

Sustainable Signals

Opportunities for Asset Managers to Meet Asset Owner Demands

SUSTAINABLE INVESTING

There is a major opportunity for asset managers to better align their sustainable investment practices, products and reporting with the expectations and priorities of asset owners globally, according to the latest Sustainable Signals survey from the Morgan Stanley Institute for Sustainable Investing. For the first time, the survey combines insights from both asset owners and asset managers to give a more complete industry snapshot. Our findings suggest that if asset managers were to take advantage of the opportunity, and if gaps in ESG data and unmet demand for specialized talent were addressed, then this could help boost sustainable investing market growth opportunities.

SUMMARY

1 A Growing Market with Different Regional Outlooks >

2 Where Asset Managers Can Meet Growing Asset Owner Demand >

3 Opportunities and Challenges Ahead for Market Growth >

FIGURE 1

Institutional investors who already implement or plan to implement sustainable investing



Summary



STATE OF PLAY:

A Growing Market with Different Regional Outlooks

- Institutional investors continue to embrace sustainable investing, with 77% reporting an increased interest over the last two years.
 - EMEA currently outpaces other geographies, but APAC seems poised for the most growth over the next two years.
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MAJOR FINDINGS:

Where Asset Managers Can Meet Growing Asset Owner Demand

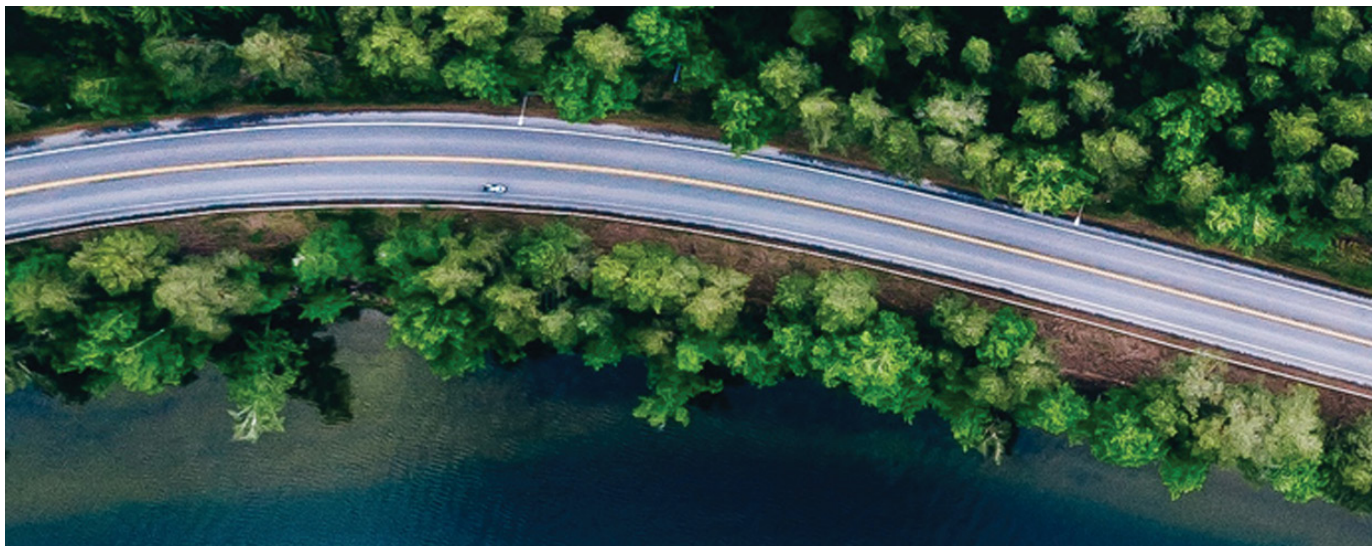
- **Investment Practices:** Asset managers can adopt and demonstrate the sustainable investing practices prioritized by most asset owners, highlighted by a 49-percentage point gap in desired ESG reporting and disclosure practices.
 - **Product Development:** Asset managers can design new investment products to meet rising asset owner demand across a range of sustainability themes, led by a 19-percentage point and 17-percentage point gap in interest for water solutions and climate change products, respectively.
 - **Data & Metrics:** Asset managers can provide access to more of the ESG metrics commonly sought by asset owners, evidenced by a 29-percentage point in climate risk stress testing data and a 22-percentage point gap in climate risk scenario analysis data.
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LOOKING AHEAD:

Opportunities and Challenges for Market Growth

- **Opportunities:** Both standardized ESG products and customized portfolios are poised for growth, although varying by region; asset managers and asset owners have an opportunity to set net-zero targets.
 - **Challenges:** Institutional investors seek better data to measure environmental and social impact and are contending with a talent gap.
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METHODOLOGY

This report, the latest in the Sustainable Signals series is designed to illuminate global market trends in sustainable investing. The report builds on our previous separate surveys of asset owners and asset managers by combining survey data and analysis on these two investor segments under the umbrella of 'institutional investors'.

