Standards: The building blocks of trust for Australia's ESG investing landscape

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1. Background

ESG (environmental, social and governance) investing is growing worldwide with some ESG asset funds valued at USD 387 billion, whilst a number of ESG funds are outperforming non-ESG funds. Australia’s ESG related investments are relatively small compared to world leaders such as Europe, however Australia’s ESG investments are on the rise. To understand ESG investing and the significant role it plays for Australia’s wider economy, it is important to grasp what ESG refers to and why and how organisations are disclosing their ESG impacts.

ESG refers to the use of environmental, social and governance factors to assess the impact an organisations operation has on its employees, society, and the environment (PwC, 2022).

Examples include:

- Environment (E): Climate change and carbon emissions, waste management and energy efficiency.
- Social (S): Gender and diversity and employee engagement.
- Governance (G): Whistle-blower schemes and board composition.

Internal and external influences such as socially conscious consumers, changing policies shaped by international environmental commitments, stakeholder pressures and the desire to improve brand reputation are encouraging organisations to become transparent about the environmental and social impacts of their operations (Pandit, 2021). Organisations can disclose these impacts and activities through ESG disclosure frameworks and standards.

These ESG disclosure frameworks and standards allow for investors to ‘socially screen’ organisations and to filter out investments deemed to operate in an unsustainable manner (SustainoMetric, 2022). Investors screen ESG data provided by organisations through non-financial reporting to assess potential investment opportunities. However, in most countries ESG disclosures remain non-mandatory to disclose within an organisation’s financial reporting.

ESG can provide benefits to Australian organisations and to the Australian economy. McKinsey found that an ESG proposition can create higher value by increasing returns, reducing rising operational expenses, ease regulatory pressures, enhance employee productivity and increase returns (Henisz et al., 2019).

The purpose of this research is to uncover the ESG investment landscape both globally and in Australia, and to understand how Australia can contribute to international standardisation activities. To answer this research objective the following questions and priorities were identified:
2. What is ESG investing and who is leading ESG investments?

This section provides a brief overview of the global ESG investment market and aims to understand which countries hold the proportion of ESG investment funds, and to establish how Australia compares.

ESG investing, also referred to as impact investing or socially responsible investing, is the act of considering ESG factors alongside financial factors when making an investment decision (MSCI, 2022). These investors can rely on independent ratings who score an organisation's environmental, social and governance impacts (Napoletano & Curry, 2022).

ESG investing is growing worldwide with the value of ESG assets growing ninefold in 4 years. Between 2018-2022 the global value of ESG Exchange-Traded Fund (ETF) assets worldwide grew significantly. In 2018, the value of worldwide ESG ETF assets was at USD 41 billion and as of February 2022 the value of ESG ETFs assets reached USD 378 billion (ETFGI, 2022).

At the end of 2021 Europe held the most share of ESG ETF assets worldwide. More than 60% of the total market share of ESG ETF assets under management were in Europe. The United States followed with 36% of the total market share of ESG ETF assets under management, while the Asia Pacific accounted for 3% of the worldwide ESG ETF assets (Abboud, 2022).

Europe also leads in other ESG related investing, in September 2021 Europe held 10 times the value of sustainable asset funds in comparison to the United State who held the second largest value of sustainable funds (Abboud, 2022). Europe manages a high proportion of the global ESG fund assets worldwide, with 81% concentrated in Europe, followed by 13% of global ESG fund assets managed in the United States (Morningstar, 2022).

The current European regulatory landscape on ESG disclosures may contribute to Europe’s dominant stance as a region that holds a high volume of the worlds ESG and ESG related investment funds. EU law requires large companies to
disclose how they operate and manage environmental and social challenges. This includes environmental matters and anti-corruption and bribery (European Commission, 2020).

2.1 Australia and ESG Investing

Australia’s value of ESG related investments is small when compared to other countries. Australia and New Zealand ranked as the 5th largest region to hold sustainable funds worldwide, reaching just over USD 27 billion of sustainable assets as of September 2021. During the same time period, Europe the largest region for assets of sustainable funds reached over AUD 3 trillion (Morningstar, 2021).

Although small, ESG related investments in Australia are on the rise with responsible investment accounting for 40% of the total market in 2020, up from 31% in 2019 (RIAA, 2021). When investing, Australians focus on social and environmental issues. In 2022, an online survey conducted by Responsible Investment Association Australasia to understand the leading environmental and social issues considered when investing in Australia found that 53% of respondents indicated that renewable energy and energy efficiency is important to them when considering investments through superannuation, banking, and other investments. Healthcare and public health (48%) took second place, followed by sustainable water management (41%) (RIAA, 2022).

