a reminder, "ESG" stands for "Environmental, Social, and Governance" and generally refers to a set of measures that have been developed to assess corporations on these three key aspects of social responsibility. And it is a very popular term, right up there with responsible investing as the most popular label for values-based investing.

But what are the biggest players saying? When you adjust for assets under management (AUM), ESG takes the lead (see **Figure 2**).

In fact, 5 of the 10 largest asset managers — Vanguard, State Street, BNY Mellon, Capital Group, and PIMCO — use ESG as the primary label for their values-based investment strategies. Interestingly, while responsible

Figure 1: What Primary Term Do the 100 Largest Asset Managers in the World Use to Describe Values-Based Investing?

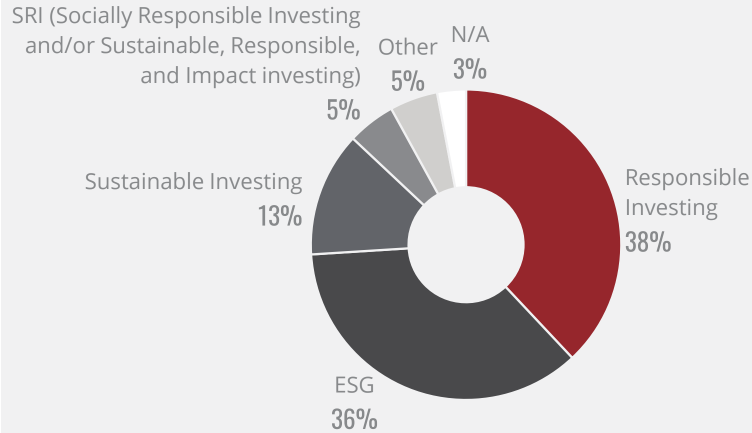
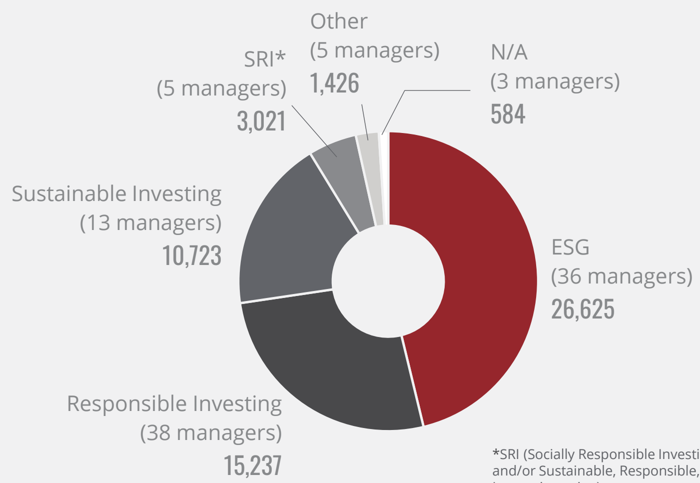


Figure 2: 100 Largest Asset Managers — Primary Term by AUM
Total AUM in 2019 (€B)



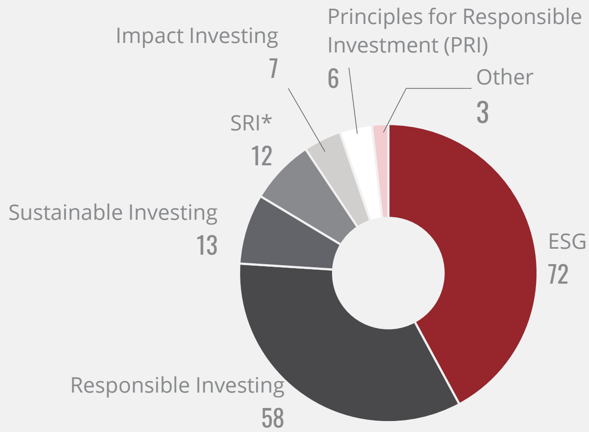
*SRI (Socially Responsible Investing and/or Sustainable, Responsible, and Impact investing)

[1] *https://www.ipe.com/Uploads/j/e/b/Top-400-Asset-Managers-2019.pdf*

investing is used nearly three times as much as sustainable investing, it only has a slight lead in terms of AUM. However, this is mostly driven by BlackRock's use of sustainable investing as a term, accounting for just about half of sustainable investing's AUM.

This trend really caught our eye: When using responsible investing or sustainable investing as a primary term, companies will use ESG as a secondary term to help describe what they are talking about. When we include for primary and secondary terms, ESG becomes a big leader (see **Figure 3**).

Figure 3: **100 Largest Asset Managers — Primary or Secondary Term**



*SRI (Socially Responsible Investing and/or Sustainable, Responsible, and Impact investing)

We found that 23 of the top 25 asset managers use ESG in some way. And those that use ESG as a primary term are more likely to let it stand on its own (44% use no other terms), compared to those who use responsible investing as a primary term (61% use ESG as a secondary term).

