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ASSET MANAGEMENT

Impact Investing Digest

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What We're Reading

- **Lenders Scolded for Climate Ignorance in 'Insane' Florida Real Estate Deals**

  Bloomberg / by Danielle Moran, Katia Porzecanski and Eric Roston / May 13, 2019

  Hurricane Michael killed seven people and caused more than $6 billion in damage in Florida, a toll compounded by warmer, higher seas and wetter air, the signs of climate change scientists have long warned about. But investors have yet to pay any kind of meaningful attention, buying up long-dated debt and financing real estate decades into the future. The risks of climate change have begun to pop up in prospectuses and credit-analysis, to little effect. Ahead of a new debt offering, Miami Beach told potential investors that officials are "keenly aware of the risk from hurricanes and sea-level rise." Miami Beach successfully raised its $162 million, with a 20-year maturity pricing at the same yield as a similar April offering by Charlotte, North Carolina, an inland city with much less climate risk. Both issues had the same call provisions, coupons and ratings from Moody's and S&P. Comparisons are difficult, but if markets were acknowledging the scale of Florida-specific climate risk, Florida's bonds should sell at a discount, relative to similarly structured bonds sold elsewhere. Similar warnings are starting to reverberate among other financial institutions. BlackRock published a 20-page explanation of how climate-risk has become a necessary assessment in understanding shifting levels of risk and value. The report concludes that 58% of U.S. metropolitan areas will face climate-related damages amounting to 1% or more of GDP by 2060-2080, and that "a rising share of muni bond issuance over time will likely come from regions facing economic losses from rising average temperatures and related events."

- **Companies See Climate Change Hitting Their Bottom Lines in the Next 5 Years**

  The New York Times / by Brad Plumer / June 4, 2019

  Many of the world's biggest companies are bracing for the prospect that climate change could substantially affect their bottom lines within the next five years. Under pressure from shareholders and regulators, companies are increasingly disclosing the specific financial impacts they could face as the planet warms, such as extreme weather that could disrupt their supply chains or stricter climate regulations that could hurt the value of coal, oil and gas investments. In 2018, more than 7,000 companies submitted such reports to CDP, formerly known as the Carbon Disclosure Project. After analyzing submissions from 215 of the world's 500 biggest corporations, CDP found that these companies potentially faced roughly $1 trillion in costs related to climate change in the decades ahead unless they took proactive steps to prepare. By the companies' own estimates, a majority of those financial risks could start to materialize in the next five years or so. Many firms are bracing for direct impacts. Hitachi Ltd., a Japanese manufacturer, said that increased rainfall and flooding in Southeast Asia had the potential to knock out suppliers and that it was taking defensive measures as a result. Google's parent company, Alphabet, Inc., noted that rising temperatures could increase the cost of cooling its energy-hungry data centers. Others are keeping a close eye on the potential public reaction to climate change. Total, a French energy company, is grappling with the possibility that ambitious efforts by nations to limit global warming and restrict fossil fuel use could render some oil and gas reserves "unburnable." In all, the world's largest companies estimated that at least $250 billion of assets may need to be written off or retired early as the planet heats up. Those assets include buildings in high-risk flood zones, or power plants that may have to shut down in response to tighter pollution rules. Only a fraction of companies worldwide currently report their climate risks, and many, including energy giants Exxon Mobil and Chevron, did not submit a disclosure to CDP last year.

- **Funds Say Climate Change Is Now Part of Their Investing Equation**

  The Wall Street Journal / by Georgi Kantchev and Sarah Kent / June 10, 2019

  Abu Dhabi's $800 billion sovereign-wealth fund recently added a new question to its investment process: How will the earth's changing climate affect a potential asset's price? This addition was driven, fund officials say, by a fiduciary duty to earn the highest returns and avoid risks. Asset managers and investors increasingly believe there are profits to be made and losses to be avoided by considering how climate change—and government efforts to combat it—might affect companies and industries over the long term. Funds are pouring billions of dollars into technologies and industries they think will benefit from a transition to a clean-energy world and avoiding those that are likely to be hurt by it. Climate investing is essentially a bet on a major repricing in markets due to historic shifts in how we drive, heat our homes and regulate our industries. Areas that stand to prosper span a broad swath of industries from renewable energy to transport, and from green architecture to agriculture. Oil and coal companies, on the other hand, could lose out as investors fear the risk of "stranded" assets if electric cars pick up pace or governments crack down on fossil fuels.

