How can investors balance short-term demands with long-term sustainability?

EY Institutional Investor Survey

December 2024

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Foreword

The transition to a more sustainable economy is arguably both the greatest opportunity and the greatest risk facing institutional investors today. Trillions of dollars of funding are needed to achieve net zero while the world also requires investor support to address numerous other social and environmental challenges.

In this context, the 11th edition of the *EY Institutional Investor Survey* explores the extent to which institutional investors are actively integrating sustainability into their investment strategies, both as an opportunity and as a risk. It also considers the current state of sustainability reporting and its usefulness for investment decision making.

The survey canvasses the views of 350 investment decision-makers from institutions around the world, including asset management firms, wealth management firms, insurers and pension funds. Additional insights into the results have been gained through interviews with individual institutional investors and EY professionals. There are mixed views on whether the incoming mandatory reporting regulations will address these gaps.

Unfortunately, the survey findings indicate that despite their positive statements about using sustainability information, many investors are concerned that ESG-related investments and initiatives are harmful to short-term corporate performance. They are also likely to consider environmental, social and governance (ESG) factors as less — rather than more — significant to their decision-making in the immediate future.

Accordingly, we see an emerging "say-do" gap — where what investors say about sustainability is not backed up by what they do in practice. A contributing factor to this gap is that investors appear to lack confidence in the sustainability information being provided to them. In fact, a majority believe that greenwashing is a worsening problem and that the materiality, comparability and accuracy of companies' sustainability reporting is in serious need of improvement.

This report explores those themes in greater depth, offering insights into the challenges faced by investors today as well as their own strategies for integrating sustainability into their business models. It also offers some practical suggestions for how investors and companies can help to close the say-do gap.

Closing the say-do gap is vital because it is expected to result in more capital being allocated to projects that make a positive difference over the long term. Additionally, it allows sustainability to be recognized for what it is — not just a portfolio risk, but equally importantly, a major value driver of investment strategies.

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The say-do gap

The global EY organization has been assessing investor sentiment on corporate sustainability performance – also known as environmental, social and governance (ESG) performance – for over a decade.

During that time, there has appeared to be an increasing trend for institutional investors to care about, and embed, ESG into their decision-making. This year, we decided to delve deeper, to explore whether this commitment is evident in practice – or whether there is a growing "say-do" gap.

Sadly, the survey highlights a pronounced "say-do" gap emerging between what investors say about their commitment to integrating sustainability into their decision-making and what they do in practice. This is despite the transition to a more sustainable economy presenting significant risks and value creation opportunities for investors.

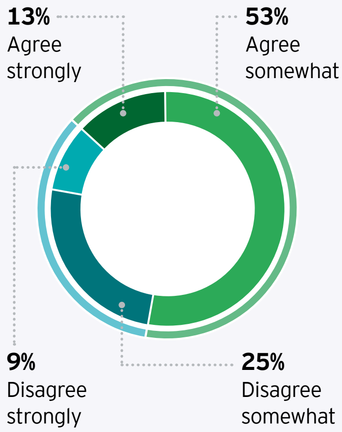
More than four in five investors (88%) surveyed for the report say that their institution has either somewhat or substantially increased its use of ESG information over the past year. This reflects the growth in corporate sustainability reporting, which equips them with more information than ever to guide their decision-making. Having this information to hand is not necessarily leading investors to allocate capital to sustainable assets, however. In fact, 92% of investors agree that the risk to near-term performance outweighs the long-term benefits of many ESG-related investments and initiatives.

What's more, there is little sign that investors intend to prioritize ESG investments more strongly in their capital allocation strategies in the immediate future. In fact, the research implies the opposite. Despite the worsening climate crisis and growing concerns over other sustainability-related issues, nearly two-thirds (66%) of investors surveyed believe that their institution is likely to decrease its consideration of ESG factors in investment decision-making.

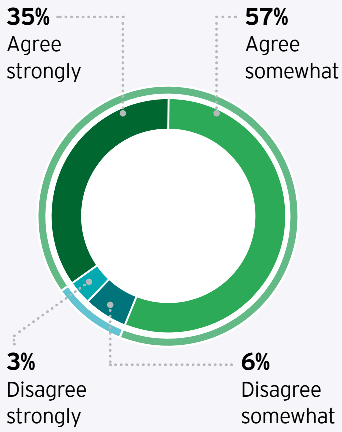
Figure 1. Investors believe that long-term ESG-related investments can compromise near-term performance

Q To what extend do you agree with the following statement

My institution is likely to decrease its consideration of ESG factors in investment decision-making.



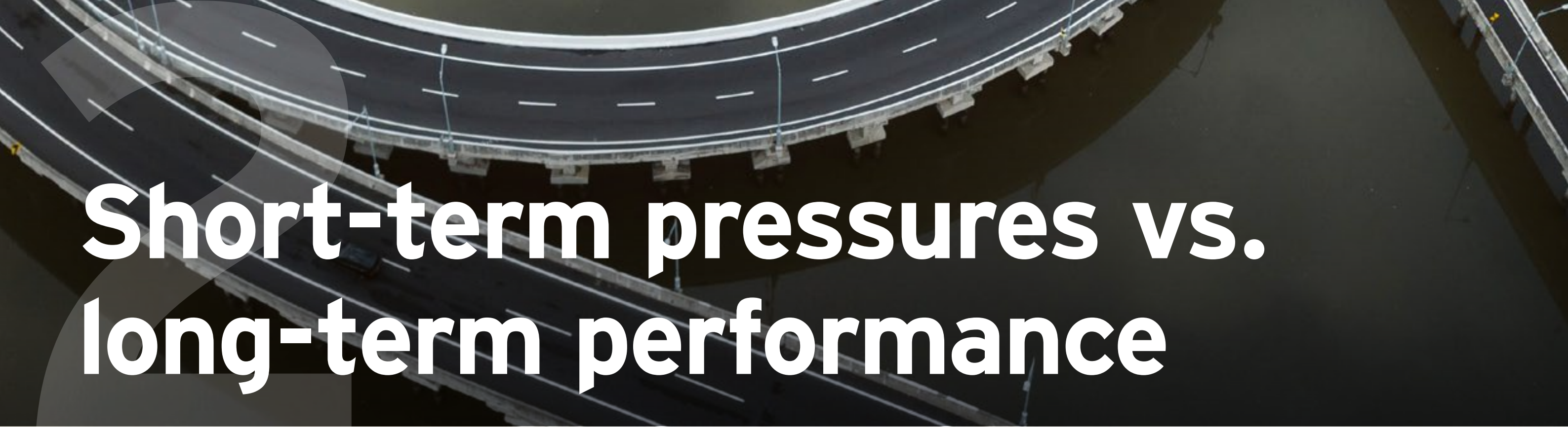
The risk to near-term performance outweighs the longer-term benefit of many ESG-related investments and initiatives.



These findings paint a worrying picture given investors' critical role in driving the transition to a more sustainable economy. For example, the Energy Transitions Commission estimates that, on average, total global capital investment of US$3.5 trillion annually is needed to bring about the energy transition to enable a net-zero economy by the middle of this century.[1]

From a strategic perspective, the allocation of capital to transition is about far more than investors "doing the right thing." The United Nations Environment Program has warned that the world is on track for a temperature rise this century of up to 3.1°C, with disastrous implications for the planet. Going forward, investors' capital could therefore be threatened by severe climate events that physically impact the companies they invest in as well as heightened transition risk — including unpredictable and interventionist regulatory and policy change — that undermines the viability of business models.[2]

By not sufficiently integrating sustainability factors into their decision-making, investors risk missing out on the opportunities associated with transition. For example, the 2023 [EY Sustainable Value Study] found that the companies taking the most action to address climate change are 1.8 times more likely to report higher-than-expected financial value from their climate initiatives, compared with those taking the least action.



