2022 Sustainable & Impact Investing Outlook: Reimagining the Future

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Executive Summary

- The sustainable and impact investing industry continues to scale, affording investors an increased level of influence on public and private markets in 2022.
- The most pronounced investor opportunity is expected to be in climate change and the future of work, two areas with significant implications for investment portfolios and for society.
- The industry is likely to be on the cusp of even larger adoption in the year ahead, as new regulations and fiduciary guidance seek to clarify and standardize a still nascent industry.
- Put together, our three 2022 sustainable and impact themes provide an elevated opportunity for investors to help reimagine the future (Exhibit 1).

Exhibit 1: 2022 Sustainable and Impact Investing Themes and Viewpoints

Climate Change – From the Boardroom to the Kitchen Table
- Board members and private wealth clients alike are experiencing the importance of integrating climate change considerations into their investment decisions.
- Investment opportunities in climate technological innovation and adaptation are growing, made possible by recently enacted legislation.
- Environmental investors may adopt a hybrid approach to divesting from the most carbon-intensive industries while engaging with power-player companies that can move the market.

The Future of Work in the “New Normal”
- The pandemic has triggered a greater awareness of worker welfare, with a range of implications for public companies.
- Shareholder demand to understand diversity, equity and inclusion programs and policies has resulted in a surge of new data to inform investors.
- Companies that respond in an agile and resilient manner to the demands of the “new normal” will likely succeed.

Collision of ESG Interests and Fiduciary Standards
- Sustainable investing has been growing quickly, but there is no regulation of what constitutes “ESG investing.”
- Increased data will empower investors and asset managers to more accurately determine the level of greenwashing.
- This enhanced ability to evaluate strategies will likely lead to winners and losers among asset managers, an increased comfort level in this space for fiduciaries and potential inclusion of sustainable and impact strategies in retirement plans.
Introduction

The events of 2021 served to remind sustainable and impact investors of their opportunity to influence and reimagine the future. The pandemic raged on, underscoring disparities in healthcare access and workplace policies, while a nationwide push for racial equity challenged corporations to reexamine their approaches to creating inclusive environments. Meanwhile, one in three Americans experienced a severe weather disaster in summer 2021, serving as a reminder that the pace of climate change is accelerating. These issues defined conversations for both society and investment portfolios.

Amid this backdrop, the sustainable and impact investing industry continued to scale, with assets in U.S. sustainable funds almost doubling from $183 billion in September 2020 to $330 billion in September 2021. In third-quarter 2021 alone, 38 funds with sustainable mandates were launched — a record number of sustainable funds in a quarter. This growth may reflect the strength of these strategies throughout the pandemic and recession as well as growing evidence identifying environmental, social and governance (ESG) issues as financially material. Not only did these strategies endure the volatility of the pandemic with fewer steep drawdowns, but they also illustrated the performance benefits of investing in companies adopting a longer-term stakeholder-centric model with higher ESG profiles and alignment with the transition to a low-carbon economy.

Glenmede’s Sustainable & Impact Investing team has identified three themes we believe will drive investment opportunities and societal impact in 2022:

1. **Climate change — from the boardroom to the kitchen table**, describing the urgency of embedding climate change considerations and action into board leadership, C-suites and lifestyles.
2. **The future of work in the “new normal,”** exploring the increased focus on how corporations are redesigning the workplace and quality jobs to ensure resilient, innovative, secure and inclusive companies.
3. **Collision of ESG interests and fiduciary standards,** recognizing the evolution of fiduciary guidance and regulation on ESG applications affecting investors, trustees, asset managers and board directors.
Theme 1: Climate change — from the boardroom to the kitchen table

As of fall 2021, severe weather has cost the U.S. more than $100 billion,\(^5\) with one in three Americans experiencing a severe weather disaster in the summer alone.\(^6\) The past year was marked by pronounced effects of climate change, as illustrated by the frequency of extreme weather events, immigration patterns driven by populations seeking refuge from drought and natural disasters and a climbing death toll of Americans who died due to hurricanes, floods, heat waves and wildfires (Exhibit 2).

Exhibit 2: Billion-Dollar Weather and Climate Disasters

The Biden administration is addressing the impact of climate change, with the recent announcements that the federal government will target carbon neutrality by 2050, and extensive investments in clean energy, electric vehicle charging stations and water sanitation contained in the $1 billion infrastructure bill enacted in November 2021.\(^7\),\(^8\) Alongside policy action, energized players including companies, investor coalitions and local governments have entered the market with an emphasis on the roles they can play. Tactics range from slashing emissions through divestment, investing in climate innovation and integrating climate considerations into corporate strategy and executive compensation, with several large corporations such as Amazon.com, Microsoft Corporation and The Procter & Gamble Company releasing net zero targets with significant business implications.

