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ASSET MANAGEMENT

Impact Investing Digest

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What We're Reading

- **Clients Want Socially Responsible Investing But Advisors Remain Skeptical**

  Advisor News / by Brian O'Connell / August 31, 2018

  A lack of professional guidance on SRI funds is keeping many investors on the SRI sidelines. According to the latest Charles Schwab ETF Investor Study, three out of four exchange traded fund investors would invest more in SRI funds "if they had more education and professional guidance." While younger investors and women, especially, are flocking to socially responsible funds, 84% of all ETF investors believe they're sacrificing investment returns by engaging with SRI funds – a belief that isn't backed up by the facts. A 2017 Morningstar report said sustainable / responsible funds and indexes perform on par with comparable conventional funds and indexes. Companies with higher environmental, social, and governance scores and ratings can outperform comparable firms in both accounting terms and stock market terms. Too many advisors still tie SRI funds to performance problems, so many are reluctant to even offer, let alone recommend SRI investments. Most advisors still think it's too hard to put a well-diversified portfolio together with SRI funds. That, too, is a misconception. Advisors looking to kick some tires on SRI funds have plenty of options.

- **Is Tesla or Exxon More Sustainable? It Depends Whom You Ask**

  The Wall Street Journal / by James Mackintosh / September 17, 2018

  The problem here isn't the ESG ratings, but that they are used as though they were some sort of objective truth. In reality they are no more than a series of judgments by the scoring companies about what matters. To illustrate these differences, we can dig into the scores given to five big companies by FTSE Russell, MSCI and Sustainalytics. Tesla is ranked by MSCI at the top of the industry and by FTSE as the worst carmaker globally on ESG issues. Sustainalytics puts it in the middle. The explanation comes down to what is measured, and how the measurement is affected by disclosure. MSCI gives Tesla a near-perfect score for environment, because it has selected two themes as the most important for the car industry: the carbon produced by its products, and the opportunities the company has in clean technology. FTSE gives Tesla a "zero" on environment, because its scores ignore emissions from its cars, rating only emissions from its factories (to confuse things further, FTSE's separate "Green revenue" score gives Tesla 100%).

  Tesla highlights another major difference in scoring: what to do when a company doesn't disclose. FTSE says it has to assume the worst if no information is provided about issues that matter to a company – and that giving it the worst score encourages more disclosure. Tesla, which discloses little about its operations compared with other automakers, suffers from FTSE's approach, particularly on social issues (where all three give it low scores on how it treats workers). MSCI is more generous, assuming that if there's no disclosure the company operates in line with regional and industry norms. Sustainalytics gives points for disclosure of policies as well as low scores for issues where there is too little disclosure.

  Another problem is how to put the separate E, S and G scores together. Should a highly polluting company be able to offset that by having great governance and treating workers well? Sustainalytics ranks Exxon top of the five companies overall, because it puts a 40% weight on social issues, where Exxon does well thanks to strong policies for its workers, supply chain and local communities. MSCI ranks Exxon fourth in part because it puts a 51% weight on environment and only 17% on social issues.

  And sometimes the assessments simply differ. MSCI puts Alphabet in the bottom quartile of its industry for the subcategory of corporate governance thanks to controlling shareholders and related-party transactions, although its overall governance score is lifted by a strong score on "corruption and instability" issues. FTSE takes the opposite approach, putting Alphabet in the top half of its peer group for governance, and says it is held back in part by a weak score for anticorruption assessments and training, as well as tax disclosure.

  Investors should not treat ESG scores as settled facts to be used on their own, but as potentially worthwhile analysis that needs to be understood before being acted on. The thick ESG reports behind the scores offer useful detail about the policies and controversies around each business. But just as with financial accounts, investing without understanding is unlikely to deliver what you want.

- **Gov. Jerry Brown Signs Bill Requiring California Corporate Boards to Include Women**

  LA Times / by Patrick McGreevy / September 30, 2018

  Gov. Jerry Brown signed a bill into law that makes California the first state to require corporate boards of directors to include women, saying that despite potentially "fatal" legal problems in the measure, it is time to force action. The new law requires publicly traded corporations headquartered in California to include at least one woman on their boards by the end of 2019. By the end of July 2021, a minimum of two women must sit on boards with five members, and there must be at least three women on boards with six or more members. Companies that fail to comply face fines of $100,000 for a first violation and $300,000 for a second or subsequent violation. A quarter of California's publicly traded companies do not have a woman on their boards. The legislation is opposed by more than 30 business groups, including the California Chamber of Commerce, which said it appears to violate existing law and the state and US constitutions because it will "displace an existing member of the board of directors solely on the basis of gender."