Short-term pressures vs. long-term performance

As their widespread use of ESG information indicates, investors do acknowledge the economic and political importance of sustainability.

They also understand that long-term value is generated by companies transitioning to more sustainable business models. Nevertheless, immediate macroeconomic and geopolitical pressures mean that their investment decision-making is still largely determined by short-term objectives.

Nearly two-thirds (63%) of investors surveyed say that shifts in the business cycle — including periods of slower economic growth and recession — is the factor that will most acutely or substantially affect their institution's investment strategy over the next two years. In terms of core macroeconomic factors that might impact economic performance and the business cycle, investors are most likely to monitor trade restrictions and tariffs (62%), cost of capital (53%) and labor cost and availability (50%).

Figure 2. Business cycle dynamics and climate change drive decision making

Q **To what extend do you anticipate the following factors will affect your institution's investment strategies over the next two years?**

	Acute impact	Substantial	Moderate	Little or none
Shifts in the business cycle	22%	41%	33%	4%
Impact of climate change	21%	34%	29%	16%
Geopolitical conflict and relations between governments	9%	37%	48%	6%
Political uncertainty within nations	11%	29%	28%	31%

Investors' concerns about the business cycle are understandable given the complexity and uncertainty of today's macroeconomic and geopolitical landscape. Economic growth is sluggish with global GDP forecast to rise by just 3.2% in both 2024 and 2025, according to the International Monetary Fund.[3] Many of the world's biggest economies are only expanding at an anemic rate while their governments wrestle with budget deficits and spiraling debt burdens — a scenario that is already leading some to levy higher taxes on businesses. Furthermore, interest rates remain elevated while labor shortages are afflicting many markets. Naturally, investors will consider all these factors in their decision-making since they could affect the performance of assets.

Economic concerns might be their primary focus, but investors say they are also prioritizing sustainability. In fact, the majority of investors surveyed (55%) state that the impact of climate change will acutely or substantially affect their investment strategies in the near term.

Investors' monitoring of trade restrictions and tariffs may also reflect their interest in climate issues. Certain markets are using tariffs to protect their competitiveness in sustainability-related industries, such as the manufacturing of electric vehicles. Another example is the EU's Carbon Border Adjustment Mechanism, which applies an emissions tariff on imports of goods with a high risk of carbon leakage from countries that are not members of the EU Emissions Trading System. Similarly, green and blended finance can reduce the cost of capital — an outcome that will naturally be of interest to investors.

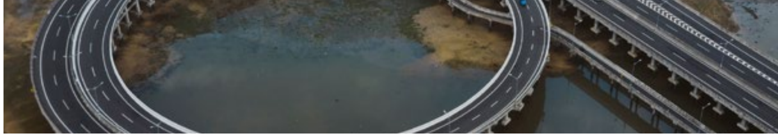
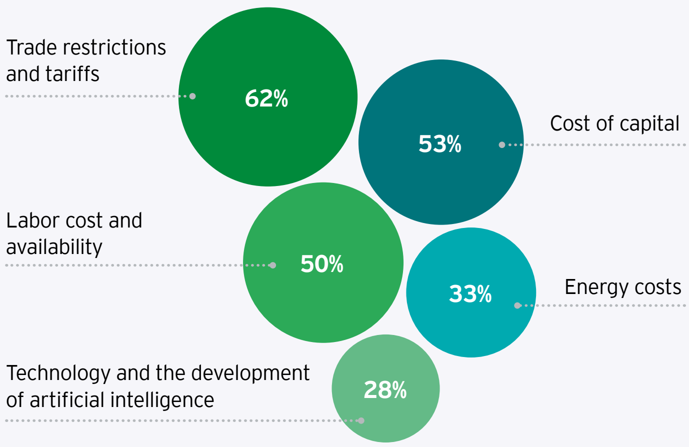


Figure 3. Investors monitor trade policy, capital costs, and labor closely

Q **Which of the following macroeconomic factors are you most likely to monitor closely in an effort to gauge changes in economic performance and the business cycle?**



Investors in Europe and North America are far likelier than their peers in other parts of the world to see climate change as a driver of investment strategies. This correlates with the maturity of those markets in terms of regulation and policy relating to climate change.

"We focus on the basics of blocking and tackling in wealth management," explains a US wealth advisor with more than US$20 billion under management, who was surveyed as part of this research. "Yes, we pay close attention to geopolitical and climate matters, to the extent we can, and we try to think through the most likely scenarios, the time frame over which they'll occur, and whether or not we want to play. But the fact is that good investing is tied to all of these things – company performance, the impact of geopolitics on markets and suppliers, macroeconomic fundamentals, and now climate change."

Making the transition

Despite their warm words, it is not always clear that investors rank sustainability, including climate change, that close to economic concerns on their priority lists, however. While there are some notable exceptions – including large Canadian pension funds – many investors are still strongly motivated by the desire to deliver short-term returns to their clients. There are some well publicized examples of companies being pressured by their investors to maintain the status quo, rather than pursue transformation to more sustainable business models.

"We are seeing investors – particularly asset managers – push companies against action on being progressive on long-term value if it's at the expense of short-term profit generation," says Dr. Matthew Bell, EY Global Climate Change and Sustainability Services Leader.

A major reason why investors may not push for change is that they believe they are sufficiently diversified at a portfolio level in terms of their sustainability-related risks. In this situation, they may not be particularly concerned about risk diversification at an individual company level. So, they encourage certain investee companies in exposed sectors to concentrate on maximizing value for as long as they can through their current business models rather than transition to new business models. Of course, this is a short-sighted perspective since dissuading companies from transforming is detrimental to the global fight against climate change and could expose those companies to serious transition risks. It also restricts the pool of sustainable businesses that investors themselves can invest in.

Investors also argue that there is a lack of historical correlation between sustainability objectives and financial performance, which makes it hard for them to evaluate sustainable investment performance. This is partly due to a lack of high-quality disclosures and data, but it is also down to evolving approaches to sustainability over the past 30 years.

The link between the say-do gap and investors' focus on short-term performance was already evident in the *2022 EY Global Corporate Reporting and Institutional Investor Survey*. Most relevant to this was the claim made in the study by more than three-quarters (78%) of surveyed investors, that companies should make investments that address ESG issues relevant to their business, even if doing so reduces profits in the short term. Yet 53% of large companies surveyed for the same study revealed that they faced short-term earnings pressure from investors, which impeded their long-term investments in sustainability. Furthermore, 20% described investors as being "primarily focused on quarterly earnings and indifferent to long-term investments such as sustainability."

Greenwashing concerns

Another factor that may be contributing to the say-do gap is that investors don't necessarily trust the information being provided to them by companies.

