



# ESG in the Investment Process

## Values vs. Value

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***“At the end of the day, it’s the investor’s  
decision as to what standards they  
expect”***

*Heike Reichelt, head of investor relations  
and new products, World Bank*

# ESG Investment Overview



## ESG Myths

Misperception	Reality
 'Negative Screen' only	→ Many options are available to suit client preferences, e.g. ESG integration
 Negative return impact	→ Study's suggest the use of ESG criteria may enhance risk/return outcomes
 <b>X</b> Small Co's <b>X</b> Emerging	→ Disclosure has improved substantially across listed equity markets
 Public not Private	→ The long term nature of private markets aligns with ESG

# ESG Investment Overview



## Defining the process



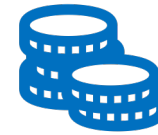
There is no silver bullet for integrating ESG into the investment process



ESG as an investment criteria is still fluid. Standards and definitions are evolving and changing quickly



Managing ESG objectives across a portfolio is substantially more difficult than across a single asset. The ultimate aim is that ESG is not differentiated within and across asset classes



A lack of standardization of incorporating ESG into the investment process suggests there will be trade-offs between achieving sustainability objectives and portfolio diversification

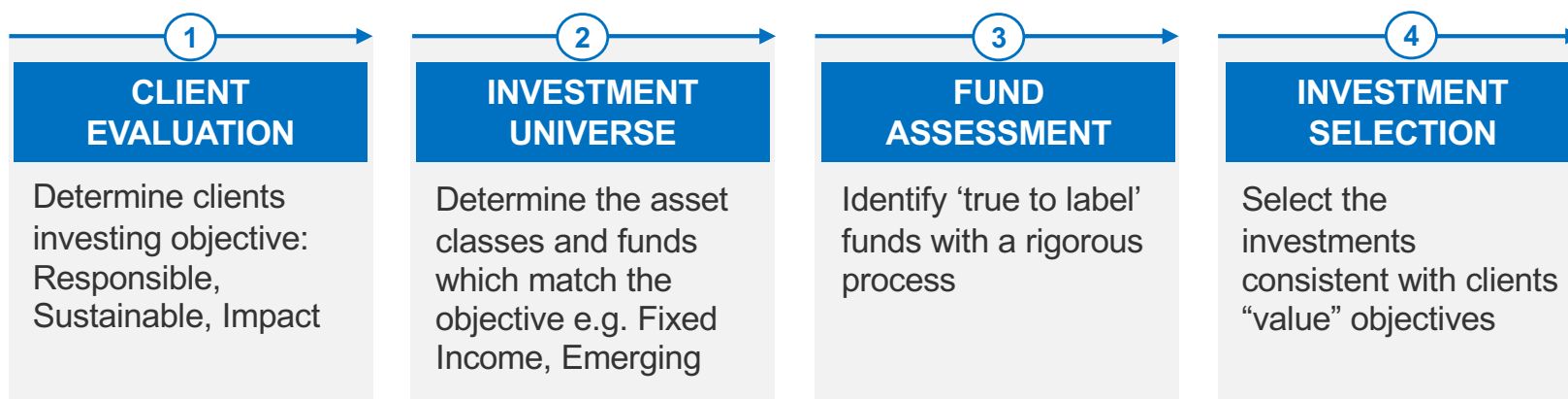
# A Roadmap for Advisors



## Implementing ESG into a managed account:

Advisors must determine:

1. **Where** a client wants to sit on the sustainability spectrum;
2. **What** a client is prepared to sacrifice for their social objectives; and
3. **How** individual preferences impact the overall portfolio.