- **Beleaguered Money Managers Find Bright Spot in ESG**

  The Wall Street Journal / by Britton O'Daly / July 11, 2019

  A record amount is flowing to investment managers who specialize in socially responsible investing, providing a bright spot for stock pickers who have otherwise struggled to keep client money. In the first half of the year, U.S. funds that consider environmental, social and governance factors when making new bets attracted a net $8.4 billion, according to data from Morningstar. That is already higher than the previous annual record of $5.4 billion collected during 2018. The rush of new ESG money coincides with a crisis of investor loyalty for asset-management companies that try to outperform the market. Investors are shifting their money away from more-expensive stock pickers and embracing lower-cost alternatives that mimic market indexes. Since 2015, clients have pulled a net $860 billion from actively managed funds, while adding a net $2.22 trillion to cheaper funds that are passively managed. While stock pickers still control a majority of the money devoted to ESG assets, cheaper ESG alternatives tied to indexes are gaining traction. The amount of money committed to passively managed ESG funds exceeded flows into actively managed ESG funds in 2018 and the first two quarters of 2019. In fact, passively managed funds attracted 63% of the total during this time, according to Morningstar. Some actively managed firms are going on the offensive. Schroders published a report in September 2018 saying passively managed funds lacked the resources for reliable research on whether companies live up to ESG standards. The report said these lower-cost funds lack the "specialist knowledge" needed to lobby the boards of portfolio companies for ESG changes. "People are astute enough to differentiate a company with a lot of experience, and a big team to do the work and evidence of a thoughtful, comprehensive strategy, from a firm that has just applied ESG to its prospectus and has someone working half time to just take ESG data from a third-party provider," said Anthony Eames, Eaton Vance's director of responsible investing strategy.

- **After years of 'glacial' change, women now hold more than 1 in 4 corporate board seats**

  The Washington Post / by Jena McGregor / July 17, 2019

  After being stuck at 16% for several years, the percentage of women-held board seats in the S&P 500 now reaches nearly 27%, according to data from ISS Analytics. Perhaps most notable is that all-male boards among S&P 500 companies have become a nearly extinct species. In 2009, there were 56 firms in the S&P 500 that did not include any women. As of June 28, there was one. Copart, an online vehicle auction company based in Dallas, has the final all-male board in the S&P 500, according to data from ISS Analytics. But it has said it intends to fill a board vacancy with a "highly qualified, accomplished woman this year." Yet that swift fall and near eradication of all-male boards among America's largest publicly traded companies disguises the challenges ahead as boards try to move closer to parity. For one, the number of all-male boards is much higher among smaller companies: Among companies in the Russell 3000 index, which also includes smaller firms, 329 have no women on the board. Meanwhile, recent research has shown that boards tend to practice a sort of "twokenism," diversifying to a point where they meet what's considered the norm and then appear to do less to raise the numbers. Another study from 2013 found that first-time female directors — as well as minority directors — tend to receive far less mentoring about boardroom norms than white men, making other appointments less likely and shorter tenures by women or minorities more likely. Gender is also, of course, only part of the diversity battle. A 2018 report from Deloitte and the Alliance for Board Diversity found that minority directors, whether male or female, make up 16% of Fortune 500 board seats. Gender diversity appears to get studied more frequently, perhaps because it seems more visible to researchers or clearer to track than race, which may not be as apparent from director bios or photographs.

Research / Reports

ESG Investor Sentiment Study */ Allianz Life Insurance Company of North America / April 2019*

Although much of the global attention within the ESG (environmental, social and governance) sector of investing has been placed on the environmental component, this study found that, in the U.S., social and governance issues are equally important as or more important than environmental record when consumers decide whether or not to invest in or do business with a company. Furthermore, the study found that a company's ESG profile plays a significant role in its overall reputation as a majority of consumers believe companies focused on ESG issues have better long-term prospects. Key findings:

- 73% of American consumers noted environmental concerns like natural resource conservation or a company's carbon footprint/impact on climate change when deciding to invest in a company
- The same percentage (73%) emphasized social issues such as working conditions of employees or racial/gender equality
- 69% highlighted governance topics like transparency of business practices and finances or level of executive compensation, as being significant in decision making
- 71% said they would stop investing in a company if it behaved in ways they consider unethical
- 84% believe companies that focus on being a good corporate citizen have better long-term prospects than those that do not

The True Faces of Sustainable Investing: Busting the Myths Around ESG Investors */ Morningstar / April 2019*

Relying on stereotypes that millennials and women are most interest in ESG investing may ignore a large, untapped market for sustainable strategies among retail investors. Morningstar found that most investors, across ages and genders, have clear preferences for ESG investment products. Key findings:

- Gender is not a useful gauge for determining interest in sustainable investing. Morningstar found that while women have a slightly stronger preference for sustainable investing than men, which was mainly driven by more women being especially passionate for sustainable investing, the difference between the weighted averages was small. Furthermore, this small difference disappeared after controlling for income, age, political ideology, religiosity, risk tolerance, financial literacy and other socio-demographic variables.
- Different generations do not have substantially different preferences for sustainable investing. The average preference score for millennials and Gen Xers were statistically equivalent, and while millennials, on average, showed a slightly stronger preference for sustainable investing when compared with baby boomers, the statistical significance between baby boomers and millennials did not exist after including socio-demographic variables.
- With 72% of the United States population expressed at least a moderate interest in sustainable investing, there may be a broader appetite for sustainable investing than previously thought.