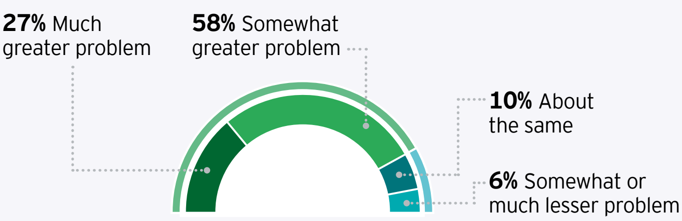
Therefore, they are cautious about allocating capital to businesses claiming sustainability credentials.

More than four out of five investors surveyed for the research (85%) say greenwashing (and similarly misleading statements about companies' sustainability performance) is a greater problem compared with five years ago. Examples of greenwashing include highly selective environmental claims or those that cannot be substantiated with evidence and positioning a product as "greener" than other options when an entire product category is harmful to the environment.

Investors' concerns about greenwashing appear to be validated by a separate EY study, the *2024 EY Global Corporate Reporting Survey*, which found that companies themselves have doubts about the credibility of their nonfinancial reporting. More than half (55%) of finance leaders surveyed for that study felt that sustainability reporting in their industry risks being perceived as including elements of greenwashing. It will be interesting to see if investor confidence in corporate sustainability information increases as more jurisdictions move to mandatory sustainability disclosures and reporting and sustainability standards continue to evolve.

Figure 3. Greenwashing is a worsening problem

Q **Greenwashing is a ________ compared with five years ago.**



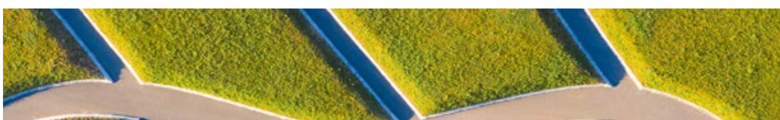
Given their lack of confidence in the ESG information being provided to them, it's surprising that 93% of investors surveyed for this report say that they are confident that companies will meet their targets for sustainability and decarbonization. The puzzle is compounded by other EY research suggesting that companies are, in fact, struggling to meet their goals.

For example, the 2023 EY Sustainable Value Study highlighted that companies were delaying their target year to achieve their climate ambitions from a median of 2036 to 2050. Meanwhile, the 2024 EY Global Corporate Reporting Survey found that fewer than half (47%) of finance leaders think it's very likely that their organization will deliver against its major sustainability priorities and meet stated targets, such as achieving net zero on time.

Often companies will have completed initiatives focused on "low-hanging fruit," such as buying renewable energy certificates or reducing business travel, but they are still wrestling with how they can achieve harder targets. These may include targets such as transforming supply chains or electrifying their entire operations through renewable energy – a challenge because most grids don't have enough renewable energy to meet demand.

The disconnect between investors' confidence over targets and what companies themselves are saying could be attributable to one of several factors. It could suggest wishful thinking on the part of investors or that investors are not actively tracking companies' progress against their targets. It is more likely, however, that investors are monitoring what companies say on sustainability, but expect them to switch to more achievable targets over time.

To protect their capital and effectively manage their risks, investors should encourage their investee companies to publish a transition plan and disclose their financial commitment to transition activities. The EY Global Climate Action Barometer 2024 found that only 41% of companies had adopted a transition plan for climate change mitigation. Furthermore, regardless of whether they had a transition plan or not, just 17% had disclosed capital expenses (capex) in relation to climate initiatives and only 4% had disclosed operating expenses (opex).



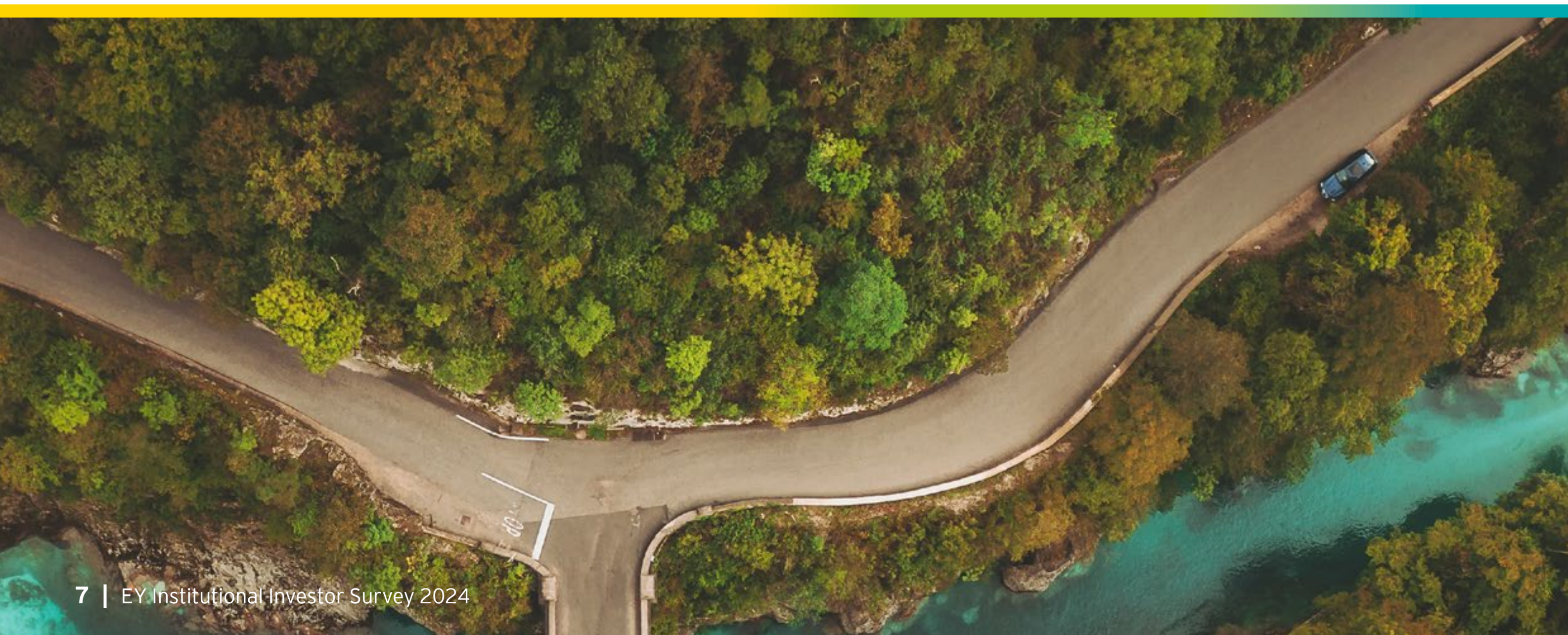
Voting for change

The investors surveyed say that they consistently support ESG shareholder resolutions, with 86% confirming that their recent voting record had been to generally vote in favor. Political or social pressure on ESG matters is the factor most likely to have influenced investors' voting on ESG and sustainability-related shareholder solutions (with 39% saying this had a substantial impact). That result was very nearly matched by outcomes from prior ESG and sustainability-related initiatives (38%).

Interestingly, however, the survey findings do not align with wider data that points to much lower levels of support from institutional investors for ESG-related shareholder solutions. This may be another example of the say-do gap. For instance, data from the Principles for Responsible Investment (PRI) reveals that average levels of support for shareholder resolutions fell from 28.3% in 2023 to 21.6% this year.