Whilst Australia experiences a growth in ESG investing, the same study found that Australians remain concerned over greenwashing, with 72% of respondents concerned that responsible investors engage in greenwashing (RIAA, 2021).

Greenwashing is term used when an organisation misleads consumers when disclosing the environmental impacts of their product or service (Netto et al, 2021). However, the Australian Securities and Investments Commission is currently cracking down on greenwashing into ESG and green funds by conducting a review into practices of fund managers (Armour, 2021).
3. What is the ESG policy context in Australia?

ESG disclosure regulations are in place in the EU and planned for New Zealand in 2023, while Hong Kong and Singapore introduced both mandatory disclosure requirements and ‘comply or explain’ provision (Wynn-Pope et al., 2021).

While ESG reporting is voluntary in Australia there are mandatory ESG related reporting instruments, for example the National Greenhouse and Energy Reporting (Environment) and workplace gender equality Act (Social). The Australian Council of Superannuation Investors (ACSI) and the Financial Services Council (FSC) established an ESG reporting instrument, ‘ESG Reporting Guide for Australian Companies’ that consists of guidelines and standards for non-financial reporting.

Mandatory reporting requirements will soon be a reality for organisations operating in Australia (Wynn-Pope et al., 2021).

4. What are the key challenges with implementing ESG indicators?

Lack of harmonised ESG framework standards

There exists no global body monitoring ESG reporting. A lack of ESG standards and frameworks coupled with a lack of comparable ESG data sets are common barriers faced by organisations worldwide. In 2021, 40% of business leaders surveyed in the United States, Brazil, the United Kingdom, Germany, and India cited balancing ESG with growth targets as the largest barrier to ESG progress. Followed closely by a lack of reporting standards and regulations/complexity (37%) (PwC, 2021). Other barriers included lack of leadership (33%) and volatility of regulatory requirements (31%).

In 2021, HSBC surveyed 2,000 capital market issuers and institutional investors across 19 industries. A shortage of expertise or qualified staff, regulatory or legal constraints followed by a lack of comparability of ESG data across issuers is preventing organisations to pursue ESG investing. It is worth noting that in 2020, 50% of organisations cited a lack of comparability of ESG data across issuers as the number one barrier when pursing ESG. There was a significant decrease in 2021, where only 32% of respondents noted a lack
of comparability of ESG data across issuers as an investment barrier (HSBC, 2021).

In 2021, BNP Paribas conducted the ESG Global Survey with asset owners and managers whose organisations incorporate ESG into their investment decision making process. Of the 356 respondents, 39% found challenges around data quality and consistency as the main barrier for further ESG investing worldwide. Followed by inconsistent data across asset classes (38% of respondents) and conflicting ESG ratings (28% of respondents). Organisations surveyed in 2019 reported the same challenges (BNP Paribas, 2021).

In the context of Australia PwC analysed Australia’s top 200 companies (ASX 200). The analysis revealed that despite the growing recognition of ESG amongst organisations and its importance, 66% of companies do not have their ESG reporting assured. This can be because of the lack of globally accepted standards and frameworks on ESG reporting, making it difficult to compare data from one company to another (PWC, 2021).

A lack of ESG understanding

In March and April 2021, Natixis Investment Managers surveyed 8,550 investors globally across 24 countries with the goal of understanding their views on the markets and investing (Goodsell, 2021). The results cited the main reasons keeping investors from investing in ESG was a lack of knowledge (41%) and uncertainty as to whether ESG investing has influence on non-financial issues.

Lack of trust in ranking scorings from various frameworks and indices

Fragmented scoring between independent ESG rating providers can deter investors from making ESG investments. In 2022, Statista compared the ESG scores of the 25 largest companies by market capitalisation reported by three ESG score providers- Sustainalytics, S&P Global and MSCI. Statista found that each of the three ESG score providers reported differences in ESG
scores. Standardised ESG scoring is out of 100 (higher is better). Berkshire Hathaway (US) is a good example of this divergence; S&P Global gave Berkshire Hathaway an ESG score of around 67 (slightly above average), MSCI had the equivalent score of around 35 (below average) and S&P Global had an equivalent score of 8 (well below average) (Statista, 2022).

5. An Investor’s Perspective

ESG investing is on the rise, as investors are directing their focus towards sustainable investments.

A high volume of ESG index funds are outperforming regular index funds. For example, between March 2019-March 2021 the S&P 500 ESG index outperformed the regular S&P 500 index (S&P Global, 2022).

