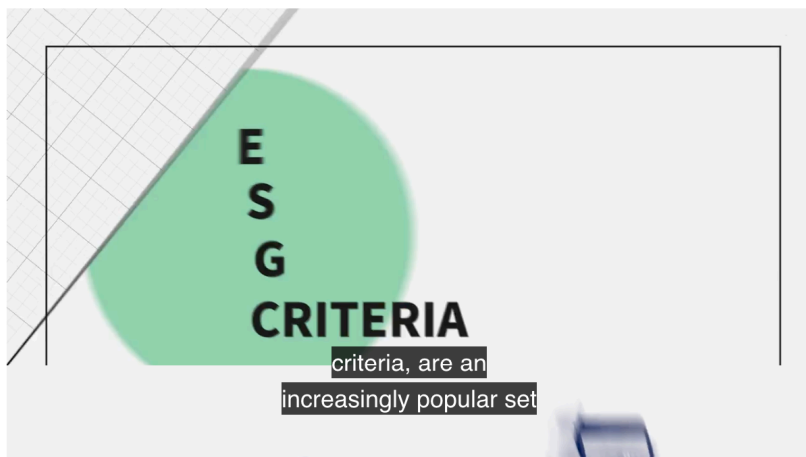


3 Trends to Watch in ESG Investing



What Is ESG Investing?

[Environmental, social, and corporate governance \(ESG\) investing](#) focuses on companies that support environmental protection, social justice, and ethical management practices. Like all [investors](#), ESG investors value returns. However, they avoid prioritizing profits above [supporting companies](#) that fit into their ethical frameworks.

Ethical investing is a growing force in capital markets, and ESG funds posted increased inflows of nearly \$650 billion, or 10% of worldwide fund assets, in late 2021, according to Reuters.^[1] In the United States at the start of 2022, \$8.4 trillion, or 13% of total assets under professional management, were sustainable investment assets.^[2]

Despite a switch in 2022 to net outflows for funds marketed as “sustainable”—the first time in more than a decade, amid turbulent markets—ESG investing remains a growing force in capital markets. ^[3] Below are three of the most important trends in this area.

KEY TAKEAWAYS

- Environmental, social, and governance (ESG) investing seeks to support companies and projects that provide a social benefit, not just profit.
- Climate change is a major concern for environmentalists, but it also offers potential profit for renewable energy investors.
- Executive compensation is another major concern for investors who use an ESG lens, and many funds seek companies with equitable pay and hiring practices.
- In the U.S., a recent rule change should allow more investors access to ESG investing through their employee retirement plans.

Understanding ESG Investing

Different ESG investors follow [an array of trends in ethical investing](#). For example, some ESG investors are environmentally focused and prefer to put their money into alternative energy and green companies. Others champion social justice and seek out companies that promote diversity, economic equality, and other human rights issues.

Then there are ESG investors who focus on companies’ management practices, looking for businesses that employ approaches such as restricting [management pay](#) to reasonable levels and providing [work-life balance](#) to employees.

With the coming [transfer of wealth](#) to the millennial generation, many of these new potential investors will be looking to [put their money to work](#). This is a generation of people who are very socially conscious and often advocate for ESG causes. Many of these emerging investors will want to invest in things that they believe in and support, and learning about ESG investing can make it easier to understand what these investors are looking for.

Here are three ESG investing trends to consider.

1. Climate Change

Well over 90% of climate scientists believe that [climate change](#) is real and that human activity is responsible for it. ^[5] Several roadblocks, both political and practical, have kept many developed countries from moving full steam ahead in tackling climate change. However, progress is being made, and climate change represents an opportunity for ESG investors to profit while also supporting a cause that they believe in.

Solutions such as [cap-and-trade](#) legislation are constantly passed around like a political football in the U.S. These amount to government regulatory programs designed to limit, or cap, the total level of emissions of certain chemicals, particularly carbon dioxide, as a result of industrial activity.

If cap-and-trade legislation passes, it could have a devastating effect on nonrenewable energy sectors, such as oil and coal. However, the demise of coal and oil would create a void to be filled by [renewable energy](#) sources, such as wind, solar, and nuclear energy. ESG investors who are optimistic about climate change legislation should research potential alternative energy investments.