ONGOING DEBATES

Our own discussions with key players have suggested that the industry is slowly coalescing around "responsible investing" (and to a lesser extent, "sustainable investing") as the **what** – an umbrella term indicating a prominent role for personal values in the investing process. Meanwhile, "ESG" is the **how** – an emerging scorecard for determining the impact your investments are having. This data supports these conclusions.

We can be reasonably confident that, over time, "responsible investing" and "ESG" will become the favored terminology in this industry. But the matter is not entirely settled just yet, because what these companies mean when they use these terms is still hotly debated.

WANT TO HEAR WHAT YOUR COLLEAGUES ARE SAYING?

> If you would like a copy of the notes taken at our recent Industry Summit, where we discussed values-based investing terminology, contact us at admin@purcellcom.com.

The ESG label is a source of particularly contentious debate. Some asset managers use ESG data as indicators of thoughtful, risk-averse, forward-focused corporate management. Here's an example — a quote from Ron O'Hanley, president and CEO of State Street.

"As stewards of our clients' assets, we are deeply invested in understanding the environmental, social and governance issues (ESG) that are material to a company's ability to generate sustainable performance."

Notice how he uses the ESG term not to indicate a commitment to social responsibility, but in terms of sustainable *performance*. Profitable management skill is valuable, but it's not exactly what values-based investors are asking for.

Other companies, however, go exactly the opposite direction, using ESG as a way to connect to values-based goals. For example, notice how PIMCO describes their ESG strategies as having a goal of “positive change” *in addition to* financial returns:

“PIMCO’s … ESG strategies are founded on the belief that it’s possible to achieve both attractive financial returns and positive change.”

So while the preferred terminology might be clearing up, what that terminology means still remains murky. And that can be problematic for advisors and wealth managers, who must answer those questions for clients.

AS SEEN ON BLACKROCK.COM

> *“We see sustainable investing as the umbrella and ESG as a data toolkit for identifying and informing our solutions.”*

RUBBER, MEET ROAD

The large asset managers may be well placed to set the terminology, especially among institutional investors. But for individual investors, it’s advisors and wealth managers that are on the front lines of describing and explaining values Investing.

Part of the reason we chose “values-based investing” as our own generic term at the outset is because that’s what advisors are doing. Anecdotally, many advisors have told us that they dispense with the terminology challenges altogether. They focus on getting clients to articulate the values they want their investments to be aligned with.

Outside of those personal conversations with clients, however, we’re noticing a strong reluctance by the large wealth management organizations to talk broadly about the topic. In fact, only 2 of the 20 largest wealth management firms mention any sort of values-based investing on their public websites, and only 4 of the biggest 20 registered investment advisors mention it.

We understand why — it’s hard to know which clients care about values investing, and it’s safer to let the client be the one to bring it up. But this is a missed opportunity in an era where increasing numbers of investors want values-based investing options. When 97% of asset managers are talking extensively about values investing, and only a handful of advisors are doing so, there is a clear disconnect.

AS SEEN ON JANUSHENDERSON.COM

> *“Responsible investment is the term Janus Henderson uses to cover its work on environmental, social and corporate governance (ESG) issues in the companies in which we invest.”*

FOLLOW THROUGH IS INADEQUATE

One key reason why advisors are having trouble talking about values-based investing is that asset managers aren't following through consistently with data and explanations. According to Morgan Stanley, almost 80% of investment managers agree that they could improve client service by providing performance related to an investment's ESG impact in addition to financial performance. However, only 44% of managers share ESG data with institutional clients, and even fewer (30%) do so with retail clients.

AS SEEN ON CREDIT-SUISSE.COM

> *"Sustainable investing [strategies]… promote leaders in ESG criteria."*

Likewise, a survey from BNP Paribas suggests that asset managers have difficulty turning data into illuminating insights, because ESG data can be inconsistent and ESG ratings can conflict. Clearer terminology may help advisors may become more comfortable, but it's hard to sell a concept to a wealthy client when you don't have clear, consistent data to work off of.

Sharing this data and providing explanation is particularly important because *everyone is doing it differently*. Unlike established industry terms like "growth" or "large cap," one firm's values-based investing can look drastically different from the next. Even ESG data providers come up with wildly different results of what is a "good" investment from a values perspective. Researchers from MIT looked at ESG ratings and found such low correlation between them that they labeled the problem "aggregate confusion."

We would like to see the major asset managers take a more active role in reporting on the impact of their investments, and clearly articulating how they are defining and measuring impact. Otherwise, advisors will continue to be left out to dry and unprepared to answer key questions from clients, much less promote strategies in any meaningful way. It's a topic we'll continue to discuss with our clients and in conversations around the industry.

NEXT?

We have argued that the second major communications challenge for responsible investing is evolving context. Having explored the challenge of terminology, we now want to turn our attention to better understanding the challenges of context – especially when it comes to the way ESG data is sourced and used.

In the meantime, our key takeaways from this research are that "responsible investing" and "ESG" are terms we should be using, and we are going to move away from our generic "values-based investing" language. But when we use these terms, we must be absolutely clear about what we mean. We'd also like to hear back from you: How do you perceive the challenges of responsible investing?

Please send us your thoughts and questions at admin@purcellcom.com.