According to the PRI, there are a couple of reasons for this downward trend. The first is that shareholders believe that certain resolutions are overly demanding for companies to implement, which leads to them being withdrawn. The second is anti-ESG sentiment, which has resulted in some shareholders either filing anti-ESG resolutions or not supporting pro-ESG resolutions.[4]

Furthermore, the survey indicates some skepticism among investors around the potential for ESG and sustainability resolutions to have a long-term impact on shareholder value. Only 26% say that the resolutions' potential to drive long-term value had substantially influenced their firm's voting. Even fewer (10%) state that their firm's voting record had been driven by the belief that the resolutions would impact near-term profitability.



Gauging the impact of climate change

In general, investors' strategy toward sustainability investment is likely to be driven by one or more of the following factors: government policy and regulation; their own decarbonization or net zero target; commitments made to clients at fund and investment level (the fund mandate); and portfolio performance and risk, including the risk of stranded assets or physical risks.

Investors use different frameworks to assess their investments depending on the extent to which they are driven by policy, targets, mandates or risk. In the Nordics, for example, some pension funds are aiming to transition their investment portfolios to net-zero greenhouse gas emissions by 2050.[5] It is not just climate issues that investors are monitoring either. Increasingly investors are paying close attention to a wide range of other social and environmental issues, including biodiversity and nature, governance and human rights practices.

"In Europe, the consciousness about the importance of ESG factors has broadened out," says the chief investment officer of a large pension fund in Switzerland. "I think we're beyond the stage where it's just about CO_2 footprint or just global warming. There are other topics in the ESG space that are also important, like labor and social policies."

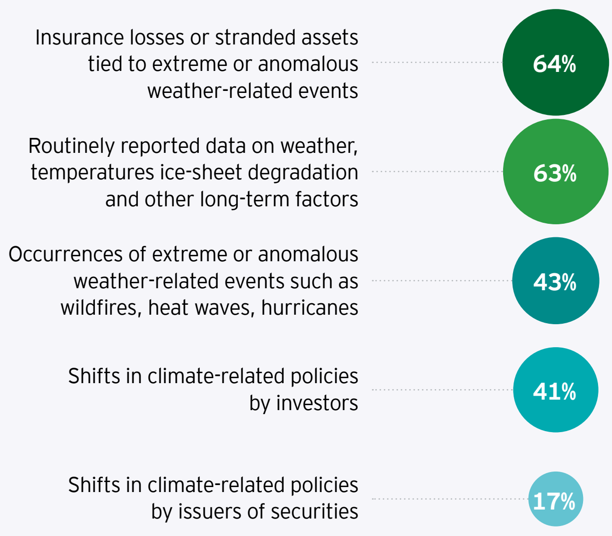
When it comes to gauging the impact of climate change, the survey highlighted that investors heavily monitor portfolio performance and risk. Nearly two-thirds (64%) of investors surveyed say they are most likely to closely monitor insurance losses or stranded assets tied to extreme or anomalous weather-related events. This reflects the direct financial impact these threats can potentially have on a portfolio. Research suggests that insurance premiums for physical risks and natural catastrophe protection are set to increase by 50% by 2030, reaching US$200–US$250 billion globally.[6] Another report predicts that the global cost of decommissioning stranded assets in the energy sector could be as high as US$8 trillion.[7]

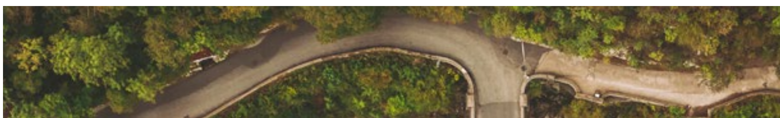
In line with their concerns around insurance losses and stranded assets, 63% of investors also monitor routine climate reporting, including routinely reported data on weather, temperatures, ice sheet degradation and other long-term factors. Additionally, investors are interested in what their peers are doing, with 41% paying attention to shifts in climate-related policies by other investors.

Overall, the survey suggests that investors see 'outside-in' macro information as more meaningful than company-specific disclosures. Just 17% monitor shifts in climate-related policies by companies, implying that corporate reporting as it currently stands may not be giving investors the insights they need to inform their high-level decision-making.

Figure 4. Investors monitor insurance losses and routine climate reporting more than company policies

Q **Which of the following factors are you most likely to monitor closely in an effort to gauge the impact of climate change?**





Climate litigation

Another risk that investors are monitoring is the risk of climate litigation. There has been a rise in cases launched against companies and governments, typically launched by well-funded lobbying and activist groups. Some of these cases challenge companies and governments for not taking enough action on climate. Others come at the issue from a different angle – for example, ESG backlash cases that challenge the incorporation of climate risk into financial decision-making. Among other types of case, there are also "green vs. green" cases focused on potential trade-offs between climate and biodiversity or other environmental aims.

More than 1,800 climate litigation cases have been filed globally since 2015, according to the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science. By far the most documented cases have been filed in the US. In 2023, 230 new climate cases were filed worldwide, but the growth rate slowed last year, suggesting a slowdown in the overall growth in climate litigation.[8]

Climate litigation is not just a risk because it is costly and time-consuming. Regardless of whether a lawsuit is won or lost, it can damage a company's reputation and potentially undermine its standing with customers, regulators and society at large, with far-reaching implications for its business model. This, in turn, can impair the value of an investor's stake in the business.

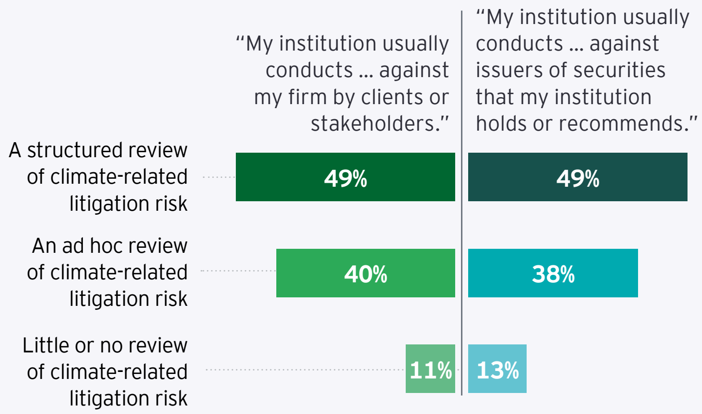
As they are acutely conscious of the risks posed by climate litigation, investors are carefully scrutinizing the extent to which they are exposed. Nearly half (49%) of investors surveyed undertake structured reviews of climate-related litigation risk against their firm by clients or stakeholders, while 40% undertake an ad hoc review. Similarly, 49% of investors say their institution undertakes a structured review of climate-related litigation risk against the companies it invests in, with 38% carrying out an ad-hoc review.

"More and more institutional investors have concerns around reputational damage as a result of greenwashing and they want to prevent that," says Michelle Davies, EY Global Sustainability Legal Services Leader. "So they are asking companies for much greater access to information about their processes and systems for identifying, managing and mitigating reputational risk."

In future, it is possible that the risk of climate litigation will deter investors from investing in the most exposed sectors such as chemicals, fossil fuels, mining and heavy industry. As a result, the investor pool operating in this space could become more limited in size.

Figure 5. Investors scrutinize the risk of climate litigation carefully

Investors' review of climate-related litigation risk



Sustainability reporting

Investors can access a wealth of sustainability information thanks to the plethora of initiatives and frameworks that have been launched since the Global Reporting Initiative began in 1997.