SURVEY

This report presents results from a quantitative online survey by Coalition Greenwich on behalf of the Morgan Stanley Institute for Sustainable Investing. Between April and May 2022, 201 asset owners in North America, Europe and Asia Pacific and 110 asset managers across the same regions, responded. Asset owners included: insurers, pension funds, financial institutions, foundations, endowments. Asset owners surveyed had at least \$50 million in investable assets, with the largest cohort (42%) having more than \$1 billion and less than \$10 billion in investable assets. Investment products offered by asset manager respondents included mutual funds, SMAs, real assets and index funds, among others. Asset managers had at least \$50 million in client assets, with a majority (72%) managing \$100-\$500 million in assets.

This report also references our 2020 asset owners survey findings, based on 110 responses, and our 2019 asset managers survey findings, based on 300 responses. Both of these prior surveys also drew responses from across North America, Europe and Asia Pacific.

DEFINITIONS

In this latest survey, we defined sustainable investing as the practice of making investments in companies or funds that aim to achieve market-rate financial returns while considering positive social and/or environmental impact. We defined institutional investors as asset owners and asset managers and present some combined data and some broken down between these two investor types.

STATE OF PLAY:

A Growing Market with Different Regional Outlooks

Our 2022 survey confirms the growth of the sustainable investing industry among institutional investors, with interest rising across both asset managers and asset owners. While there are regional differences in adoption and drivers among asset managers specifically, the overall picture is of a robust market primed for additional growth opportunities. This is especially true for APAC asset managers, who expressed the most interest in expanding their sustainable investing approaches and products over the next two years.

Institutional Investors Continue to Embrace Sustainable Investing

Our survey found that 85% of asset managers and 83% of asset owners already implement or plan to implement sustainable investing in all or part of their portfolios (Figure 1). While all institutional investors employ a broad spectrum of sustainable investing approaches in their portfolios, ESG Integration has a clear lead (Figure 2). The one exception is asset managers in EMEA, where 86% of respondents implement exclusionary, negative, restriction or values-based screening.

Among asset classes, public equities remain dominant, adopted by 66% of asset managers and 64% of asset owners. Among fixed income asset classes, half of global asset managers and one-third of asset owners surveyed currently invest in green bonds.



SUSTAINABLE INVESTING APPROACHES DEFINED

In this survey, sustainable investing approaches were defined as follows:

Environmental, Social, & Governance (ESG) Integration

Proactively considering ESG criteria alongside financial analysis

Restriction Screening

Exclusionary, negative or values-based screening of investments

Shareholder Engagement

Direct company engagement or activist approaches

Thematic Investing

Pursuing strategies that address sustainability trends such as clean energy, water, agriculture or community development

Impact Investing

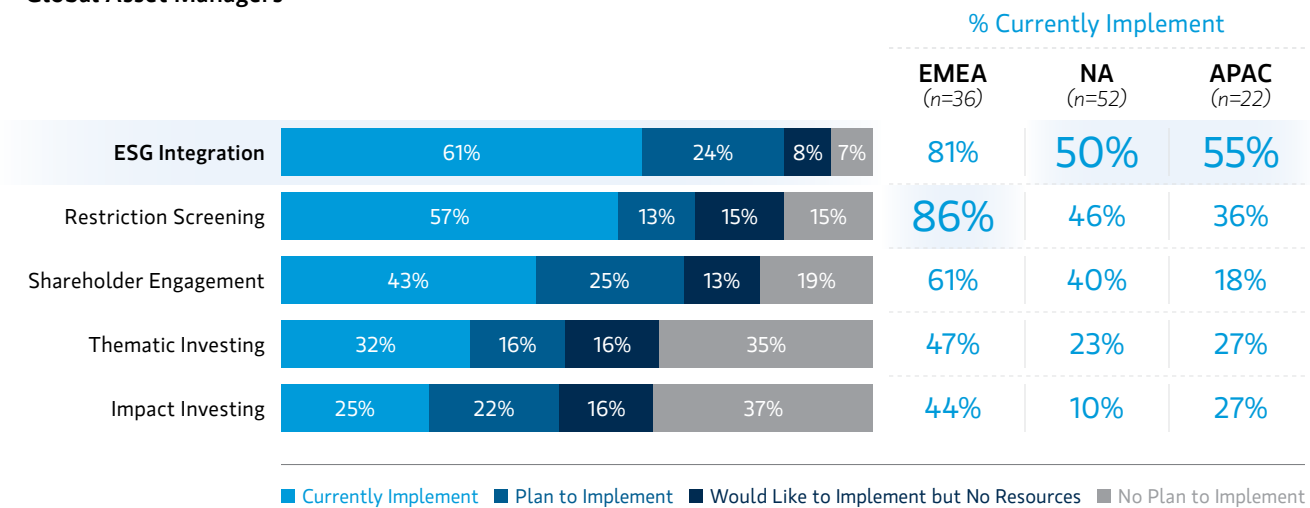
Seeking to make investments that intentionally generate measurable positive social and/or environmental impact