According to a survey conducted by BlackRock in 2022, the environmental part of ESG is the main focus among global investors. Among respondents who currently focus on ESG investments, 88% stated that they focus on the environmental factor, while 60% focus on the governance aspect and 52% focus on the social aspect (Blackrock, 2022). The survey cited that these results are likely to change, the environmental aspect will remain top priority whilst social aspects will take second priority followed by governance.

Australian investors sought reassurance that their investments are sustainable through independent labelling or certification (RIAA, 2021). A survey conducted by the Responsible Investment Association Australasia to identify the top responsible investment priorities for consumers found that 75% of respondents seek responsible investment products to accompany an independent certification or labelling provided by an independent third party (RIAA, 2021).

A survey conducted by Natixis in 2021, found that 66% of institutional investors surveyed cited ESG integration which is using data and research to make investment decisions (Blackrock, 2022) as their main strategy when making ESG investment decisions. Followed by exclusionary screens (45%) and impact investments (42%), respectively (Natixis, 2022). The top two barriers to ESG integration in Australia are a lack of understanding of ESG issues and a lack of company culture that is conducive to integrating ESG into the investment process (CFA Institute, 2019).
6. Exploring the ESG standards landscape

The research identified nine organisations who have established standards and ESG disclosure frameworks. This includes the World Economic Forum, the European Commission, the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), International Integrated Reporting Council (IIRC), the Task Force on Climate-related Financial Disclosures (TCFD), the International Organization for Standardization (ISO) and CBP.

The Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), CDP and the Task Force on Climate-related Financial Disclosures (TCFD) are the most common ESG frameworks and standards referenced amongst organisations. According to a 2021 study published by UNCTAD, 95% of stock exchange worldwide referenced the sustainability reporting framework maintained by the Global Reporting Initiative as part of their ESG guidance, followed by SASB (77%), International Integrated Reporting Council (75%), CDP (66%) and Taskforce on Climate-related Financial Disclosures (54%) (World Investment Report, 2021).

In June 2021, to simplify the complex landscape of ESG reporting, the IIRC and SASB merged and formed the Value Reporting Foundation. Further alignment endured for sustainability disclosures when in March 2022 the International Financial Reporting Standards (IFRAS) Foundation and GRI announced to align capital market and multi-stakeholder standards (IFRS, 2022).

TCFD focuses on providing organisations with guidance to disclose their ESG impacts, whilst GRI standards help organisations communicate these impacts (Mohin, 2017). GRI for example enables organisations to publicly disclose their impacts on the economy, environment, and people through standards. GRI standards are categorised into three standards: universal standards, sector standards and topic standards (GRI, 2022).

The International Organization for Standardisation (ISO) has established an ISO Strategic Advisory Group (SAG). One of proposed areas of work is to begin mapping indicators used in current ESG frameworks (TCFD, GRI and VRF) to ISO standards that address those indicators. This analysis can serve as an opportunity to find gaps for next steps. Australia is actively participating on the SAG ESG (ISO, 2021).
ISO has three key technical committees who develop ESG related standards:

- ISO/TC 207, Environmental management (Standards Australia is a participating member*)
- ISO/TC 322, Sustainable finance (Standards Australia is an observing member*)
- ISO/TC 309, Governance of organizations (Standards Australia is a participating member)

These technical committees are already coordinating their work to ensure alignment with international ESG standardisation activities.

7. Recommendations

Organisations worldwide are increasingly disclosing ESG metrics in their annual reports. Regulations are already in place in the EU, Singapore, and Hong Kong, with the anticipation that mandatory disclosures of non-financial indicators are on the horizon for Australia. Therefore, it is important that organisations have the tools and practices in place to disclose ESG indicators. Standards Australia recognises that many voluntary ESG frameworks and ESG standards are available to the industry and it can therefore be difficult for organisations to identify best practices for various ESG indicators.

Through participation in ISO activities, there is an opportunity for experts and industry to contribute to standardisation of all aspects of ESG, this will include mapping standards and tools to help organisations build their ESG approach. Standards Australia is actively participating on the Strategic Advisory Group on ‘ESG’ and calls on industry experts such as those in finance institutions to join. Engagement in such international standardisation activities will help to protect Australia’s best interests and ensure that Australia’s voice is represented on the international standardisation stage.

If you want to know more about the research, or you want to join Standards Australia’s Strategic Advisory Group on ESG or want to enquire further about the work underway at Standards Australia, please reach out to our research team at research@standards.org.au.
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