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THE NEW BOTTOM LINE

ESG as a driver of investment strategy and performance

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Presented by:
Responsible Investor &
Thomson Reuters

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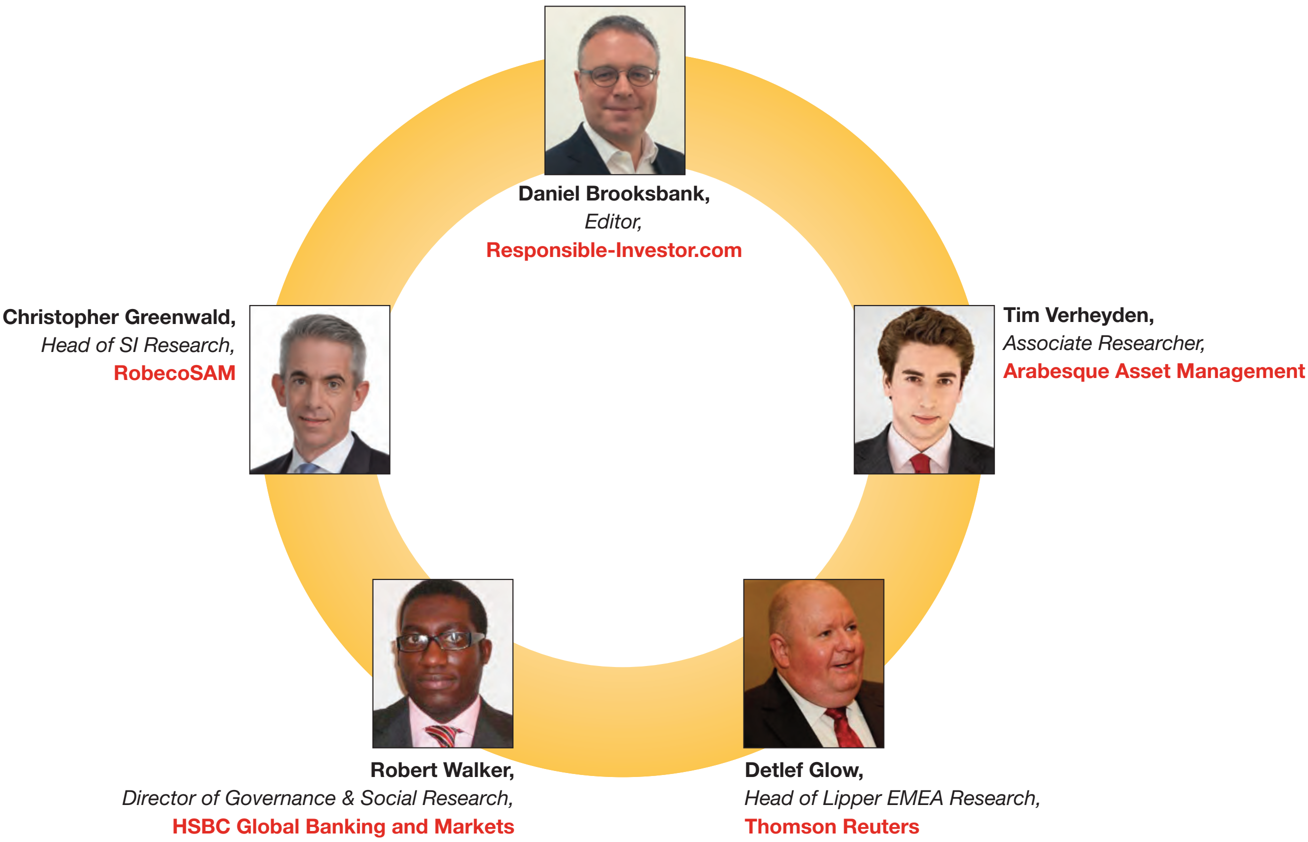
Recorded on April 20th, 2016

With environmental, social and governance (ESG) investing ESG increasingly on the agenda of the world's policymakers and leading investors, Responsible Investor and Thomson Reuters convened a webinar in April 2016 entitled 'ESG new bottom line – ESG as a driver of investment strategy and performance'.

The expert panel included:

- **Christopher Greenwald**, Head of Sustainability Investing Research at RobecoSAM, the investment specialist focused exclusively on Sustainability Investing
- **Dr Tim Verheyden**, Associate in the ESG Research department at Arabesque, the boutique fund manager
- **Robert Walker**, Director of Governance & Social Research at HSBC Global Banking and Markets
- **Detlef Glow**, Head of Europe, Middle East and Africa (EMEA) Research at Lipper, the provider of mutual and hedge fund data, analytical tools, and commentary that is a subsidiary of Thomson Reuters.

It was moderated by **Daniel Brooksbank**, Editor of Responsible-Investor.com.



Christopher Greenwald kicked off the session by focusing on the issue of long-termism and looked at the Focusing Capital on the Long Term initiative that was created in 2013 by Canada Pension Plan Investment Board and McKinsey. He also took a look at the new Long Term Value Creation Index launched at Davos this year.