FIGURE 2

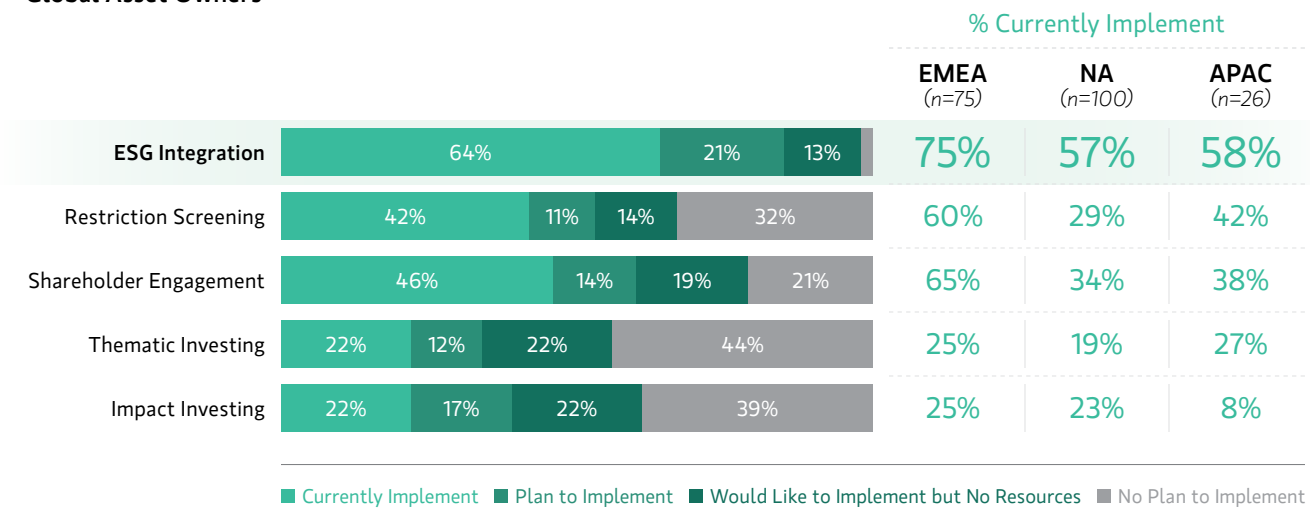
Current approaches to sustainable investing favor ESG integration*

Which of the following approaches or activities around sustainable investing does your organization implement?
(n=311)

Global Asset Managers



Global Asset Owners



Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

*Response percentages may not add up to 100% due to rounding

Interest in Sustainable Investing is Rising for Asset Managers and Asset Owners

Almost eight in ten institutional investors reported an increased interest in sustainable investing since May 2020. APAC asset owners saw the most interest (92%), followed closely by EMEA asset managers (86%), EMEA asset owners (82%), and APAC asset managers (82%). (Figure 3).

When asked what was driving growth, global asset managers primarily cited a combination of client demand and investor pressure, while global asset owners cited public sentiment. Even so, differing regional dynamics are at play, with regulatory developments representing a critical driver in EMEA and market performance a top driver for APAC asset owners (Figure 4).

77%

of global institutional investors reported an increased interest in sustainable investing since May 2020.

FIGURE 3

A majority of asset managers and asset owners globally see an increased interest in sustainable investing

To what extent do you agree or disagree with the following statement: My organization has seen increased interest in sustainable investing over the last 24 months.
(n=307)

