“Integrating Sustainability into Investment Analytics: What the Market is Telling Us”

Billy Nauman - Reporter, Financial Times
ESG: The basics

- Environmental, Social and Governance
- Positive vs Negative Screens
- Divestment vs. Engagement
- Long term risk analysis
  - Climate risk (transition vs physical)
  - Natural capital (biodiversity)
  - Social risks (labor strikes, consumer protests, supply chains)
  - Governance risks (internal controls, CEO oversight, scandal avoidance)
- Change the world
- Do no harm to the world
- Do no harm to our portfolio
Explosive AUM growth

US Sustainable AUM (2020): $17.1 trillion

This represents 33% of the $51.4 trillion in total US assets under professional management.

Source: US SIF
What about pensions?

US Inst’l ESG AUM: $6.2tn

Source: US SIF
Examples

New York state's $226bn pension fund plans rolling fossil fuel divestments
Shift in strategy adds to pressure on US energy companies

Calpers, Schroders call for mandatory inclusion of climate risks in accounts
Big investors demand groups follow BP's example and consider global warming risk in financial statements

Calstrs plans green shift after Joe Biden's victory
The $254bn pension fund hopes to cut emissions and boost eco-friendly investments
DC is a different story

As of 2018, only 2.8% of 401(k)s offered an ESG fund on their menu

Source: Plan Sponsor Council of America

Why?

- Fiduciary duty
- Flip flopping ERISA guidance
- Product availability
What about performance?

Source: BlackRock, as of May 11, 2020. For illustrative purposes only. This is a set of 52 globally-representative, widely analyzed sustainable indices and their non-sustainable counterparts. Indices are unmanaged and used for illustrative purposes only and are not intended to be indicative of any fund’s performance. It is not possible to invest directly in an index.
What makes a “good” company?

- Rating subjectivity
- Data challenges - non financial metrics
- Risk materiality

Figure 2
Firms with high disagreement

Normalized ratings for the 25 firms with the highest mean absolute distance to the average rating (MAD) within the normalized common sample (n=924). Firms are sorted by their average rating. Each rating agency is plotted in a different color.

Source: MIT Sloan “Aggregate Confusion”
Disclosure metrics - Alphabet Soup

- SASB, GRI, TCFD, CDP, IIRC, CDSB, WRI, WEF IBC
- The EU: SFDR, NFRD and the Green Taxonomy
- Materiality
- Survey fatigue
- Verification/auditing
- IASB SSB… TBD?
Mandatory ESG disclosure in the US?

- SEC, CFTC, DOL turning over a new leaf under Biden
- BlackRock chief Larry Fink backing mandatory global disclosure framework
- Fed joins NGFS
Questions for the future

- Will ESG outperformance continue?
  - Tech/growth bias: [https://www.ft.com/content/12bd616e-442b-11ea-a43a-c4b328d9061c](https://www.ft.com/content/12bd616e-442b-11ea-a43a-c4b328d9061c)
  - Bubble fears: [https://www.ft.com/content/0a3d0af8-7092-44c3-9c98-a513a22629be](https://www.ft.com/content/0a3d0af8-7092-44c3-9c98-a513a22629be)

- Does ESG even work?
  - Companies ignoring engagement: [https://www.ft.com/content/798f752a-5db1-498c-8d1d-6389b66f317d](https://www.ft.com/content/798f752a-5db1-498c-8d1d-6389b66f317d)
  - Things keep getting worse: [https://www.ft.com/content/a967f863-1bf8-448b-9448-b67540e80b4d](https://www.ft.com/content/a967f863-1bf8-448b-9448-b67540e80b4d)
  - The failure of “Sustainability Inc.”: [https://hbr.org/2021/05/overselling-sustainability-reporting](https://hbr.org/2021/05/overselling-sustainability-reporting)
Sources and further reading

- “ESG funds defy havoc to ratchet huge inflows” https://www.ft.com/content/8e9f8204-83bf-4217-bc9e-d89396279c5b
- “Calstrs plans green shift after Joe Biden’s victory” https://www.ft.com/content/6762a43d-79fe-471d-8f3b-41e2fb8f3835
- “Calpers, Schroders call for mandatory inclusion of climate risks in accounts” https://www.ft.com/content/09444686-e4da-4360-98ba-51fc670c3826
- https://mitsloan.mit.edu/sustainability-initiative/aggregate-confusion-project
- “One small step for man, one giant leap for ESG accounting standards” https://www.ft.com/content/210aa3f4-457d-42a4-9ccc-e8745b6d0f31
- “Federal Reserve zeroes in on climate risk” https://www.ft.com/content/c50d3b98-22b3-489f-8788-24ed50fb68d8
- “Fink promises cultural change at BlackRock after discrimination allegations” https://www.ft.com/content/1a00b465-374e-4eb9-921f-726ab5d33bc1