! **Warning:** Climate change represents an existential threat to human society, with many nations pledging to become carbon neutral by 2050. ^[6] Reaching these goals, however, will require substantial investments in alternative energies and other [green technologies](#).

2. Equal Pay

A global wage report on the gender wage gap by the United Nations' (UN) International Labour Organization (ILO) found when analyzing data gathered from 70 countries that in 2018–19, women earned, on average, [only about 80% of what men earn](#) for doing the same jobs. ^[7] A study for 2022–23 of a more limited sample comprising 22 countries noted that there was very little change in the gender pay gap. ^[8]

Companies that actively improve gender equality may be more attractive investments for ESG-sensitive investors. Those who believe the [gender wage gap](#) is a pressing problem have growing opportunities to invest in companies that prioritize being on the forefront of this issue.

★ **Tip:** To get the latest analysis and advice on green investing, check out [The Green Investor podcast](#), powered by Investopedia.

3. Executive Compensation

For those affected by the [Great Recession of 2007–09](#), insult was added to injury when news stories emerged about the exorbitant salaries paid to [chief executive officers \(CEOs\)](#) who had largely contributed to the downturn. In some cases, executives were paid millions to go away quietly after they had run their companies into the ground.

Executive compensation is a major concern for many ESG investors. For investors who fall into this camp, opportunities abound, as many large corporations are dialing back their executive compensation to more reasonable levels. The CEOs of several major companies have voluntarily reduced their annual compensation, though it should be noted that these executives were already very wealthy before making this decision.

For ESG investors who feel that runaway executive compensation undermines the [economy](#), it might be time to seek out and invest in companies that are proactive on this issue.

Retirement Plans

The U.S. [Department of Labor](#), reversing a Trump administration-era decision, issued a final rule in November 2022 that should give investors greater access to ESG investments in their [401\(k\) retirement plans](#). The rule rescinds two rules that went into effect in late 2020. Those rules had barred retirement plan fiduciaries from considering the potential financial benefits of ESG investments and [portfolios](#) in selecting plan investment options. ^[9]

Employer retirement plan sponsors, the Labor Department said, had complained that rule had a “chilling effect” on placing ESG investments on 401(k) menus. ^[9] With the new regulation in place, plan [fiduciaries](#) will have a wider latitude to consider ESG impacts in building those menus.

Consideration of ESG attributes has increased substantially in the past decade. For example, a 2022 study by global asset management firm Schroders found that 87% of defined contribution retirement plan participants want to invest in line with their values. ^[10]

However, most 401(k) plan participants do not have access to ESG options. Industry estimates vary, but only about 5% to 15% of 401(k) plans include ESG funds. ^[11] The Labor Department rule issued in late 2022 will make it considerably easier for plan sponsors to increase that proportion.

US SIF: The Forum for Sustainable and Responsible Investment, a leading advocate for ESG investing, applauded the Labor Department’s decision.

“In reality, the rule is catching up to where the marketplace has been for years,” US SIF said. “The final rule helps to address the gap between the growth of sustainable investment overall and the much more limited growth of sustainable investment options in retirement plans.” ^[12]

How Did ESG Investing Start?

Although ethical concerns have always existed in investing, the institutional practice likely dates back to the 1950s and '60s, when [union pension](#) funds began to seek investments that would accomplish both social good and reliable returns. A few years later, there was increasing [pressure to divest from the apartheid regime in South Africa](#), creating demand for more ethically minded fund management.

What Is the Difference Between ESG Investing and Impact Investing?

[Impact investing](#) places a high priority on achieving social good, regardless of whether the investment returns a measurable profit. This is distinct from ESG investing, which seeks out socially beneficial investments but nonetheless seeks to earn profitable returns.

How Big Is the ESG Investing Market in the U.S.?

In the U.S. at the start of 2022, \$8.4 trillion, or 13% of total assets under professional management, were sustainable investment assets. ^[2]

The Bottom Line

Sustainable investing is a growing force in capital markets, as more funds seek investments with favorable social outcomes as well as opportunities for profit. Companies that implement strong environmental practices and fair wages aren't just helping society; they may also be making themselves more attractive to investors.