Asset Managers



Asset Owners

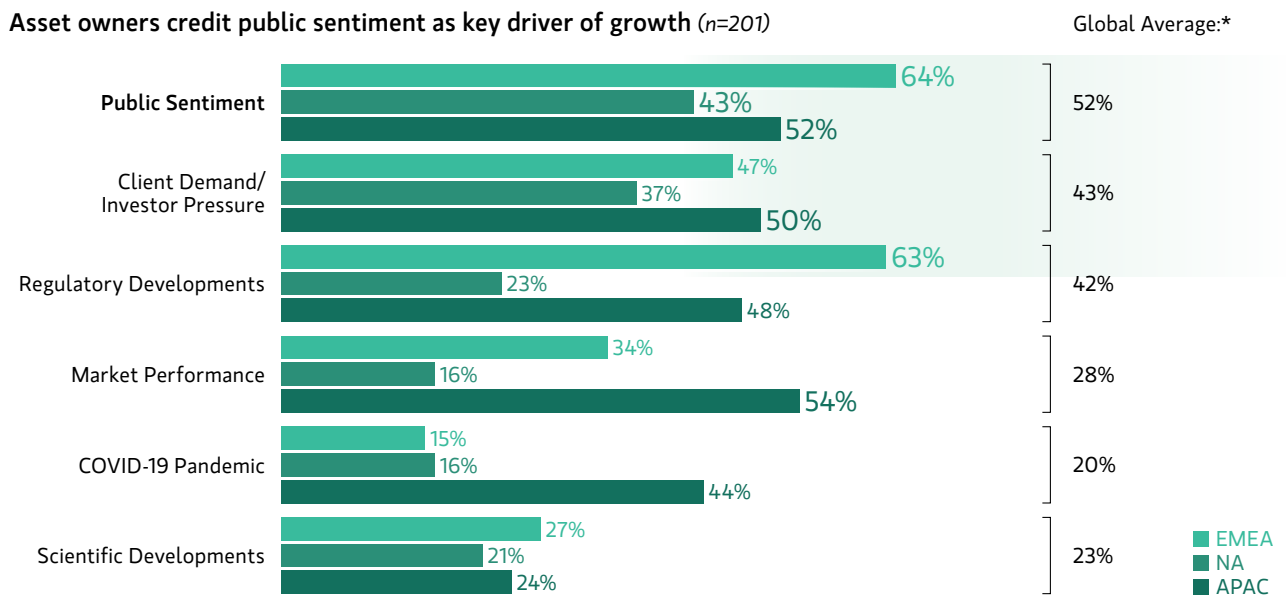
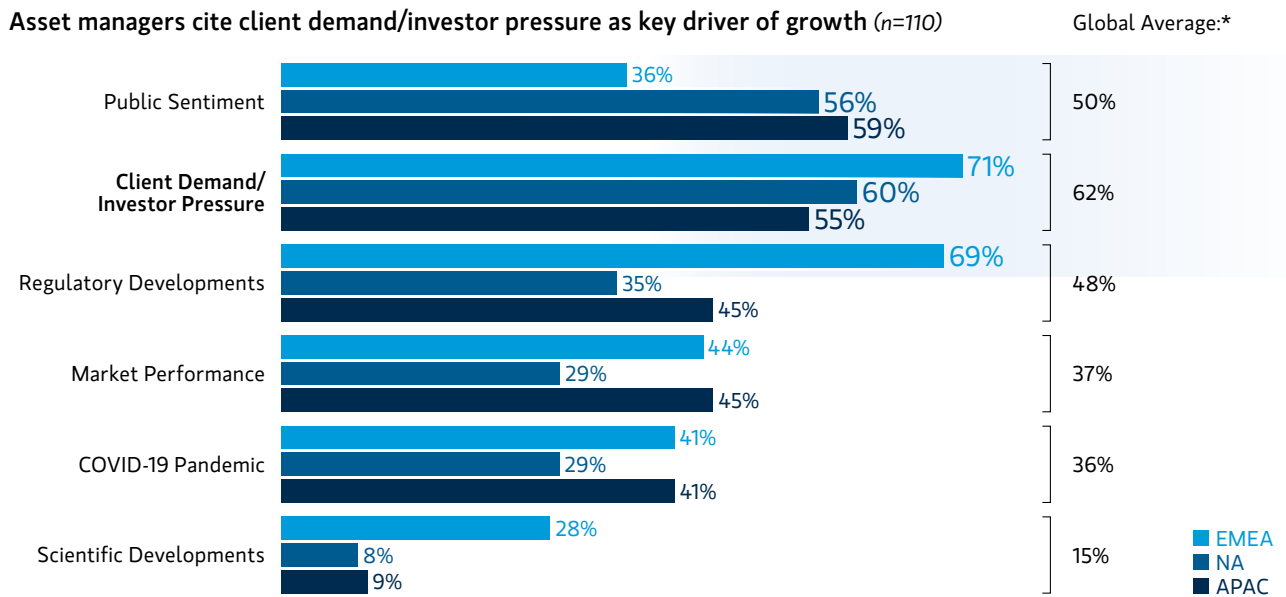


Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

FIGURE 4

Drivers accelerating or advancing sustainable investing practices

How have the following changed your sustainable investing practices or strategy within the last 24 months?



Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

*Global averages are weighted based on regional breakdown

EMEA Currently Outpaces Other Geographies, but APAC Seems Poised for Most Growth

Key regional differences are also emerging as the market develops. Our survey found that European asset management firms are outpacing their North American and Asia Pacific peers in terms of broad integration of sustainable investing policies and practices within their firms (Figure 5).

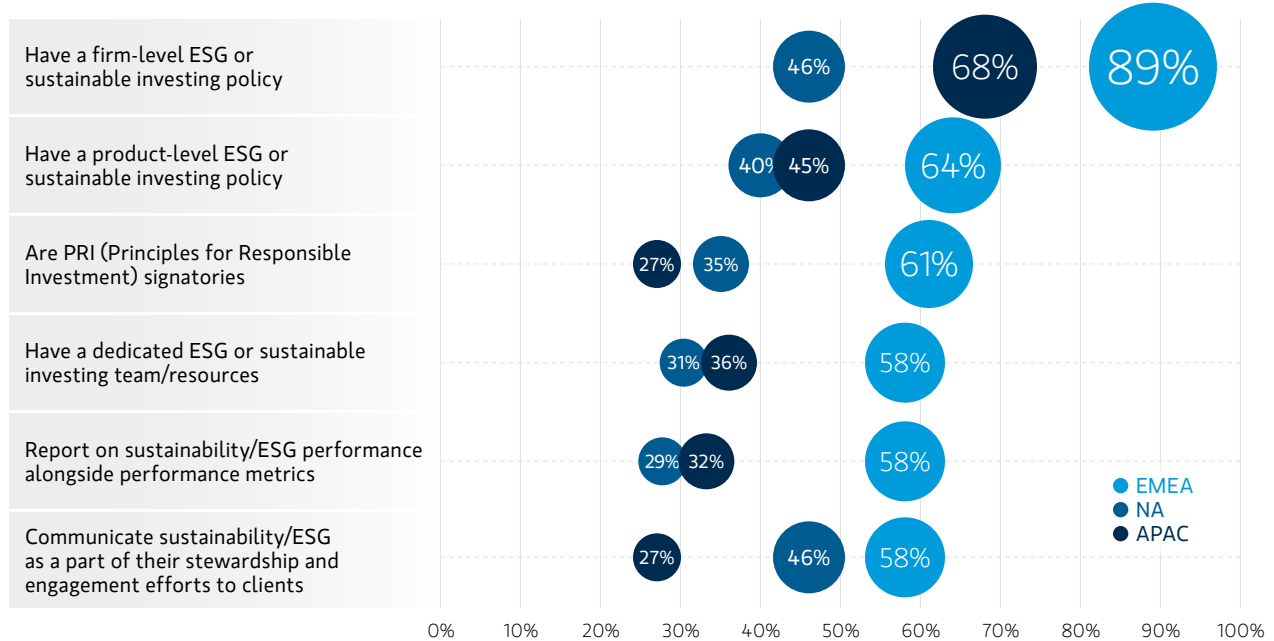
However, our findings also suggest that APAC institutional investors—especially asset managers—expressed the most interest in growing their sustainable investing market share