In particular, the arrival of the Task Force on Climate-Related Financial Disclosures (TCFD) in 2015 was a major step forward. By driving companies to produce consistent disclosures, the TCFD's recommendations helped investors to better understand climate-related risks and opportunities.

Today, a huge shift is underway in the sustainability reporting landscape as a result of two recent developments. The first is the launch of the International Sustainability Standards Board's (ISSB's) inaugural sustainability disclosure standards, IFRS S1 and IFRS S2. While these standards are voluntary, they are starting to be formally adopted by jurisdictions around the world and are likely to become mandatory in many countries. The standards aim to meet the information needs of investors and other capital providers by enabling companies to deliver decision-useful, consistent and comparable information in a cost-effective and assurable way.

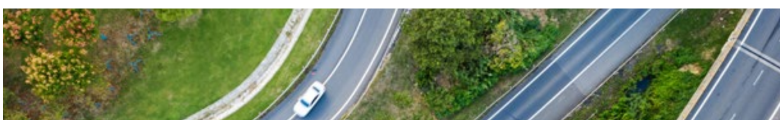
The other major development is the EU Corporate Sustainability Reporting Directive (CSRD). The CSRD mandates around 49,000 companies within scope to publicly disclose material information about the sustainability risks and opportunities facing their business, as well as their own impacts on people and the environment (a requirement known as "double materiality"). Reported information under the CSRD should be consistent with the EU Taxonomy, an EU-wide classification system that establishes a list of environmentally sustainable economic activities. The CSRD is intended to meet the information needs of all external stakeholders of companies, not just investors. (For a more detailed explanation of the ISSB's disclosure standards and the CSRD), see Appendix A.

Yet, despite the expected future growth in sustainability reporting, it seems that investors are not currently getting decision-useful information. Over one-third of investors surveyed (36%) are dissatisfied with the progress made by companies in delivering new nonfinancial performance reporting. What's more, investors are most disappointed in the materiality, comparability and accuracy of sustainability data. Four in five investors surveyed (80%) believe that the materiality and comparability of sustainability reporting need improvement, with 62% saying the same for accuracy.

Figure 6. Despite broad satisfaction, investors see need for improvement

Q **Which of the following dimensions of sustainability reporting are in greatest need of improvements?**

	Acute need	Substantial need	Little need
Materiality of reporting	39%	41%	20%
Comparability of report across issuers	37%	43%	19%
Accuracy of reporting	32%	30%	38%
Timeliness of reporting	10%	60%	29%
Transparency and definitions of reported information	10%	54%	36%



Materiality is a challenge because companies don't want to risk leaving anything out of their reporting that might be material. As a result, they may provide so much information that it is almost impossible for investors to discern which factors are truly material to the business are therefore likely to impact its valuation. Already, companies' sustainability reports are often hundreds of pages long and mandatory requirements are only likely to increase them further.

Comparability is another challenge because companies are often measuring different things, using different metrics, over different timeframes. Also, there can be selective interpretation of certain terminology, such as being "Paris aligned" in transition planning. This makes it hard for investors to compare and contrast the performance of different companies.

The quality of nonfinancial data that is used to produce sustainability reporting probably explains why accuracy is highlighted as an issue by investors. Data can often be incorrect, incomplete, inconsistent and out of date. Due to these quality issues, investors may therefore lack the confidence to rely on reports generated by companies — another explanation for the say-do gap.

"Where ESG factors are being used in decision-making, investors have a strong preference for good, robust data," says Matt Handford, EY Americas Financial Services Climate Change and Sustainability Leader. "Most of the time, that relates to climate-related data, because it's accessible to investors. More traditional metrics are also used — for example the percentage of women on the board is popular from a diversity perspective. But it's more challenging to find benchmarkable data across other areas."

Many of the improvements that investors are looking for in terms of materiality, comparability and accuracy may be seen as the ISSB and CSRD frameworks are implemented in practice. Nevertheless, it's only early days for both. The ISSB's standards only came into effect in 2024, while the first companies to report under the CSRD will report in 2025 on 2024 data. As the benefits of the frameworks become clearer to investors, they should become more confident about the quality of companies' sustainability reporting, which will help to close the say-do gap.

"The requirements will help investors to undertake greater comparison between different sectors and different businesses and compare a business's progress against their own expectations or what it has previously said," says Shaun Carazzo, EY Global Financial Services Climate Change and Sustainability Services Leader. "As a result, we should expect investors to have greater visibility over the corporate agenda for climate change, including companies' plans for transition, and the ability to measure their progress."

Mixed views on usefulness

For now, investors still have mixed views on the likely usefulness of the CSRD and ISSB standards. They believe that the ISSB standards are better articulated to investors and companies, which is likely a reflection of the "financial materiality"-focused nature of the ISSB standards. In addition to financial materiality, CSRD requires an "impact materiality" lens to be applied. Nevertheless, there's a perception that while both sets of standards are suited to support long-term investment decision-making (which is what they are designed for), they are far less suited to supporting short-term investment decision-making. This is a challenge for investors who understand the importance of investing for the long-term but have their own performance measured on a quarterly basis — a situation that exacerbates, motivates and even incentivizes the say-do gap. Furthermore, less than one-third (29%) of investors think the CSRD reporting standards are sufficiently detailed and complete for investment decision-making while 22% say the same of the ISSB standards.

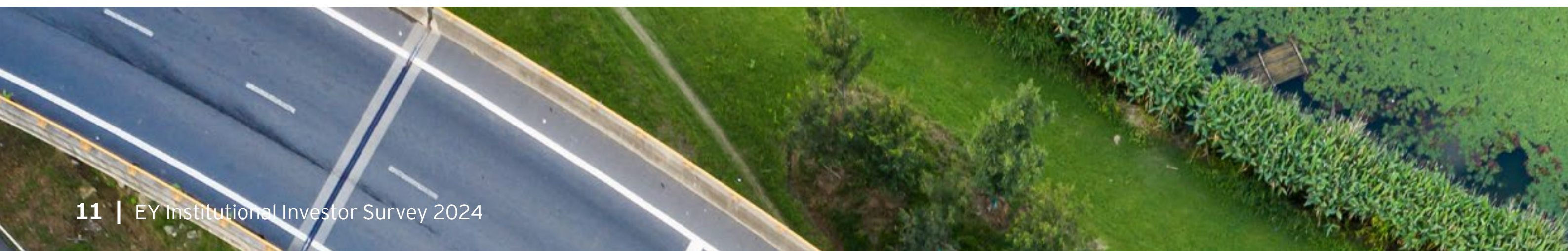


Figure 7. Investors have mixed views on new sustainability reporting standards

The investors interviewed for this report were broadly positive about the new standards, however. "I think people will get savvier about how useful these aggregate measurements are and whether or not they correlate to actual improvement in the fundamental behavior," says the director of investment at a North American insurance company.

A UK pension investor adds: "Giving us different data on a more frequent cadence will sharpen the resolution of the information mosaic that we're building." She explains that investors will hire analysts to "do the work of sifting the wheat from the chaff and figuring out which data points actually have predictive power or actual correlation to ESG outcomes in ways we care about."

As more sustainability reports are published under the new frameworks, companies will be able to compare and contrast the quality of their reporting. At the same time, investors will have an opportunity to identify what good looks like.