- **Climate Change Will Get Worse. These Investors Are Betting on It**

  Bloomberg / by Christopher Flavelle / October 8, 2018

  As the U.S. grapples with a second straight year of record hurricanes, floods and wildfires, a small but growing number of hedge funds, pension plans and other investors are testing strategies to take advantage of those signs of climate change. The investments include storm and flood protection along the coast, desalination plants in drought-prone regions, new approaches to agriculture and even land far from the ocean for when rising seas shift the real estate market. Consider what might happen to food production. As precipitation patterns change and oceans become more acidic, outdoor environments will become less reliable. Demand will increase for technologies that allow indoor agriculture and even aquaculture.

- **Demand Grows for SEC Rule on ESG Disclosure**

  Pensions & Investments / by Hazel Bradford / October 15, 2018

  On Oct. 2, a sizable group of institutional investors and asset managers, state treasurers and ESG advocates petitioned the SEC to mandate standardized disclosure of environmental, social and governance information by publicly traded companies. As the effort to get that information company-by-company becomes increasingly time-consuming for all parties, investors and advocates say that standardized data will provide a better way to review companies' risk management and long-term performance while saving everyone time and trouble. There are no illusions that getting a response to the petition, not to mention companies' acceptance, will take time. "Companies are not jumping at the chance to have a new regulation on them, but at the same time, if there was a unified approach, it could help them," said Bryan McGannon, director of policy and programs with US SIF in Washington. While many companies already do sustainability disclosure, "the biggest challenge to investors is consistent data so you can do apples-to-apples comparisons," Mr. McGannon said.

- **BlackRock Stakes Claim on 'Sustainable Investing' Revolution**

  Financial Times / by Peter Smith / October 22, 2018

  BlackRock intends to become a global leader in "sustainable investing", says Larry Fink, as the world's largest asset manager launched a range of exchange traded funds in the US and Europe that incorporate environmental, social and governance criteria. "Sustainable investing will be a core component for how everyone invests in the future," the BlackRock chairman and chief executive said in an interview with the FT. Mr Fink estimated that assets in ETFs that incorporate these "ESG" factors will grow from $25bn to more than $400bn in a decade. BlackRock currently has close to 25% of the market segment with $7bn of assets. Mr Fink said sustainable investing did not mean investors had to sacrifice returns, adding that the group's in-house research department was working with MSCI, the index provider, to produce quantifiable data backing up that view. BlackRock defines sustainable investments as those that drive positive social or environmental impact alongside financial results. Some of those investments will screen out companies which operate in controversial sectors, such as fossil fuels, tobacco or weapons, while others will target businesses that advance low carbon use or renewable energy.

Research / Reports

2018 ESG Survey */ Callan / August 2018*

Callan's 2018 ESG Survey, conducted in May 2018, reflects input from 89 unique institutional U.S. funds that were asked about their approach to, and opinion on, environmental, social and governance (ESG) factors when evaluating investments. Key findings:

- 43% incorporated ESG factors into the investment decision-making process — the highest in the six-year history of Callan's survey.
- Incorporation of ESG factors into the investment decision-making process nearly doubled to 43% in 2018 compared to 22% in 2013.
- Achieving an improved risk profile was the most frequently cited reason for incorporating ESG.
- 41% of respondents who incorporated ESG plan to broaden the scope of incorporation in the future.
- 15% of those who have not yet incorporated ESG factors are considering it.
- 55% of those who have incorporated ESG consider ESG factors with every investment / manager selection.
- Ongoing disparity in ESG adoption rates by fund type and size: Corporate funds saw the most modest rise in ESG adoption rates, from 14% in 2013 to 20% in 2018; 39% of public funds indicated they incorporate ESG in 2018, up from 15% in 2013; Foundations reported the highest rate of ESG incorporation at 64% in 2018 (vs. 35% in 2013); Endowments incorporated ESG factors at a rate of 56%—more than double the rate in 2013 (22%).
- 72% of large funds have incorporated ESG factors into investment decisions.

Return on Values */ UBS / September 2018*

For its second global Investor Watch, UBS surveyed 5,300 wealthy investors on sustainable investing, a topic of growing interest. Key findings:

- Interest among clients is high, but engagement is low.
- Adoption differs dramatically by country. For example, 60% of investors in China say they have sustainable investments, compared to only 12% of U.S. investors.
- Momentum is strong. Investors expect sustainable investing to grow from 39% of investors today to 48% in five years.
- Investor preferences vary by age and asset level. Younger investors and ultra-high-net worth have the highest rates of adoption (56% and 44% respectively).
- Performance is not a barrier. 82% of investors expect sustainable investment returns to match or outperform those of traditional investments.