over the next 24 months (Figure 6). APAC asset managers led the field in plans to expand sustainable investing products in the next two years, with particular interest in Hedge Funds (36%), Private Debt (33%) and Real Assets (31%). They also led peers in plans to implement a range of sustainable investing approaches including Shareholder Engagement (45%), ESG Integration (32%), Restriction Screening (32%) and Thematic Investing (23%) over the 24 months.

FIGURE 5

EMEA leads on implementing sustainable investing practices or strategies

Which of the following characteristics apply to your organization's sustainable investing practices or strategies? (n=110)



Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

FIGURE 6

APAC asset managers poised for most growth in sustainable investing

Which of the following approaches or activities around sustainable investing does your organization plan to implement in the next 24 months?
(n=311)

Plans to Implement Sustainable Investing Approaches

	EMEA	NA	APAC
ESG Integration	14%	27%	32%
Restriction Screening	6%	10%	32%
Shareholder Engagement	22%	19%	45%
Thematic Investing	17%	13%	23%
Impact Investing	25%	19%	23%

In which of the following asset classes does your organization plan to find or develop sustainable investment products in the next 24 months?
(n=311)

Plans to Find or Develop Sustainable Investment Products Across Asset Classes

	EMEA	NA	APAC
Public Equities	6%	18%	29%
Public Fixed Income	9%	17%	25%
Private Equity	21%	9%	24%
Private Debt	23%	8%	33%
Hedge Funds	8%	11%	36%
Commodities	8%	8%	22%
Multi-Asset Solutions	17%	3%	19%
Real Assets	22%	8%	31%
Cash Equivalents & Money Markets	21%	3%	22%

Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

MAJOR FINDINGS: Where Asset Managers Can Meet Growing Asset Owner Demand

Our survey highlighted several areas where asset managers have an opportunity to meet growing sustainable investing interest and demand from asset owners. These opportunities provide insight into how asset managers might better differentiate themselves in this maturing market.

INVESTMENT PRACTICES

Asset Managers Can Adopt and Demonstrate the Sustainable Investing Practices Prioritized by Most Asset Owners

Asset managers have an opportunity to adopt and better articulate their sustainable investing practices to meet the top demands of current and prospective clients. Across all seven measures that asset owners prioritize when evaluating and selecting third-party managers, the biggest gap

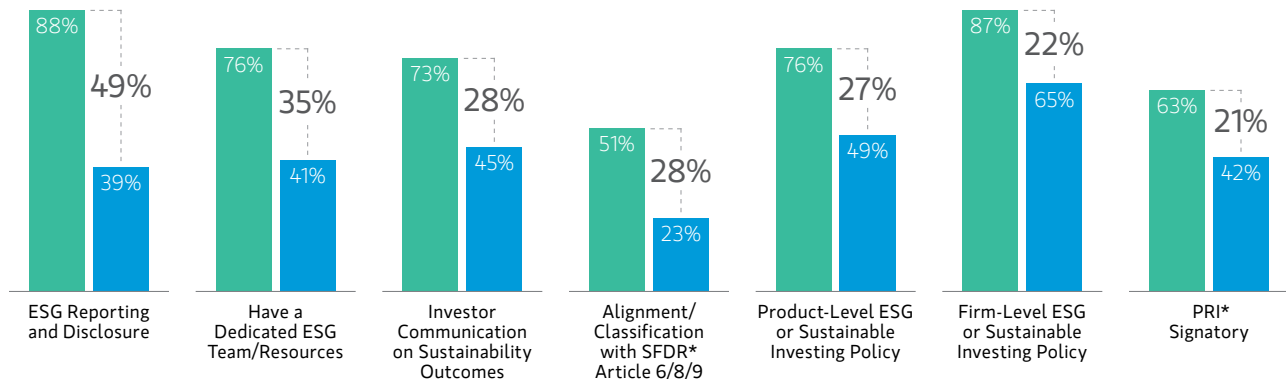
(49 percentage points) is in ESG disclosure. Just 39% of asset managers report on ESG performance alongside financial performance despite 88% of asset owners saying they seek third-party managers (Figure 7) with such practices.

