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ASSET MANAGEMENT

Impact Investing Digest

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What We're Reading

- **This Has Been a Good Year for Many U.S. Sustainable Funds**

  The Wall Street Journal / by Dieter Holger / December 8, 2019

  Many U.S. sustainable funds are set to beat the broad market this year, easing some long-held concerns that values-based investing comes at the expense of returns. Through November, 48% of large-cap sustainable funds have outperformed the S&P 500, compared with only 26% of all large-cap funds, according to fund tracker Morningstar Inc. Sustainable funds are often overweight tech stocks and less invested in energy, says Todd Rosenbluth, director of mutual fund and exchange-traded fund research at CFRA Research. "That has contributed favorably" to their performance, he says. Google parent Alphabet Inc., Apple Inc. and Microsoft Corp. are regularly among the top holdings of sustainable funds. In 2017, around half of individual investors in a Morgan Stanley survey said they believe there is a financial trade-off for investing around environmental or social issues. Still, the ESG investing trend has gained steam this year, with net inflows into sustainable funds reaching a record of $17.7 billion through November, compared with $5.5 billion for all of last year, according to Morningstar. Recent research from the International Monetary Fund found that the performance of sustainable funds is at least comparable to that of conventional equity funds. Some ESG funds have done even better.

- **Goldman Sachs Pledges $750 Billion to Environmental Causes by 2030**

  Reuters / by Elizabeth Dilts Marshall / December 16, 2019

  Goldman Sachs Group said it will provide $750 billion in financing, advisory services and investments for initiatives that fight climate change, as well as those that foster economic opportunities for underserved people over the next decade. The bank also updated its internal environmental policy framework to rule out providing financing to any new projects that will drill for oil in the Arctic or that create new thermal coal plants or new thermal coal mines. Goldman Sachs Chief Executive David Solomon announced the plans in an editorial in the Financial Times, where he wrote that there is "a powerful business and investing case" for the bank to take steps to address climate change and the growing worldwide opportunity gap. Goldman emphasized that it will not pass up any significant amount of revenue as a result of the $750 billion commitment and the ban on financing certain drilling and coal activities. A Goldman Sachs executive said that the bank has not financed any projects like those in recent memory. The $750 billion commitment will be deployed in several ways, including by investing in and advising companies to take steps to reduce their carbon emissions and become more sustainable, the bank said. For example, earlier this year Goldman worked with Italian electricity company Enel to raise $1.5 billion through a bond offering that linked the investments to Enel's commitment to increase its renewable energy base by 25% before 2022.

- **Municipal Bond Issuers Face Steeper Borrowing Costs from Climate Change**

  The Financial Times / by Billy Nauman / January 7, 2020

  Municipal bond investors across America are waking up to the financial risks of climate change, as increasingly frequent extreme weather threatens cities' ability to pay back their debts. Within a decade, according to research from BlackRock, issuers equivalent to 15% of today's "muni" market are likely to see increasing impacts of weather-related events that could knock as much as 1% off their economic output. Now, concerns over climate-change exposures have begun to spread in the $4.1 trillion market, about one-quarter of the size of the US Treasury market, where American cities, states, counties or other local governments go to raise money. Credit rating agencies have begun to factor such risks into their evaluations, and reward those cities that appear well prepared. Miami Beach, for example, issued "general obligation" bonds — backed by the Florida city's taxing authority, rather than any particular stream of revenue — in March last year. They were rated AA+ by Moody's partially because of Miami Beach's climate resilience work. As part of an ongoing environmental, social and governance arms race among rating agencies, Standard & Poor's recently rolled out a new tool that uses its data on companies' assets to better predict physical climate risk for corporate issuers — but has yet to apply the system to munis. For now, investors are not punishing borrowers over these issues. BlackRock analysts recently compared two bonds with similar characteristics but vastly different climate risk profiles and found no difference in their yields. The first came from Jupiter, a Florida city near West Palm Beach, in an area beset by hurricanes. The second was from Neptune, New Jersey, an area near the Jersey Shore that is much more insulated from storms. Mr. Rabasco chalks this up to strong demand for municipal bonds, evident in dozens of consecutive weeks of inflows into specialist muni funds last year. "In an environment like that, investors aren't as discerning . . . They don't make analytical choices because they need to put cash to work," he said. Still, he expects borrowing costs to diverge before long. "There's a bit of a learning curve, but it's happening."