Greenwald spoke of the disconnect between investors and companies around the issue of long-term investing. He cited a survey conducted by the initiative and published in the Harvard Business Review that found that 78% of C-suite executives have indicated they are under pressure to deliver financial results within one year or less. 86% of those executives claim they would be more successful if investors oriented their decisions towards a longer-term time frame. The result of this was missed investments from companies with negative consequences in aggregate on the overall economy in terms of GDP growth, employment levels and investment returns for savers.

> "There's growing evidence that short-termism has become much more prevalent over the last 20 years among both investors and corporations."

An alternative approach, he argued, was to foster a long-term horizon for both investors and companies. Promoting long-term strategic decisions and incentives by companies and investors. He said: "There's growing evidence that short-termism has become much more prevalent over the last 20 years among both investors and corporations."

In response to a question, Greenwald said companies were sometimes "misdirected" in terms of the information that they are incentivized to disclose. "Oftentimes, in my own meetings with investor relations officers, I often hear the response, 'well, I'd love to talk more about these long-term issues with investors but I'm just not getting questions'."

Tim Verheyden spoke of the "earnings game" of quarterly results – but countered with the example of Paul Polman at Unilever, who successfully ditched earnings guidance. "Focusing on the long-term absolutely does not have to be a problem and can be accepted by investors," Verhayden said.

In his presentation, Verheyden focused on the link between sustainability and performance. "As much as the 'old fashioned' SRI/ESG debate has been about values and ethical investing, we'd like to emphasise today that it's all about improving your investment returns while minimizing your tail risk."

He discussed a survey Arabesque conducted with Oxford University, a 'meta study' of over 200 academic papers. They found "a very compelling argument for sustainability in driving performance".

"First you see there's a very good link between sustainability and a lower cost of capital, the same is true in terms of operational performance level and finally on stock market performance." Arabesque wasn't the first to see this, there was also a study by Deutsche Bank and the University of Hamburg which uncovered a "non-negative" relationship between sustainability and corporate financial performance.

> "We think that ESG provides you with information, additional information which is not readily exploited in the market and it can help you in making better stock decisions."

"We believe it is all about information and market efficiency," he said, adding: "We think that ESG provides you with information - additional information - which is not readily exploited in the market and it can help you in making better stock decisions."

But Verheyden reckons the quality of ESG data currently is not on a par with fundamental and technical data. So investors and analysts need to find out which corporate information is indeed material. His firm does this by using forensic accounting techniques, he said.

HSBC's Robert Walker, when asked about the role of sell-side analysts, said: "When I speak to clients what I'm increasingly seeing is that sophisticated investors are beginning to develop their own ESG tools. Buyside investors are understanding the importance of ESG and how it can help avoid risk and also identify opportunities." He described how the bank produced a global ESG handbook in December 2015 – and found that ESG investing has grown from close to zero a decade ago to an estimated $60trn, based on signatories to the PRI.

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Walker explained: "We tested whether there was correlation between ESG scores and performance. And how did we do this? We ranked the MSCI World index by the change in Thomson Reuters ESG composite scores. We looked to see how those scores evolved from 2008 and 2014.

"What we found was that when we compared the top decile of ESG scores with the bottom decile, that the top decile companies based on ESG outperformed the bottom decile by 26 percentage points over a five-year performance period.

"What we found was that, of the E, S and G components, it was actually the environmental component that showed the most outperformance. As a governance specialist I was very surprised by that because I thought it would be governance - but it was environmental that was leading that ESG outperformance."

Another finding was that emerging markets appear more sensitive to ESG factors. So while developed markets generally have better ESG indicators than emerging markets, stock pricing in emerging markets appears more sensitive to movements in ESG factors. "It's really about momentum. Companies moving from a lower base to a higher base were driving, to a much bigger extent, that ESG performance." He also made the point that governance really matters in emerging markets - important given HSBC's reach.

Lipper's Detlef Glow pointed to a range of studies showing ESG is producing at least the same returns as conventional investment. "More and more foundations and other institutional investors take this issue of ESG in the investment process very seriously." He spoke of regulators forcing pension funds to invest in a sustainable manner and the trend of foundations starting to align their investments with their mission purpose. This was leading to asset managers looking to act as long-term investors rather than as "tactical" investors only looking for short-term opportunities.

He said: "You have to bear in mind all the duties a fiduciary has for its client." It's the duty of a fiduciary to look at all the information available, and that includes ESG data. And investment screens and the growth of overlays with exclusion criteria, which had become "more or less mainstream in the industry".

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Glow pointed out that: "ESG criteria can be used to avoid the losers, i.e. to help to protect the investors' interests as well as their capital". He argued that the use of ESG criteria could help investors avoid corporate scandals such as Enron, WorldCom, Parmalat, BP and Volkswagen – in effect a form of risk management. In this context, the quality of data was a key consideration.

THE NEW BOTTOM LINE webinar was viewed live by more than 600 individuals representing 300+ institutions globally and has since been viewed on demand by a further 200+ individuals.

To learn more about Thomson Reuters ESG data please visit financial.thomsonreuters.com/esg

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