FIGURE 7

Opportunities for asset managers to adopt and demonstrate desired sustainable investing practices

Asset Owners: When evaluating third-party investment managers on the basis of sustainable investing, how important are the following characteristics? (n=191)

Asset Managers: Which of the following characteristics apply to your organization's sustainable investing practices or strategies? (n=110)



■ Asset Owners Responding 'Extremely Important' or 'Somewhat Important' ■ Asset Managers Implementing

*Sustainable Finance Disclosure Regulation (SFDR) / Principles for Responsible Investment (PRI)

PRODUCT DEVELOPMENT

Asset Managers Can Design New Investment Products to Meet Demand Across a Range of Sustainability Themes

Asset managers globally have an opportunity to meet growing demand for strategies focused on a broader range of sustainability themes, especially water solutions, climate change and education (Figure 8). Even though asset owners

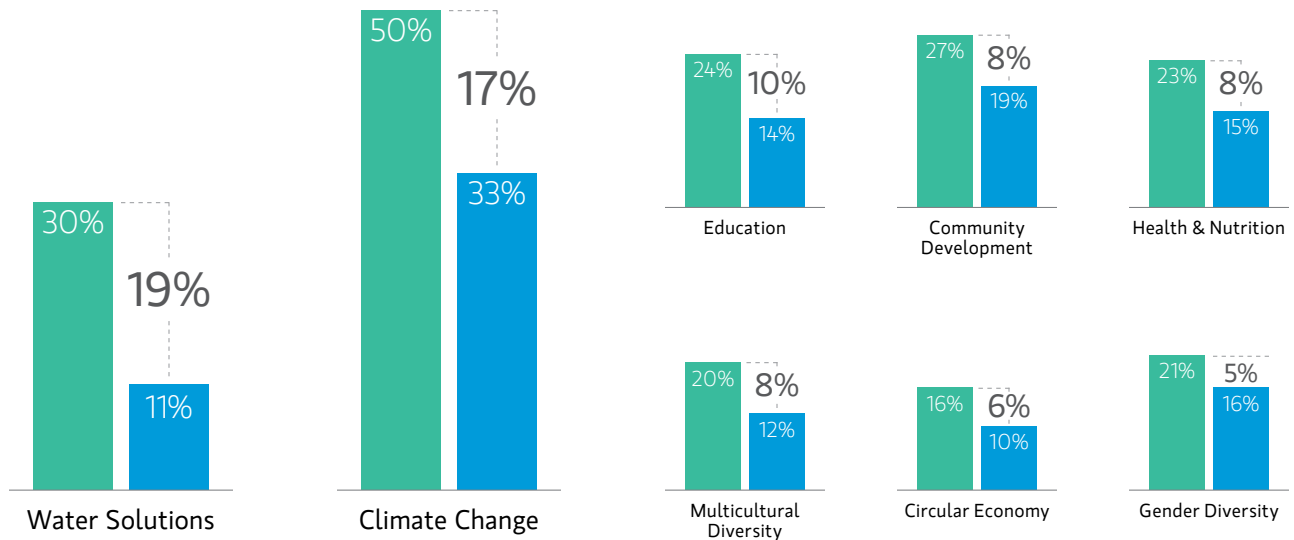
and managers align on their top thematic investment priority—climate change—our survey reveals there’s still opportunity for more products that meet rising investor demand.

FIGURE 8

New products could meet asset owners’ interest in water solutions and climate change investment themes

Asset Owners: Has your organization set any specific thematic priorities in which it is currently or might consider, exclusively, or primarily investing? (n=201)

Asset Managers: Does your organization offer thematic products and solutions that seek to address any of the following sustainability themes? (n=110)



■ Asset Owners Indicating Thematic Priority ■ Asset Managers Offering Product or Solution

ADDITIONAL DATA & METRIC GAPS:

Plastic Waste Reduction (Δ4%) and Biodiversity (Δ1%).

DATA & METRICS

Asset Managers Can Provide Access to More of the ESG Metrics Commonly Sought by Asset Owners

Asset owners want more transparency from firms managing their assets on ESG issues ranging from climate change and water usage to Board structure and proxy voting. For example, half of asset owners want climate risk related data but less than a third of asset managers provide these metrics to clients, despite the topic being a key focus of the Task Force on Climate-Related Financial Disclosures.