# A Roadmap for Advisors



## Implementing ESG into a managed account:

There are 3 ways of implementing ESG into a managed account – each has advantages and disadvantages

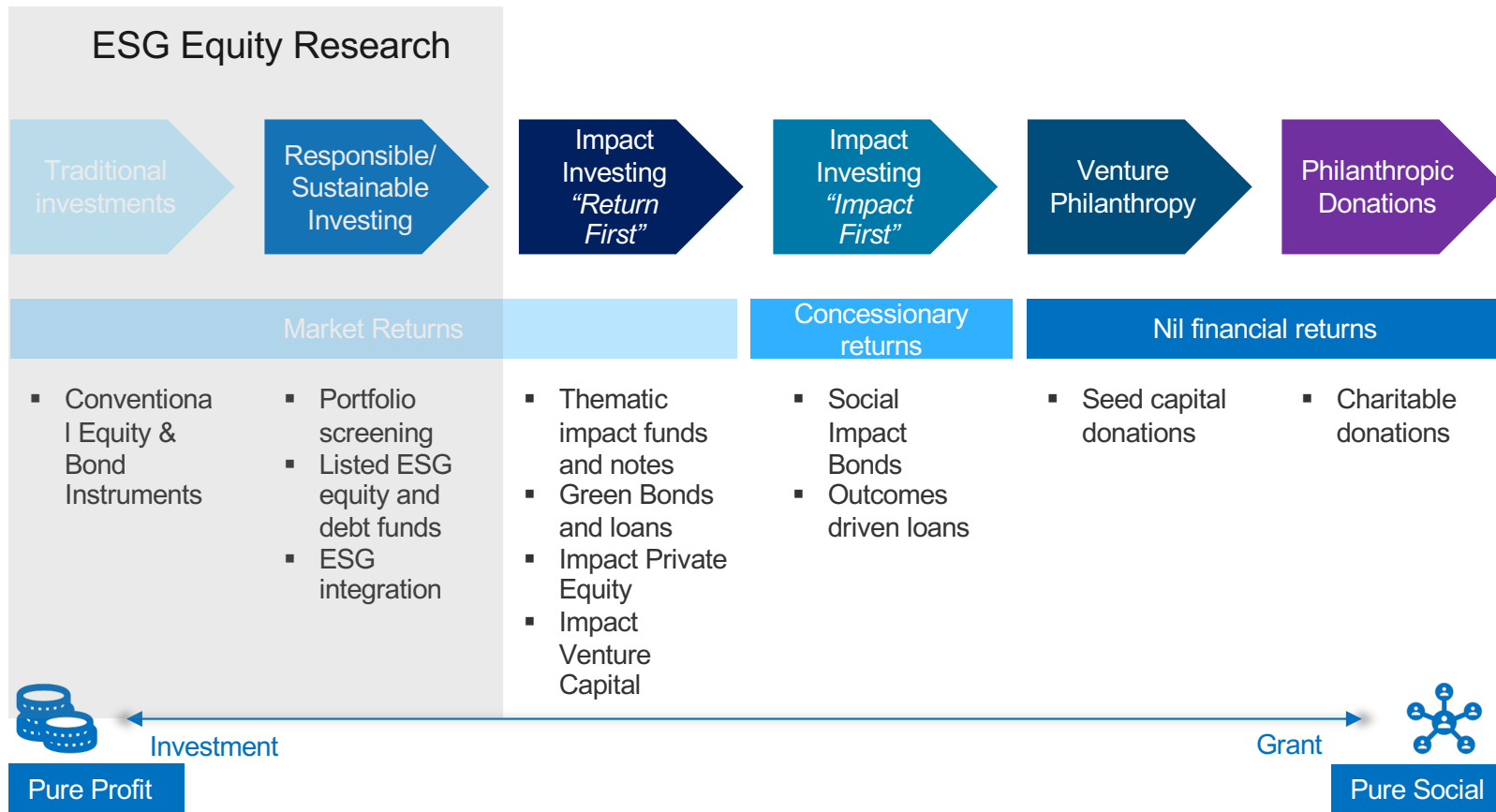
- 1** At a direct equity level (buying individual stocks)
- 2** At a managed fund level (buying funds which apply ESG criteria); and
- 3** At an aggregate portfolio level (pre selected portfolio)