Source: National Oceanic and Atmospheric Administration


**WHAT IS NET ZERO?**

According to the Net Zero Climate Initiative, net zero refers to a state in which greenhouse gases going into the atmosphere are balanced by removal out of the atmosphere. The term net zero is important because, for carbon dioxide at least, this is the state at which global warming stops. The Paris Agreement underlines the need for net zero, requiring states to achieve this balance. For net zero to be effective, it must be permanent, that is, sustained.

*Source: https://netzeroclimate.org/what-is-net-zero*

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**What this means for investors**

Investors should expect companies in heavy carbon-emitting industries to face the increasing risk of stranded assets, driven by a changing resource landscape (e.g., depletion), new government regulations (e.g., carbon pricing) and falling clean technology costs, with the threat of divestment in the absence of corporate action to address these risks. Meanwhile, corporations across all sectors will likely face requests from investors on financially relevant data related to their scope 1, 2 and 3 emissions⁹ to better assess a company’s true exposure to a warming world going forward. As such, we expect asset managers to issue increasingly sophisticated environmental strategies focused on climate change adaptation and mitigation solutions, ranging from the use of green hydrogen to electrify heavy trucking and airline industries, low-carbon techniques in heavy cement production and selective divestment from companies unwilling to shift away from high-carbon-emitting or destructive practices such as deforestation. Many early stage private companies to large-scale publicly traded companies seeking to shift their energy mix ahead of the transition are exploring these opportunities. Investors may exit 2022 with an enhanced ability to build climate-change-related considerations across their entire portfolios to both address risks and position for growth opportunities.
Theme 2: The future of work in the “new normal”

With more than 4 million Americans quitting their jobs in October 2021 alone, the continuation of “The Great Resignation” incites an evaluation of how the pandemic may change the future of work. Companies are facing scrutiny for their reactions to the pandemic and what lasting changes will look like in the recovery, including flexible work arrangements and strategies to address rising inequality among women and communities of color in the workplace. Overarchingly, many sustainable and impact investors are seeking to assess how a company is continually attracting, retaining and empowering top talent at a time when employees nationwide are rejecting the status quo.

Recent research led by NYU in partnership with Glenmede resulted in a framework for what constitutes a "quality job," comprising those human-capital-related metrics found to be most financially material to corporate financial performance (Exhibit 3). Specifically, this research found that companies offering secure, equitable and flexible workplaces also demonstrate higher profitability, better product quality and lower volatility.

Exhibit 3: Proxies for Assessing Quality Jobs

<table>
<thead>
<tr>
<th>Security</th>
<th>• Living wage: Does the company pay its workers a level of income sufficient to afford the basic needs to life?</th>
<th>• Healthcare: Does the company offer employees access to paid sick leave and provide adequate health and safety training?</th>
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<tr>
<td>Viability</td>
<td>• Controversy screening: Has the company experienced any significant labor rights controversies?</td>
<td>• Community relief fund: Has the company provided financial assistance to the communities in which it operates?</td>
</tr>
<tr>
<td>Equity</td>
<td>• DEI considerations: Does the company offer programs and policies that promote inclusivity for women and people of color?</td>
<td>• CEO-to-median-worker pay ratio: How did executive leadership manage compensation during the pandemic?</td>
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<tr>
<td>Flexibility</td>
<td>• Work-life balance: Does the company offer access to benefits for caretakers (e.g., parental leave, back-up dependent care, eldercare)?</td>
<td>• Training and education: Do company benefits include assistance for employees to pursue training and education to advance their careers?</td>
</tr>
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</table>

Source: Based on the Quality Jobs Framework developed by NYU’s Center for Sustainable Business
A robust assessment requires access to improved data on human capital, enabling investors to assess companies’ ability to provide effective diversity, equity and inclusion (DEI) policies and programs, robust health and safety programming and livable wages. Currently, compliance rates with these datasets across the largest U.S. employers remain low at 20%\(^{12}\), but shareholders and legislation could help drive improvement in 2022. Notably, the 2021-2022 proxy season as of October 2021 saw a 44% increase in shareholder resolutions requesting diversity demographic details as well as data on hiring, retention and promotion rates.\(^{13}\) DEI disclosures have been further strengthened by the Biden administration’s 2021 executive order on advancing racial equity\(^{14}\) and by Nasdaq’s Board Diversity Rule requiring all listed companies to disclose uniform diversity data.\(^{15}\)

**What this means for investors**

Investors may see a transition in 2022 from pioneering companies proactively sharing data on worker welfare and DEI to a mandate for corporate disclosure, ushering in opportunity for the development of strategies assessing companies’ ability to offer quality jobs with clear linkage to financial materiality. Specifically, better data and frameworks such as those outlined in Exhibit 3 should help investors identify potentially resilient investments in companies offering living wages, access to healthcare and effective DEI programs and policies.\(^{16}\) Specific to DEI, a more granular view on the hiring, retention and promotion of women and people of color can position investors to better evaluate companies’ ability to offer an inclusive culture — yet another area where recent studies have shown clear linkage to strong corporate financial performance.\(^{17}\)
Theme 3: Collision of ESG interests and fiduciary standards