82%

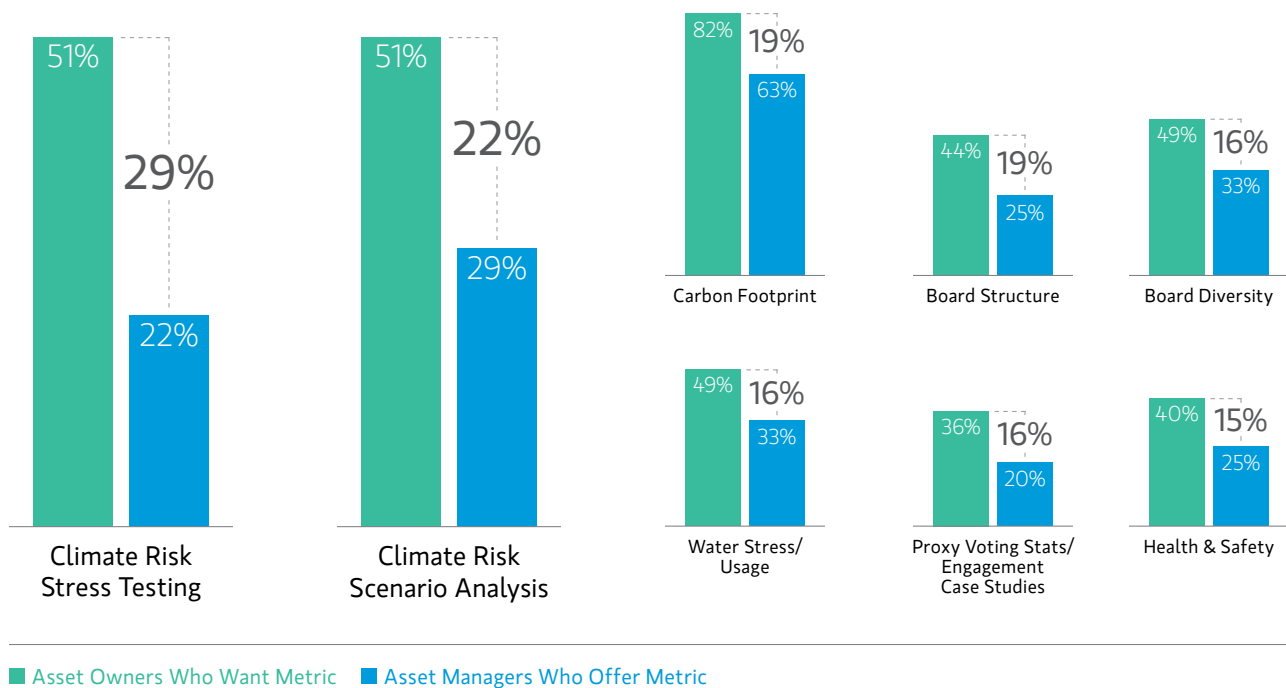
of asset owners want their managers to provide carbon footprint data, but only 63% of asset managers surveyed offer this information.

FIGURE 9

Asset owners want asset managers to provide climate risk-related data

Asset Owners: Which of the following metrics would your organization want to see in an impact report from a third-party investment manager? (n=179)

Asset Managers: Does your organization offer any of the following metrics as part of your sustainable investing strategies? (n=51)



ADDITIONAL DATA & METRIC GAPS:

Data Privacy & Information Security (Δ15%), Energy Consumption (Δ10%), Workplace Diversity (Δ9%), Pay Gap (Δ9%), Third-Party ESG Scores/Ratings (Δ7%), Internally Generated ESG Scores/Ratings (Δ7%), Executive Compensation (Δ7%) and Waste & Pollution (Δ6%).

LOOKING AHEAD:

Opportunities and Challenges for Market Growth

By taking advantage of the opportunities described above, asset managers can differentiate their firms and lay the groundwork to gain share in a growing market and increase assets under management. At the same time, challenges to growth persist. Eight in ten asset owners revealed they lack the data to adequately measure their environmental and social impact and face a talent gap in sustainable investing specialists.

OPPORTUNITIES

Where Asset Managers See Sustainable Investing Growth Within Their Organization

Among asset managers globally, 90% anticipate growth in sustainable investing at their firm. In North America and EMEA, asset managers expect the most growth in standardized products that are labeled sustainable and target a wide variety of investors. APAC managers, on the other hand, see future growth driven mostly by customization of portfolios for clients by region and sustainability theme (Figure 10).

Among specific sustainable investment vehicles, carbon offsets and allowances are also seeing growing investor interest. Almost a third of asset managers and asset owners (32%) plan to invest in this area over the next 24 months.

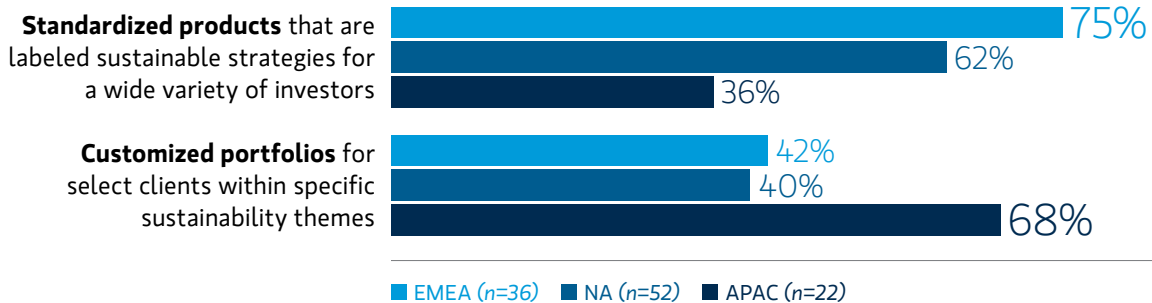
32%

of asset managers and asset owners plan to invest in carbon offsets and allowances within the next two years.

FIGURE 10

Predicted growth in sustainable investing for asset managers

Where do you see the growth of sustainable investing within your organization? (n=110)



Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

OPPORTUNITIES

An Opportunity to Set Net-Zero Targets

Even as institutional investors embrace sustainable investing and cite growing interest, our survey found that the majority (64% of asset managers and 70% of asset owners) do not yet have a net-zero greenhouse gas emissions target. This is especially true in North America, where 85% of asset owners and 81% of asset managers do not have a target.