Independent assurance

In many cases, information reported under the CSRD must be independently assured by a third party. While the ISSB standards are intended to generate assurance-ready information, those implementing them will determine whether they require assurance. Nevertheless, it is likely that assurance may be required as jurisdictions adopt the standards into their legal and regulatory frameworks. Done well, assurance should help companies to achieve high standards in their reporting and give confidence to investors that their information can be trusted.

Investors certainly support the concept of assurance – probably because they already value the assurance provided by external auditors over companies' financial information. Also, they likely see the value in an auditor scrutinizing a company's data, controls, processes and systems for nonfinancial reporting in the same way that those are scrutinized for the purposes of financial reporting. Nearly two-thirds (64%) of investors surveyed agree that ISSB and CSRD reporting should be independently audited.

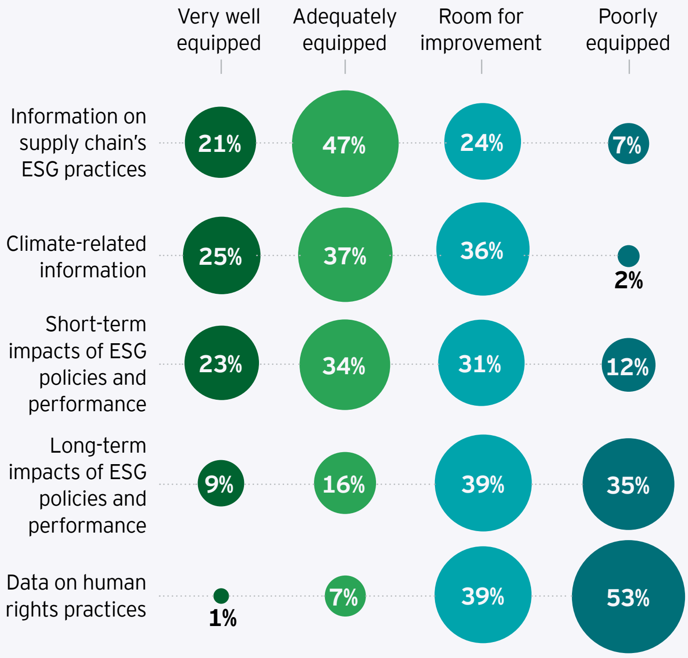
Assessment of nonfinancial performance information

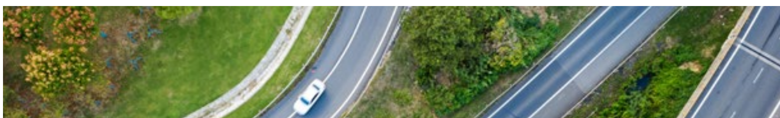
Investors are generally confident in their abilities to assess companies' sustainability-related disclosures. More than two-thirds (68%) of surveyed investors feel very well or adequately equipped to assess information relating to the ESG practices of supply chains while 62% say the same for climate-related information.

Investors are much more confident about evaluating the short-term impacts of ESG policies and performance compared with the long-term impacts, however. This is likely because of the variables and unknowns that can make it difficult to model long-term risks and outcomes. Investors don't necessarily dedicate the same amount of focus to all sustainability topics either. Some are more focused on social issues such as human rights and supply chain whereas others are more focused on climate change, decarbonization and the energy transition.

Figure 8. Investors say they are ill-equipped to gauge long-term impacts of ESG

Q **How well equipped are your institution's investment decision-makers to assess the following types of nonfinancial performance information?**





When it comes to scoring companies on sustainability, investors differ in their approaches. Some rely on information from external agencies such as CDP and Sustainalytics to monitor and score companies as part of their fund strategies. Others use their own proprietary systems. Another group might take a hybrid approach — combining agency data with their own analysis.

"We have to be aware of ESG-related matters that have an effect on companies," says the chief investment officer of the wealth manager. "But we don't want to take action unless we have something concrete. And when we make our ESG decisions, we go by data from Sustainalytics or other vendors. We may not agree — in fact, we often don't necessarily agree with how they arrive at all of their numbers. But taken in aggregate for a portfolio, or within an industry, it's certainly worth paying attention to."

Invariably, the assessment approach taken by an individual investor is likely to vary according to their resources and budget. An internal approach will be bespoke to the investor, and potentially a source of competitive advantage since clients who care deeply about sustainability issues will want to work with an asset manager that has done their own research. Through due diligence, an internal analysis team can obtain a real, more substantive perspective on a company's sustainability performance than the perspective available through a rating agency. It can be more expensive to maintain an internal team and system than to use an external agency, however.

Going forward, investors' need to analyze sustainability information will mean that they are likely to enhance their capabilities for capturing, storing and reviewing sustainability data, including sustainability information reported by companies. Already, many investors are adjusting their sustainability research and analysis capabilities in response to the ISSB and CSRD frameworks. Over half (56%) are seeking candidates with ISSB or CSRD expertise when hiring new staff while 49% are providing training on the standards and 45% are investing in data management, technology and systems that are focused on ISSB or CSRD.

Sustainability is a continually evolving area. So, a challenge for investors is being able to analyze and monitor it as definitions change. For example, investors are currently divided as to whether the defense sector can be categorized as sustainable or not. Public sentiment can also change against certain practices being sustainable — if a country is experiencing energy shortages, citizens may favor a return to power that is generated through the use of fossil fuels. These considerations must be taken into account as investors further develop their analytical capabilities.

Future outlook

It is not clear from the survey whether the say-do gap between what investors say about integrating sustainability into their decision-making and what they do in practice is likely to narrow – or widen further – in the near future.

On the one hand, investors are showing some signs of "sustainability fatigue" and recognizing the difficulties involved with quantifying and selling the ESG benefits of long-term value creation where short-term corporate performance is not strong. On the other hand, they continue to engage with sustainability at a meaningful level. They are also developing a deeper understanding of sustainability, as both a risk and a value driver for their portfolios, so they can price it into their investment strategies.

The reality is that investors are often in different places in their own maturity, depending on the market in which they invest. Some investors – particularly in Europe – are engaging in active dialogue around sustainability and holding companies to account over issues such as targets and remuneration. Meanwhile, in Japan, investors are interested in quantifying the impact of ESG on a company, including the long-term equity premium.

In the US, however, investors have grown more cautious. They have faced an anti-ESG backlash that has resulted in some pension funds being sued for breaching their fiduciary duties when considering ESG-related risks in investment decision-making. Meanwhile, numerous investors from around the world have pulled out of the Glasgow Financial Alliance for Net Zero (GFANZ) over fears of climate litigation.

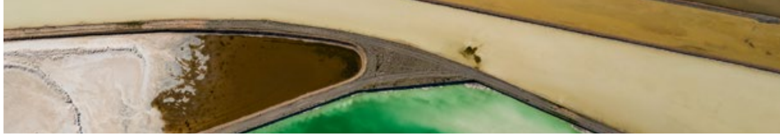
Nevertheless, the global direction of travel remains unchanged; the world's biggest markets still have ambitious net zero targets in place. China wants to reach carbon neutrality before 2060, for example, while the EU and the US are both targeting net zero by 2050. Meeting these targets will require governments to launch major infrastructure projects and companies to develop new, sustainability-oriented business models. In turn, the real economy link between sustainability and competitiveness will begin to emerge as a positive investment strategy.