Responsible Investing: Charting a Sustainable Advantage */ RBC Global Asset Management / October 2018*

This report explores the conclusions drawn from RBC Global Asset Management's 2018 survey of institutional asset owners and investment consultants from the U.S., Canada, Europe and Asia on their attitudes towards responsible investing and ESG integration. Key insights:

- *Performance has become a key selling point.* A full 38% of 2018 survey respondents believe integrating ESG factors can help generate alpha – a significant increase from 2017 results when 24% of respondents said that they consider ESG to be a source of alpha. Only 20% of respondents do not believe ESG integration is an alpha source. On the other hand, the level of uncertainty about ESG's merits as an alpha source remains strong: 42% of respondents continue to say they aren't sure.
- *Responsible investing is increasingly considered to be a fiduciary responsibility.* More than 50% of all respondents who incorporate ESG factors into their investment approach say they consider this to be part of their fiduciary duty – double the percentage who said so last year.
- *Gender diversity on corporate boards continues to be important.* 42% of institutional investors support shareholder proposals as an effective means to achieve gender diversity on boards. This replaced "market forces" as the preferred approach identified in last year's survey. 63% favor non-binding diversity targets and, of those, 64% support a target greater than 30%.
- *ESG goes beyond equities.* Equities have been the primary focus when considering ESG factors with the survey confirming that the majority (84%) of institutional investors incorporate ESG factors into their process. However, the survey also indicates that ESG analysis is moving beyond equities, as 60% of respondents incorporate it into their fixed-income portfolios, 43% in real estate, 36% in infrastructure and 34% in alternative assets.
- *Exclusion screens vs. ESG integration and engagement.* As responsible investing has developed, the discussion about how to apply the principles in a portfolio has evolved from negative screens (often excluding "sin" stocks such as alcohol, tobacco and firearms companies) to a range of approaches with an increased focus on engagement with companies as a way to influence corporate behavior. When asked in the context of the Fossil Fuel Free movement whether it was more effective to divest or engage, for example, 45% of the 2018 survey respondents said engagement is more effective (compared to 8% of respondents who prefer divestment), demonstrating that investors continue to favor engaging in dialogue with companies instead of simply selling their shares.
- *Negative screening.* Among institutional investors who apply negative screens to their portfolios, companies associated with cluster munitions and landmines were the most likely to be excluded (75% screen them out), followed by weapons generally (66%), tobacco (60%) and fossil fuels (42%). With respect to fossil fuel screens, the survey revealed pointed differences by region: fossil fuel screens are unpopular in Canada (23%) while in the U.S. they are among the most widely used screens (62%) – in line with weapons and tobacco, and even slightly ahead of cluster munitions. In the U.K., screens are applied more evenly across the board.

The Case for Sustainable Bond Investing Strengthens */ Barclays / October 2018*

Barclays' new Impact Series study adds nearly two years of data to its research into the relationship between Environmental, Social and Governance (ESG) investing and bond portfolio performance from 2016. Key findings:

- Confirms 2016 findings that tilting a credit portfolio in favor of high ESG bonds, while keeping all other risk characteristics unchanged, tends to lead to higher performance in all three markets considered (U.S. and euro investment grade and U.S. high yield).
- While the G was previously most closely associated with performance, E has had the strongest effect in the past two years in the U.S. and over nine years in Europe.
- The link between E, S and G scores and performance varies across sectors. G is important in the banking sector, while E is significant in most others.
- The euro credit market prices ESG attributes differently than the U.S. market: high ESG bonds trade at persistently tighter spreads than low ESG peers in Europe, but not in the U.S. European issuers also tend to have higher ESG ratings than U.S. issuers.

Report on US Sustainable, Responsible and Impact Investing Trends */ US SIF Foundation / October 2018*

US SIF Foundation's biennial report presents data on the numbers of institutional asset owners, money management firms and investment vehicles using sustainable investment strategies. Key highlights:

- Sustainable, responsible and impact investing (SRI) assets have expanded to $12.0 trillion in the United States, up 38% from $8.7 trillion in 2016.
- Much of this growth is driven by asset managers, who now consider ESG criteria across $11.6 trillion in assets, up 44% from $8.1 trillion in 2016.
- The top three issues for asset managers and their institutional investor clients are climate change / carbon, tobacco and conflict risk.
- From 2016 through the first half of 2018, 165 institutional investors and 54 investment managers controlling $1.8 trillion in assets under management filed or co-filed shareholder resolutions on ESG issues.

Upcoming Events and Conferences

- ### Social Finance Forum

  November 7-9, 2018 / MaRS Centre for Impact Investing / Toronto, Canada

  Social Finance Forum convenes investors, entrepreneurs, finance professionals, charity leaders and public service visionaries who believe profits should be paired with purpose. Justina will speak on a panel to help family offices identify steps to create a robust impact-investing strategy and provide advice on finding and evaluating investment opportunities.