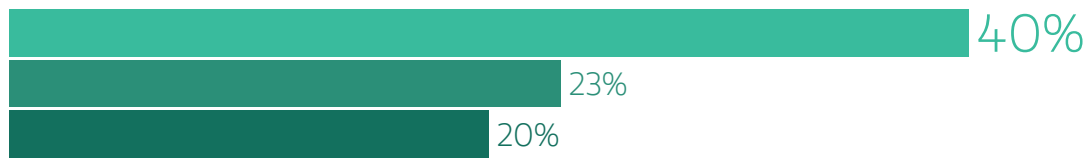
Even so, there was interest among asset owners to require external investment managers to have a net-zero target or strategy within the next two years.



FIGURE 11

Asset owners who plan to require a net-zero target from third-party managers within the next two years

Does your organization have a policy that requires external managers have a net-zero target or strategy? (n=178)



■ EMEA (n=68) ■ NA (n=90) ■ APAC (n=20)

Europe, Middle East and Africa (EMEA) / North America (NA) / Asia-Pacific (APAC)

CHALLENGES

Institutional Investors Face Hurdles When Measuring Environmental and Social Impact or Analyzing Sustainability Data

Most asset owners and managers (70%) reported being 'somewhat satisfied' with the ESG data they receive from third-party providers, with Bloomberg and MSCI the most popular providers across regions. At the same time, most investors are unable to effectively measure their environmental and social impact, with only 20% of respondents saying they had adequate data to do so. With more than half (57%) of all institutional investors agreeing that sustainable investing loses credibility when you can't measure impact, addressing this challenge seems key to continued market growth.

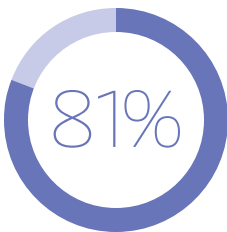
It also appears there isn't an easy fix. Almost half of institutional investors (48%) cited a lack of industry resources to help them analyze sustainability data while almost as many (45%) pointed to a lack of in-house resources. Eight in ten agreed on the need for more standardization of corporate ESG disclosure to improve sustainability data quality. Looking ahead, most respondents saw the global trend toward more ESG regulation as helpful in addressing data challenges.

FIGURE 12

Institutional investors agree more standardization and proposed ESG regulations will help with data challenges

To what extent do you agree or disagree with the following statements? (n=309)

To improve ESG data quality:

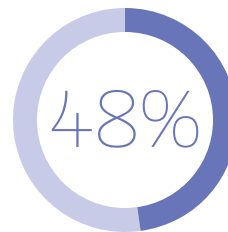


agree **more standardization around corporate ESG disclosures** will improve quality and quantity of sustainability data

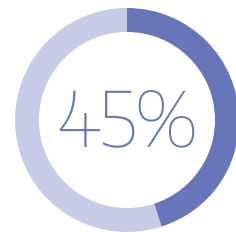


agree that **current proposed global ESG regulations** will help their organization better understand and apply sustainability data

When analyzing sustainability data:



agree there's a **lack of industry resources to help analyze sustainability data** (31% neither agree nor disagree)



agree there's a **lack of in-house resources to analyze sustainability data** (30% neither agree nor disagree)

CHALLENGES

Institutional Investors Face a Talent Gap for Sustainable Investing Specialists

A persistent industry talent gap represents an additional challenge, despite a recent hiring spree by investors. Among respondents, 66% of asset managers and 53% of asset owners reported increasing their headcount of sustainable investing specialists between May 2020 and May 2022.

Yet the talent pool is not meeting demand, with just 39% of asset managers and 23% of asset owners saying they can find qualified individuals to meet their organization's ongoing sustainable investing needs.

FIGURE 13

Institutional investors who believe there's enough qualified talent to meet their needs

To what extent do you agree that there is enough qualified talent to meet your organization's sustainable investing hiring needs? (n=307)



Conclusion

Our survey shows that sustainable investing remains an important focus area for institutional investors, especially in EMEA. While there are regional differences in both adoption and drivers, the market is primed for additional growth, particularly in APAC. 77% of all institutional investors report increased interest in sustainable investing since May 2020, and more than 80% already implement sustainable investing strategies in all or part of their portfolios—or plan to do so.

However, there are opportunities for asset managers to better align their sustainable investment practices, products and reporting with the expectations and priorities of asset owners globally. Doing so might help managers better differentiate themselves and grow assets under management in a maturing market.

Our survey revealed a need for asset managers to adopt and demonstrate the sustainable investing practices prioritized by most asset owners, such as ESG reporting and disclosure. Additionally, asset managers can design new investment products to meet rising asset owner demand across a range of sustainability themes, especially water solutions and climate change. And finally, asset managers can provide access to more of the ESG data and metrics commonly sought by asset owners, particularly those related to climate risk.

In addition, there is a pressing need to bridge gaps in ESG impact data and further develop global talent in the growing field of sustainable investing. Taken together, these actions can potentially help boost the credibility and adoption of sustainable investing strategies among institutional investors across the globe.

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The appropriateness of a particular ESG investment or strategy will depend on an investor's individual circumstances and objectives. Principal value and return of an investment will fluctuate with changes in market conditions.

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