Also, the financial losses associated with extreme weather events – which are only likely to increase in frequency and intensity – will encourage investors to maintain their focus on sustainability, at least when it comes to climate. As an example, Goldman Sachs has estimated that the combined property damage incurred by the recent Hurricanes Helene and Milton in the US could cost US$90 billion.[9]

"I think it's a temporary blip," is how the director of investment at a North American insurer describes the current hiatus on the part of investors. "I put it in the context of the cyclicality of socially conscious investing initiatives broadly around the world. Here in the US, it may come in and out of fashion, whereas in Europe I think there's a more secular trend toward institutionalizing, regimenting and normalizing concern for ESG. As politics change in the US and ESG becomes more closely tied to real valuations and investment outcomes, I expect it'll shift more toward the European view."

Going forward, a sustainable investment strategy will require investors to integrate sustainability broadly into their whole portfolio rather than confine sustainability investing to a small set of characteristics and companies. As a result, investors will need the capacity to measure investment risk more accurately and the mindset to proactively seek out better investment opportunities.

> "There is no doubt that sustainability poses a major investment risk to investors. It also presents a major opportunity, however.



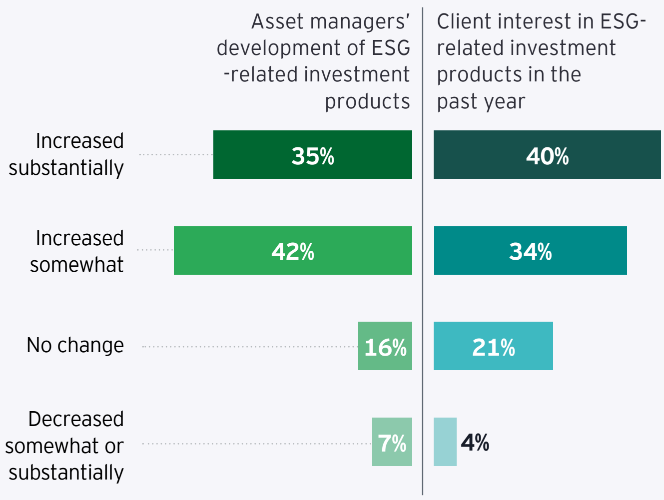
Additionally, the "Great Wealth Transfer" (the intergenerational shift of wealth) has begun. As this shift takes hold, a new generation of more sustainability-motivated asset owners most likely will be seeking sustainability outcomes alongside financial returns. Investors who are not prepared for this transition, with appropriate investment strategies and track records, are likely to be left behind.

Already, asset managers recognize that their clients are demanding sustainable investment products and they are actively trying to meet that demand. Over three-quarters (77%) of asset managers surveyed say they have increased their focus on the development of ESG-related investment products, including mutual funds and exchange-traded funds. A similar percentage (74%) note that client interest in ESG-related investment products had either substantially or somewhat increased over the past year.

Ultimately, climate risk is likely to be one of the biggest disruptions facing companies over the next 20 to 30 years. This risk is not only expected to play out in terms of extreme weather events, but also in social issues such as conflicts and migration, and economic issues such as recessions and resource shortages.

Figure 9. Asset managers continue to develop sustainable investment products in response to client demand

Shifts in asset managers' focus on ESG



Meanwhile, the economic risks associated with nature are becoming far more widely understood, increasing the pressure on companies to act quickly to address them. In fact, research by the University of Oxford has predicted that shocks to the global economy related to biodiversity loss and ecosystem damage could cost upward of US$5 trillion.[10]

As a result, there is no doubt that sustainability poses a major investment risk to investors. It also presents a major opportunity, however.

"Some companies will be well placed to navigate disruption, thrive and survive," says Ben Taylor, UK Climate Change and Sustainability Services Partner and report contributor. "Other companies will be potentially stranded, either because of their lack of balance sheet strength or because their core business model has become obsolete. Investors want to be enabling the transformation of those businesses that will innovate and adapt."

Call to action

How can the say-do gap be closed? These recommendations for investors and companies can help to build confidence in sustainability as a driver of long-term value, support the achievement of targets and accelerate the transition to a net-zero economy:

Investors

1. **Take a balanced approach to performance and risk.** As well as measuring quarterly performance, investors should undertake financial risk modeling that enables them to assess the potential value of their assets in the context of different scenarios. This will help to minimize the risk of capital loss and bolster the long-term sustainability of their business models.

2. **Monitor the sustainability-related plans and policies of governments, central banks, multilateral governmental institutions and financial institutions.** These plans and policies will have a significant impact on the risk/return ratio of investors' portfolios. As a result, they should be closely followed, assessed and interpreted, either by an inhouse team or by drawing on external expertise, or by a mixture of both. Investors should also look to create new partnerships and participate in new cohesive ecosystems that effectively mobilize more climate and sustainability finance.

3. **Analyze sectoral and corporate-level transition pathways.** To gain a deep understanding of transition pathways, investors will need to actively engage with governments, policymakers, companies, scientists and nongovernmental organizations. Corporate-level decarbonization and sustainability strategies will impact overall portfolio steerage and tilting over time. So, investors will need to analyze the likely implications of different pathways to adequately assess the risk/return ratios of their portfolios as well as individual investments. This analysis will also provide them with good insights into the opportunities associated with transition.

4. **Engage with clients to understand their expectations in relation to long-term value creation.** What returns do they expect to see, in what form and over what time frame? Client demand impacts investment mandates, products and funds, leading investment strategies to evolve over time. Investors should closely connect with their clients to adequately predict how this demand will evolve.

5. **Invest in sustainability data and technology.** Sustainability data, analysis and interpretation will become key drivers for adequately assessing risk/return across the whole portfolio. Firms need sustainability data and technology that will enable them to get the insights they need to guide and implement their investment strategies.

6. **Develop the capabilities to analyze additional information reported by companies under the CSRD and ISSB standards.** If they are not already doing so, investors should upskill to acquire the necessary skills to create the linkage from a wider set of data (that becomes more comparable over time) to their own investment strategies.

Companies

1 Engage with investors around sustainability reporting. Ask for clarification on what matters investors would consider to be material and which information would be most useful for informing their decision-making. Find out how investors are using the company's sustainability information at present and how that information can be improved.