- **BlackRock to Hold Companies and Itself to Higher Standards on Climate Risk**

  The Wall Street Journal / by Dawn Lim and Julie Steinberg / January 14, 2020

  BlackRock Inc. said it would take a tougher stance against corporations that aren't providing a full accounting of environmental risks, part of a slew of moves by the investment giant to show it is doing more to address investment challenges posed by climate change. Among the moves, BlackRock said it would be increasingly disposed to vote against management and boards if companies don't disclose climate change risks and plans in line with key industry standards. BlackRock is also pulling back from thermal coal producers in actively managed debt-and-equity portfolios by mid-2020, a move that will lead to $500 million in sales. It will expand the range of sustainable investment products as well as double to 150 the number of exchange-traded funds that address environmental, social and governance challenges. The firm said it is putting the focus on sustainability because the costs of climate change have ramifications on the price of assets and the financial ecosystem. "Climate change has become a defining factor in companies' long-term prospects," BlackRock Chief Executive Laurence Fink said in his annual letter. "The evidence on climate risk is compelling investors to reassess core assumptions about modern finance." The firm said it would provide more information on data on the carbon footprint and other potentially controversial holdings in its mutual funds. It also said it would disclose more details of its conversations with the companies its funds invest in. BlackRock also recently said it had joined Climate Action 100+, the world's largest group of investors by assets pressuring companies to act on climate change.

- **Microsoft Raises Stakes in Corporate Climate-Pledge Race**

  The Wall Street Journal / by Aaron Tilley and Russell Gold / January 16, 2020

  Microsoft Corp. is pledging to eliminate its carbon emissions and invest $1 billion as part of a wider climate commitment. The software company said that it would become "carbon negative" by 2030—taking more carbon out of the air than its operations and those of its supply chain produce. By 2050, Microsoft said, it plans to eliminate all emissions it has produced since its founding in 1975. In the past couple of years, companies as varied as cosmetics maker L'Oréal SA, pharmaceutical firm Novo Nordisk A/S and candy maker Mars Inc. have all pledged emissions cuts, according to CDP, an international nonprofit organization that presses companies to disclose their environmental impact. Companies also face calls to use fewer fossil fuels in plastics and packaging. Nestlé SA, the world's largest food company, pledged to cut its use of plastic made from fossil fuels by one-third in five years. It also said it would invest as much as two billion Swiss francs ($2.07 billion) to find more recycled material.

  Microsoft said it has been carbon neutral since 2012, in part by purchasing what are known as offsets, which finance projects that absorb carbon dioxide, such as forest preservation. It plans to have 100% renewable energy running its facilities by 2025 and completely electrify its campus vehicle fleet by 2030. Companies pledging to take more carbon out of the air than they put in are rare. Software maker Intuit Inc. said it would take such a step by 2030. CDP says only two companies in its database have pledged to reduce emissions in a verifiable manner to reach a net-zero level: Swedish property developer Castellum AB and German professional-services firm Sustainable AG. To become carbon negative across all its operations, Microsoft plans to use technologies that remove carbon and store it for long periods underground, in the soil or in a biosphere. Julio Friedmann, a research scholar at Columbia University's Center for Global Energy Policy who was an Energy Department official in the Obama administration, said companies investing in carbon-negative technology could have a competitive advantage in years to come if future policies require companies to limit their emissions. Microsoft, like many tech companies, is having to contend with a more activist workforce pushing for a more progressive position across environmental, social and political issues. Microsoft employees have criticized the company's courting of the oil-and-gas industry to adopt its cloud-computing service, Azure.

Research / Reports

Into the Mainstream: ESG at the Tipping Point / *State Street Global Advisors / November 2019*

State Street surveyed senior executives with asset allocation responsibilities at over 300 institutions—including private and public pension funds, endowments, foundations and official institutions—to give deeper insight into the increasingly important environmental, social and governance (ESG) market. Key findings:

- *Fiduciary duty, regulation and mitigating ESG risk are the key push factors driving investors towards ESG.* 46% of respondents see fiduciary duty as the key driver of ESG adoption. The other leading driver, also at 46%, for many is regulation. Regulation will increasingly shape future adoption, particularly on topics such as climate. At 44%, mitigation of ESG risk comes in very close behind, with many investors now realizing the danger that ignoring ESG entails.
- *Data quality, internal resource constraints and the need for expertise are the key factors pulling investors away from ESG.* For nearly half of respondents, the current state of ESG data — single sourced, low correlation and confusing terminology — is a hindering factor to accurately assessing the credentials of underlying companies and their portfolio-level impact. Internal resource constraints loom large when it comes to ESG adoption and implementation across asset classes. Every investor surveyed has plans to employ more ESG resources. For nearly 40% of respondents, a lack of expertise in integrating ESG was a key hindrance factor.
- *Effective risk measurement is critical for all, regardless of investment path taken.* The relevant ESG push factor influences the investment approach taken. For example, those motivated by mitigating ESG risks are more likely to implement systematic integration or positive screening, while those driven by regulatory change and beneficiary pressure are more likely to apply exclusionary screening. For 97% of institutions the ability to measure ESG risk is critical in assessing the ESG capabilities of managers. Most investors report finding it far easier to measure governance than environmental or social impact.