Component	Advantages	Disadvantages
Direct Equities	<ul style="list-style-type: none"> <li>Quick</li> <li>Ease of implement</li> </ul>	<ul style="list-style-type: none"> <li>Self-evaluation difficult</li> <li>Hard to apply consistently</li> </ul>
Funds Level	<ul style="list-style-type: none"> <li>Consistency within a fund</li> <li>Applied with experience</li> </ul>	<ul style="list-style-type: none"> <li>Inconsistent across assets</li> <li>Short term performance</li> </ul>
Portfolio Level	<ul style="list-style-type: none"> <li>Ease of implement</li> <li>Consistency across the portfolio</li> </ul>	<ul style="list-style-type: none"> <li>Requires a risk-reward trade-off</li> <li>Hard to apply consistently</li> </ul>

# Client Evaluation



## 1. The sustainability spectrum: Profit vs Social



Source: Phineas Glover: Credit Suisse

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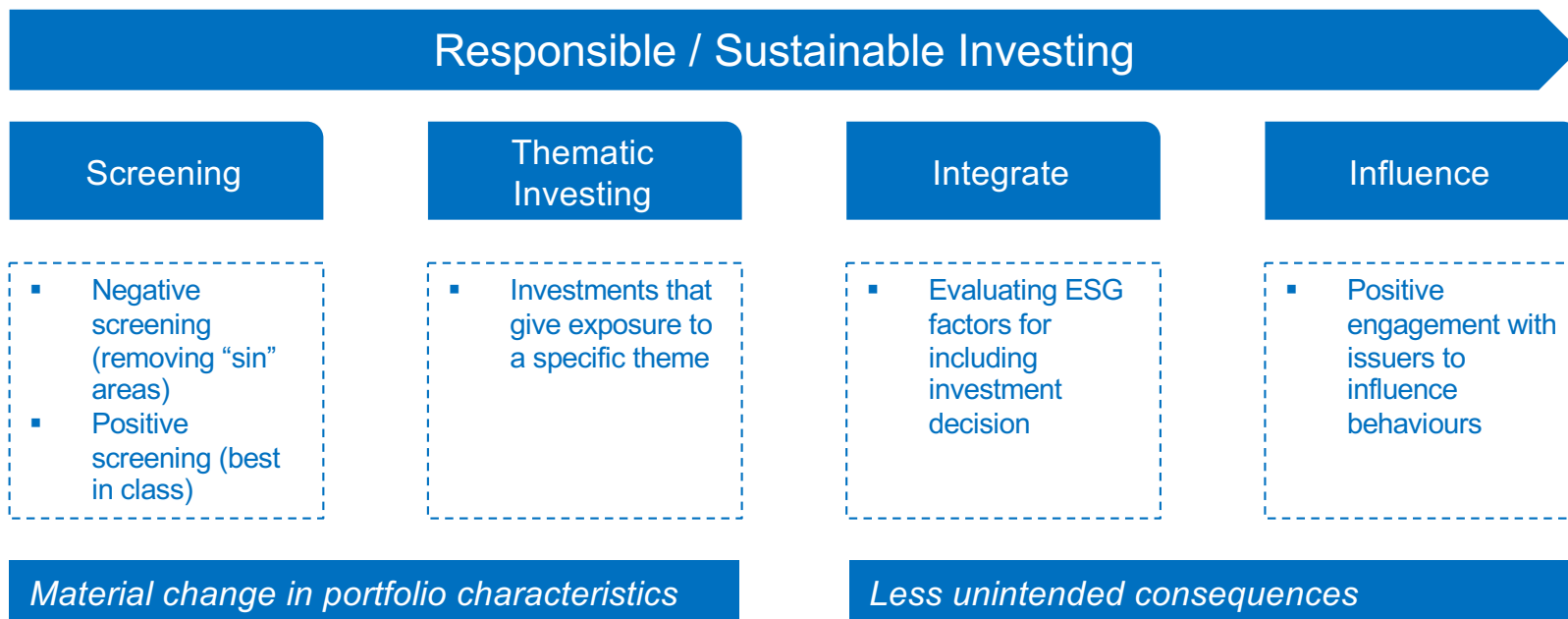
# Client Evaluation



## 2. Types of Responsible/Sustainable Implementation to consider

There are 4 main ways ESG is incorporated into the investment process

The level of sustainability will influence where a client wants to sit along this spectrum