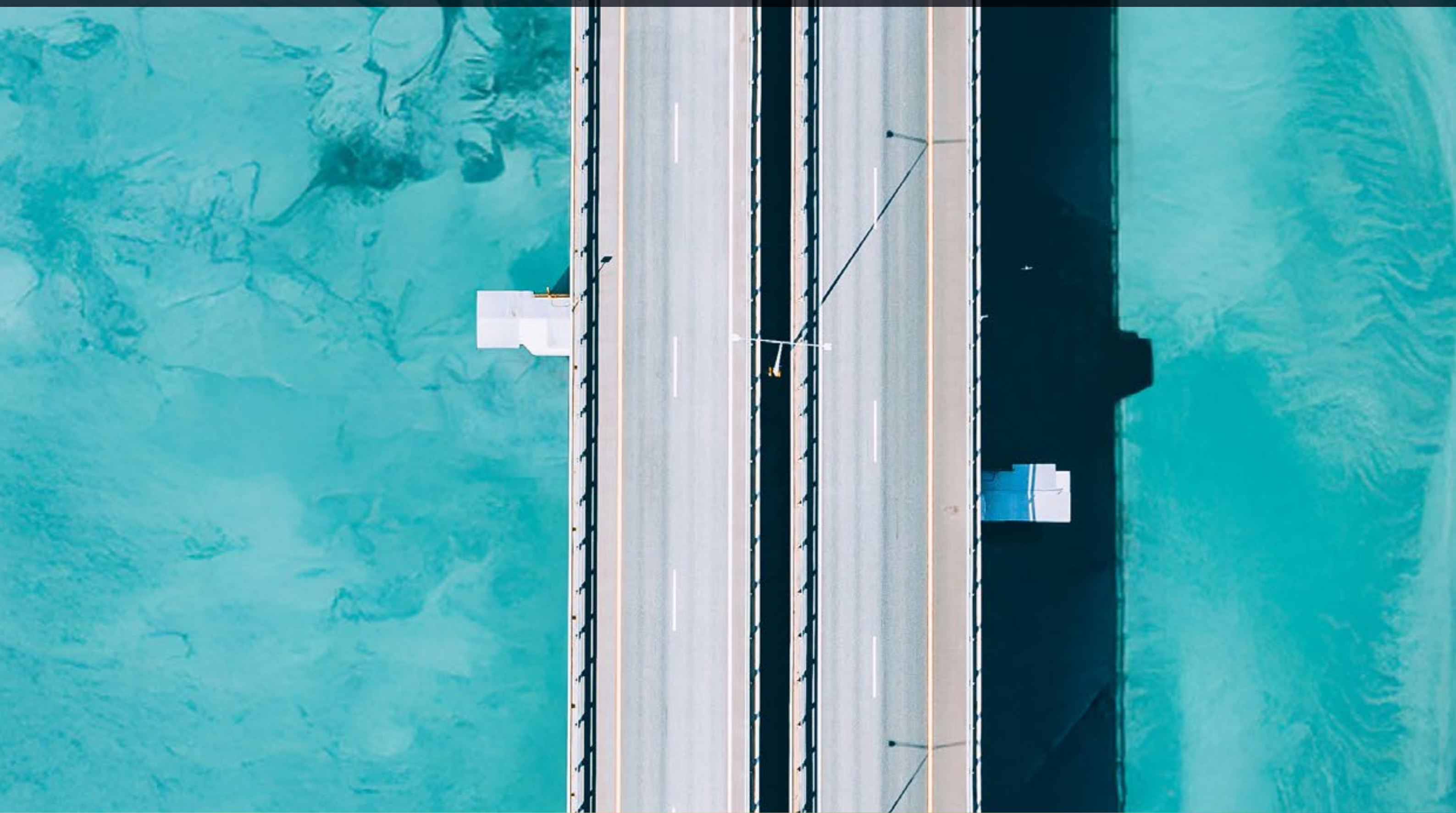
2 Prevent greenwashing. Establish control frameworks and assurance processes over targets, plans and progress updates. Ensure that robust evidence exists to support all the claims made in the company's sustainability report, on behalf of the company itself as well as its supply chain.

3 Publish a detailed transition plan. Transition plans provide investors with clarity around the company's transition. They enable the company to communicate its strategy for hitting its net-zero target, and show how they will contribute to nature positive, and be clear on the risks and dependencies in their proposals. Detail on capex and opex enables investors to understand how sustainability initiatives will be funded over time, and potential impacts on cash flows and yields.

4 Understand the frameworks used by investors and rating agencies to monitor investments for sustainability. Knowledge of these frameworks will enable the company to understand how investors are pricing sustainability into their portfolio, as both a risk and a value driver.

5 Be transparent in disclosures. Genuine transparency will help to build investor confidence in reported information. It will also equip investors with the information they need to embrace climate change and sustainability strategy as integral to their business strategies. Consider setting up a cross-functional sustainability disclosure committee to support the production of high-quality reporting.

6 Communicate the long-term value creation strategy. Demonstrate the linkage between short-term investments in sustainability and long-term capital growth and yield. Use established impact valuation models to quantify impacts on key levers of value, e.g., customer loyalty and retention, cost reduction and market penetration.



Appendix

What are the ESRS and ISSB standards?

Two new standards for sustainability reporting emerged in 2023. The European Sustainability Reporting Standards (ESRS) are very ambitious and require in-scope entities to provide detailed data and information on various sustainability topics for use by investors and wider stakeholder groups. The International Sustainability Standards Board (ISSB) standards focus on material information to meet the information needs of investors, creditors and banks.

	ESRS	ISSB
Where did these standards come from?	As part of the European Green Deal, the Corporate Sustainability Reporting Directive (CSRD) requires entities to report sustainability information under the reporting framework of the European Sustainability Reporting Standards (ESRS), approved by the European Commission in 2023	The ISSB, is a standard-setting body launched in November 2021 by the International Financial Reporting Standards (IFRS) Foundation. In 2023, the ISSB standards IFRS S1: *General requirements for Disclosure of Sustainability-related Financial Information and IFRS S2: Climate-related Disclosures*, were issued.
What do they do?	The CSRD replaced the European Union's Non-Financial Reporting Directive to close the gap between financial and sustainability reporting and data. The ESRS were developed by a body bringing together different stakeholders called the European Financial Reporting Advisory Group (EFRAG). The first set of ESRS, comprising 12 standards, covers environmental, social and governance (ESG) issues.	The ISSB standards establish a global baseline of sustainability-related financial disclosures addressing the needs of investors, creditors and banks. The ISSB standards are built on TCFD (Task Force on Climate-Related Financial Disclosures) and consolidated several existing standards (for example, the Climate Disclosure Standards Board (CDSB) and Sustainability Accounting Standards Board (SASB)) by establishing the global baseline of consistent and comparable sustainability information.
How do the standards differ?	The ESRS require a double-materiality assessment, considering what is decision-useful to investors and other stakeholders. The ESRS require sustainability information to be presented in a sustainability statement, identified as a dedicated section of the management report. The ESRS covers 10 different sustainability topics, including climate, human rights, and social governance.	The ISSB standards require the disclosure of material information that could reasonably be expected to affect an entity's prospects and is decision-useful for investors. IFRS S1 allows for the presentation of disclosures in various locations as long as the information is included in the entity's general-purpose financial reports. The ISSB standards only have so far one topic-specific reporting standard, which focuses on climate, while broader sustainability issues fall under IFRS S1.
Who are these standards for?	The ESRS cater to a wide range of users including investors, regulators, customers and the public at large.	The ISSB standards primarily cater to investors, creditors and banks.
Are these standards mandatory for all companies?	Entities in scope of the CSRD will be required to comply with the ESRS; the timeline for compliance will depend on which scope category an entity falls into.	The ISSB standards require adoption by authorities in local jurisdictions before compliance would be mandatory, determining the entities in scope and when the standards become effective.

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About the research

The EY 2024 Institutional Investor Survey is based on a survey of 350 investment decision-makers from around the world. This survey was conducted in 2024 by the EY Global Climate Change and Sustainability Services (CCaSS) group and the Custom Research Lab at Institutional Investor, LLC.

The decision-makers who were surveyed work for asset management firms, wealth management firms, private banks, insurers, pension funds, family offices, foundations, endowment funds and sovereign wealth funds. Their job titles include vice president or director of investments, chief investment officer, head of ESG/sustainable investments, portfolio manager and other investment decision-maker. Their institutions' assets under management (AUM) range from less than US$1 billion to US$50 billion or more.

In addition, several institutional investors and EY professionals were interviewed to capture their views on the research results and the topic more generally. Our thanks go to all who contributed their insights.

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