Even as sustainable and impact investing attracts record fund flows, it remains a relatively small subset of the overall traditional investment industry. What's holding investors back? A recent CFA Institute survey found 62% of respondents noted a perception of greenwashing and the need for more succinct definitions around what constitutes a “sustainable” fund, while more than 50% noted the need for more clarity on how such investments fit with fiduciary duty. Key signals point to 2022 as the year we may receive clearer guidance and regulations in this space. In March 2021, the Securities and Exchange Commission (SEC) launched its Climate and ESG Task Force, a first step toward designing more sets of disclosure and language for what constitutes a “sustainable” strategy, alongside the potential to mandate data disclosure for climate change and human-capital-related disclosures for corporations.

The SEC ultimately may mirror the playbook of the European Union (EU), which in 2020 mandated the EU Taxonomy, a set of mandated ESG-related disclosures establishing a list of environmentally sustainable economic activities for corporations to follow, and the EU Sustainable Finance Disclosure Regulation requiring asset managers who label their strategies as “ESG Integrated” and “Sustainable” to provide clear documentation for how they incorporate ESG in their investment processes.

These existing regulations and their potential influence on U.S. action may inform fiduciary guidance given the body of legal guidance suggesting that risk/return need not be sacrificed in favor of impact benefits. In late 2021, the U.S. Department of Labor (DOL) proposed a rule governing sustainable and impact investing that would weaken prior barriers to the consideration of ESG factors by ERISA plans, a reflection of a growing body of evidence on the materiality of ESG issues and the views of stakeholders who were in nearly unanimous opposition to the original rulemaking.

What this means for investors

The SEC’s stated intent to require companies to disclose expanded ESG information foreshadows a potential surge in climate change and human capital datasets, enabling the development of more targeted thematic investment portfolios. In parallel, scrutiny on asset managers may serve as the beginning of a reckoning for funds touting themselves as sustainable, potentially creating opportunities for those able to successfully defend their approach to ESG rising to the top. Finally, the reassessment of DOL rulemaking on how ERISA accounts engage in ESG investing may portend another wave of inflows, enabling 401(k) participants to invest in ESG options through their retirement funds. In 2019, only 2.6% of 401(k) plans included an ESG strategy option despite 90% of participants stating they would elect into one if offered.
Conclusion

Deepening channels of data around climate change and the future of work may enable the creation of new thematic investment strategies, providing enhanced tools for investors seeking to catalyze climate innovation and more resilient, innovative and inclusive companies. Meanwhile, new regulatory guidance on sustainable and impact investing standards may help erode investor perceptions of greenwashing and mismatch with fiduciary duty, positioning ESG for greater adoption. Put together, 2022 offers continued runway for the sustainable and impact investing industry to scale and, thus, greater influence to reimagine the future of investing and society (Exhibit 4).

Exhibit 4: Sustainable and Impact Investor Implications for 2022

1. Climate Change – From the Boardroom to the Kitchen Table
   - Heavy carbon-emitting industries may face challenges such as stranded assets, carbon pricing and divestment
   - Increasingly sophisticated environmental strategies will emerge with focus on innovation across asset classes.

2. The Future of Work in the “New Normal”
   - Corporations face increased pressure to provide strong worker welfare and DEI programs, alongside mounting evidence of financial materiality.
   - Greater data enables investors to tilt toward companies offering living wages, access to healthcare and effective DEI programs and policies.

3. Collision of ESG Interests and Fiduciary Standards
   - Issuance of “sustainability standards” promotes transparency and prevents greenwashing.
   - Reevaluation of how ERISA accounts engage in ESG prompts greater adoption by retirement fund participants.


6 Kaplan and Ba Tran.

7 The 2021 Infrastructure Bill has earmarked $65 billion for clean energy investments, $7.5 billion for a national network of electric vehicle charging stations and $55 billion to ensure access to clean drinking water.


9 Scope 1 emissions data refers to the Green House Gas (GHG) emissions that a company makes directly to sustain its operations. Scope 2 emissions data refers to emissions that a company makes indirectly, e.g., the electricity a company buys to cool and heat its buildings. Scope 3 emissions data refers to all the emissions associated with all the suppliers up and down a company’s value chain. Source: “Scope 1, 2, and 3 Emissions.” Deloitte UK. https://www2.deloitte.com/uk/en/focus/climate-change/zero-in-on-scope-1-2-and-3-emissions.html.


25 According to the 2021 U.S. Retirement Survey, conducted in late January among 1,000 U.S. consumers ages 45-75 and 230 workers with employer-sponsored defined contribution plans, 9 out of 10 participants aware that their plan had ESG options would invest in them.
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