# Investment Universe



ESG implementation varies across asset classes:

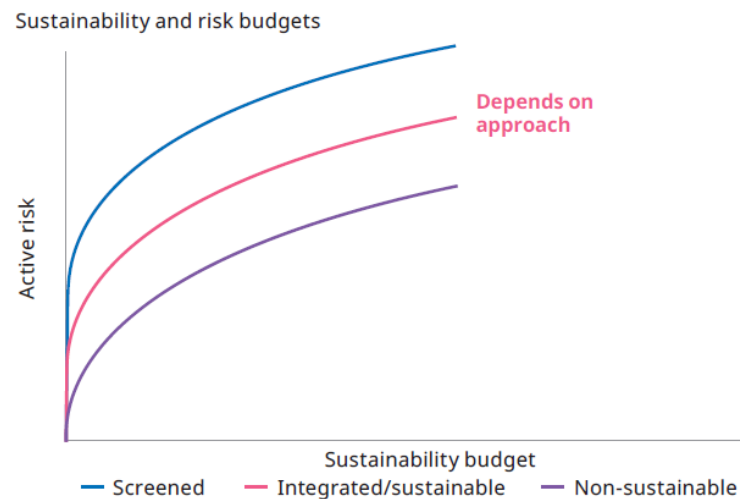
Applying ESG will vary across the different types of asset classes

Component	Screened	Integrated	Sustainable
Developed market equities	✓	✓	✓
Emerging market equities	✓	✓	✓
Government bonds	✓	✓	
Investment grade credit	✓	✓	✓
High yield debt	✓	✓	
Commodities	✓		
Private equity	✓	✓	
Real estate		✓	
Insurance linked securities	✓	✓	
Direct lending	✓	✓	
Securitised debt	✓		

Source: Schroders – Multi-Asset Investing: March 2019

## 1. The challenges to incorporating ESG into the investment process

- 1 Data inconsistencies – Company disclosures and ESG firm ratings vary greatly
- 2 Heterogeneous ideas of materiality
- 3 Varying levels of ESG integration across asset classes
- 4 Concentration risk via negative screening
- 5 Time frame constraints (TAA vs SAA)



Source: Schroders – Multi-Asset Investing: March 2019

## 2. True to label ESG? Facebook example

facebook

MSCI's initial ESG report identified risks around privacy, data security and corporate governance

Yet in 2018 as data privacy issues emerged, >20% of ESG ETF's and mutual funds owned Facebook

Risks that materialised:  
\***Social** – Protection of private client data  
\***Governance** – failure to inform customers of breach

Financial impact – Operating margins would decline due to increased investment in security and privacy

### Lessons learned:



ESG criteria vary in their application by managers



Assess the fund process for consistency with the clients values

# Investment Selection



## Key factors across investment selections

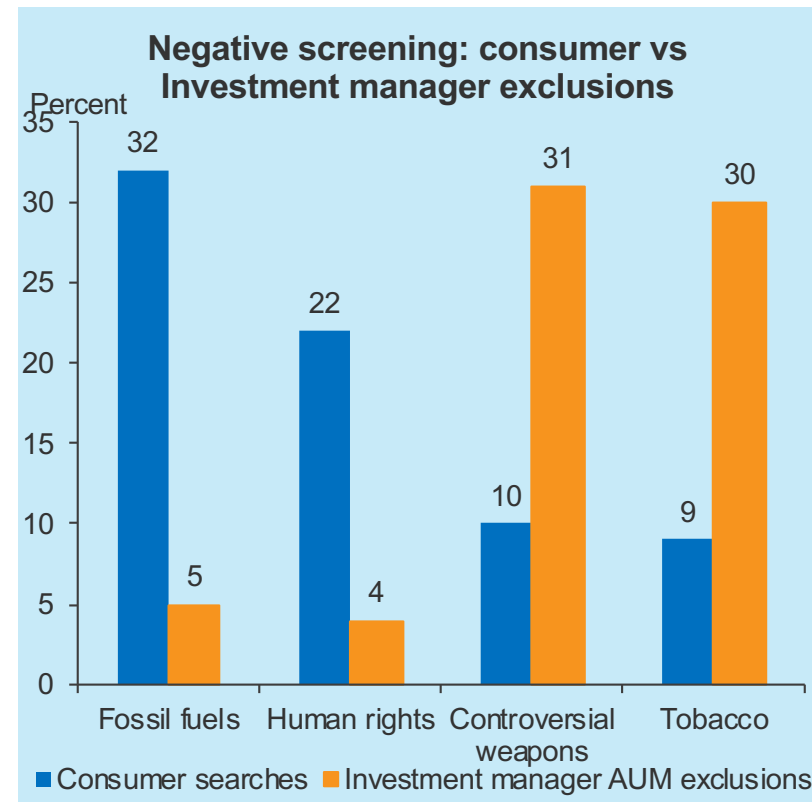
Lack of consistency in manager implementation - makes fund assessment difficult