2019 Edelman Trust Barometer Special Report: Institutional Investors / *Edelman / December 2019*

The 2019 Edelman Trust Barometer Special Report: Institutional Investors researched 600 institutional investors in six countries representing firms that collectively manage over $9 trillion in assets under management. The report identifies pivotal issues shaping investment criteria and how companies can build trust with the investment community. This year's research reveals that investors believe companies must address the needs of a wide range of stakeholders, not just shareholders, and must implement effective environmental, social-impact and governance (ESG) practices to win their trust. Key findings:

- *Investors agree that corporations need to have multi-stakeholder commitment.* 84% percent of respondents said maximizing shareholder returns can no longer be the primary goal of corporations and that business leaders need to commit to balancing the needs of shareholders with customers, employees, suppliers and local communities.
- *Investors are investing more in ESG-excelling companies.* More than half of investors believe that ESG practices positively impact trust, with 61% having increased their investment allocation to companies that excel when it comes to ESG factors. Data privacy and cybersecurity, employee health and safety, and eco-efficiency are the top priorities for shareholder engagement in the next 6 months. 99% of respondents expect the Board of Directors to oversee at least one ESG topic.
- *Investors are changing their voting and engagement policy to be more attentive to ESG.* 87% of respondents said that their firms have changed their voting and/or engagement policy to be more attentive to ESG risks and 56% of investors globally are hiring more ESG-focused staff. 86% of investors would consider investing with a lower rate of return if it meant investing in a company that addresses sustainable or impact investing considerations.
- *Investors believe Board diversity should be multi-dimensional, with diverse business areas of expertise being most desired.* 55% of respondents said that diversity within a company's board has a significant positive impact on trust. Investors prioritize the following aspects of board diversity: business areas of expertise (59%), business strategy philosophies (53%) and experience outside the industry or sector (52%), gender (21%), ethnicity (21%) and race (18%).
- *Employee activism makes a company a less attractive investment.* Investors recognize the impact that healthy culture and engaged employees have on corporate performance, with 74% seeing companies with activist employees as less attractive investments. Furthermore, 79% believe companies are not prepared for employee activism. Investors assess corporate culture by speaking with senior leadership and employees at all levels throughout the organization.
- *Companies are unprepared for shareholder activism because they fail at identifying emerging risks.* 79% of respondents stated that most companies are not prepared to handle activist campaigns, with the main issue an inability to define and specify new and emerging areas of risk and value creation, including cybersecurity, ESG and technological innovation.
- *Social media content matters.* 96% of investors use one or more social platforms on a weekly basis. When evaluating a current or prospective investment, 82% of investors consult the company's social media channels and 79% of investors consult company executive social media channels.
- *When a company is in distress, it's back to basics.* Top strategies for underperforming companies to shore up trust with investors include announcing a change to business strategy (52%), conducting a business or strategic review process (51%) and implementing significant cost cuts (46%). Increasing transparency and engaging with shareholders can also help to maintain investor trust.

2019 Study of Gender Diversity In Private Company Boardrooms / *Crunchbase, Him For Her and Kellogg School of Management / December 2019*

This new study analyzes the boards of 200 of the most heavily funded U.S.-based, private, venture-backed companies — organizations that had about $100 million in total funding each or were valued above $500 million. These companies were chosen because they play an outsize role in driving innovation and represent the public companies of the future. Key findings:

- 60% of companies did not have a single woman on the board.
- 7% of board seats were held by women.
- Executives and investors compose 80% of director seats, of which fewer than 5% are held by women.
- Female directors were most likely to hold an independent seat on the board.

Women on Boards — 2019 Progress Report / *MSCI ESG Research / December 2019*

MSCI's latest annual "Women on Boards" report, which has run since 2014, assesses gender equality on public company boards. Key findings:

- Progress is still slow, but 2019 saw a noticeable uptick: 20.0% of directors were women in 2019, up from 17.9% in 2018 and 17.3% in 2017. This 2.1 percentage-point increase in 2019 also slightly shortened the path to 30% female directorship (projected for 2027, based on the latest data). At the current pace, a 50/50 gender split among global directors might be reached by 2044.
- 57.3% of the companies subject to mandatory gender quotas had exceeded requirements as of October 31, 2019. Italy and France had the highest percentage of companies with more females than required (among MSCI ACWI Index constituents).
- The number of companies with majority female boards doubled in 2019 compared with 2018. Yet these 22 firms accounted for fewer than 1% of the constituents of the MSCI ACWI Index as of October 30, 2019; 98.7% of the boards remained male-dominated.
- The IT sector, historically lagging, had the steepest increase in companies with three or more female directors (28.3% in 2019 vs 15.5% in 2018).
- In emerging markets, female directors and executives were more likely to have financial expertise than their male counterparts: 47% vs 39%. In developed markets, we found no significant differences in professional expertise (risk or financial expertise) between male and female directors.
- More women (22%) than men (12%) were overboarded (serving on three or more boards) globally. Higher levels of multiple directorships among female directors may indicate overreliance on a limited pool of women directors.