2019 Annual Impact Investor Survey */ Global Impact Investing Network (GIIN) / June 2019*

The 2019 Annual Impact Investor Survey draws on responses from 266 leading impact investing organizations from around the world, including fund managers, foundations, banks, development finance institutions, family offices, permanent investment companies, pension funds and others. These respondents collectively manage $239 billion, a subset of the total $502 billion in the market. In its ninth edition, the Annual Impact Investor Survey provides data and insights on impact investors' motivations, activities and perspectives on market progress and remaining challenges. Analysis of trends among a subset of 83 four-year repeat survey respondents—those who responded in both 2014 and 2018—offers further insight into market growth. Key findings:

- *The impact investing industry is diverse.* Survey respondents represent a variety of investor types, including fund managers, foundations, banks, development finance institutions, family offices, pension funds and others. A majority of the investors are headquartered in developed markets; assets are allocated globally, with about half invested in emerging markets. Respondents also allocate across a variety of sectors, with the greatest share allocated to energy (15%), microfinance (13%) and other financial services (11%).
- *The impact investing market continues to grow and mature.* Collectively, respondents manage $239 billion in impact investing assets (nearly half of the total impact investing market, as measured by assets under management). A subset of 80 investors that contributed to the Annual Survey both four years ago and this year grew their assets at a compound annual growth rate of nearly 17% — a signal that the market is not only growing through new investors entering the market, but also due to increasing assets under management from those already in the market.
- *Impact measurement and management (IMM) is central to investors' goals and practices.* Respondents nearly universally measure and manage their impact, typically using a mix of qualitative information, proprietary metrics and metrics aligned to the Impact Reporting and Investment Standards (IRIS) or other standard frameworks. More than 60% of investors track their investment performance to the United Nations' Sustainable Development Goals, driven by a desire to integrate into a global development agenda.
- *Impact investors report performance in line with both financial and impact expectations.* A clear majority of respondents indicated that their investments have met or exceeded their expectations for impact (98%) and financial (91%) performance. Respondents also reported their average gross realized returns since inception. The distribution of returns data suggests that fund and investment selection is key.
- *Impact investors indicate a strong commitment to developing the industry.* Investors largely recognize their role in contributing to broader field-building efforts and industry development. For example, over 80% of respondents indicated contributing toward the various actions recommended in the GIIN's Roadmap for the Future of Impact Investing. Respondents further view the impact investing industry as playing a key role in driving broader shifts in investment practice by changing mindsets about the fundamental purpose of finance in society and promoting diversity, equity and inclusion through their policies and practices.

U.S. Board Diversity Trends in 2019 */ Harvard Law School Forum on Corporate Governance / June 2019*

Based on a review of 19,791 directorships in the Russell 3000:

- Board renewal rates continue to increase, as board refreshment, director qualifications and board diversity remain high-priority issues for companies and investors.
- The percentage of women joining boards reaches a new record high, with 45% of new Russell 3000 board seats filled by women in 2019 (compared to 12% in 2008) and 19% of all Russell 3000 seats held by women.
- Ethnic diversity also reached record highs, but has grown at a much slower pace, with ~10% of Russell 3000 directors currently belonging to an ethnic minority group, while 15% of new directors are ethnically diverse.
- New director appointments focus on non-financial skillsets, with an increased proportion of directors having international experience, ESG expertise and background in human resources.
- The average director age continues to increase, as the appointment of younger directors is less frequent than in previous years, with only 7.2% of new directorships filled by directors younger than 45 years, compared to 11.5% of new directors in 2008.

Several asset owners and asset managers had voting policies related to gender diversity prior to 2017. However, following State Street's policy initiative to require at least one female director at every board in 2017, many more large investors have become more vocal about improving gender diversity on boards in the past two years, and many have introduced similar voting policies. Proxy advisors also introduced similar policies, with ISS' policy to make adverse recommendation at all-male boards coming into effect in 2020.

More importantly, the push for gender diversity is no longer driven by shareholder engagement and voting only. New regulation in California mandates that all boards of companies headquartered in the state should have at least one woman on their boards in 2019, while at least three women board members are required by 2021 for boards with six members or more. Other states may follow suit, as New Jersey recently introduced legislation modeled after the California law, and Illinois is debating a bill that will require both gender and ethnic diversity on corporate boards.