Applying the ESG philosophy consistently across the total portfolio

Understanding the portfolio effect of using ESG components or excluding non-ESG asset classes

Negative screening is growing, but

- i) The exclusions don't always align with consumers views
- ii) Difficult to find consensus on where to draw the line



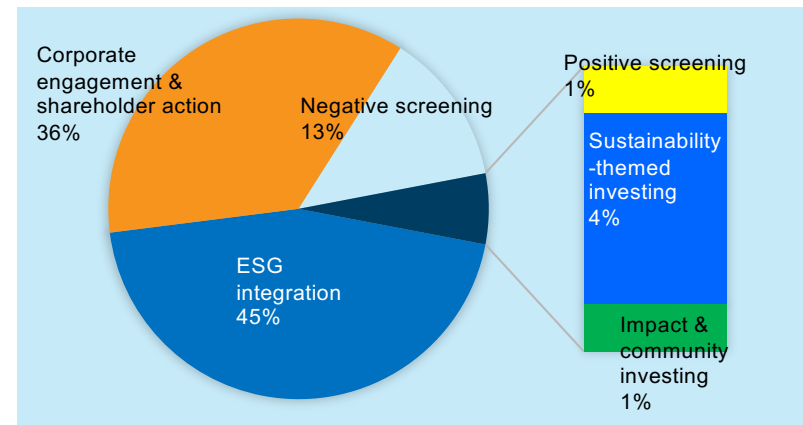
# ESG Funds in Australia



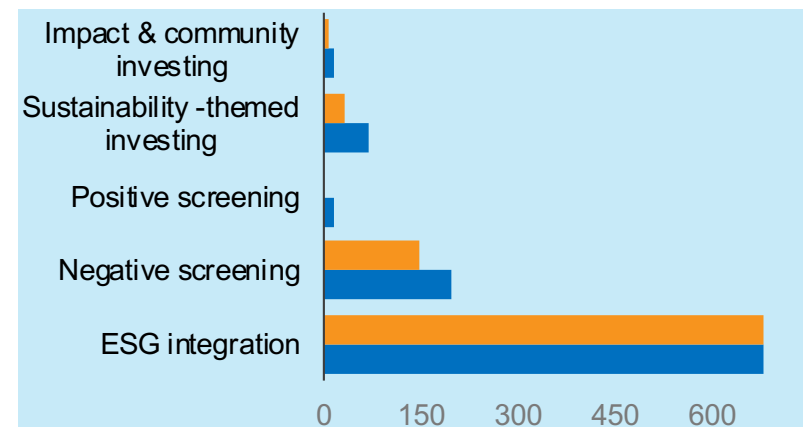
## Australian RI market

- Australia ranks well** for sustainability on the global stage with Europe leading the charge
- Retail investors are driving demand for RI funds
- RIAA online tool sees 800 visits per month
- RIAA certify 88 Australian retail funds and 150 products across most styles and asset classes
- The dominant RI strategy is **ESG integration**, contrasted with dominant global strategy ‘**negative screening**’
- Screening and themed investing is growing quickly

Composition of Australian RI market by strategy



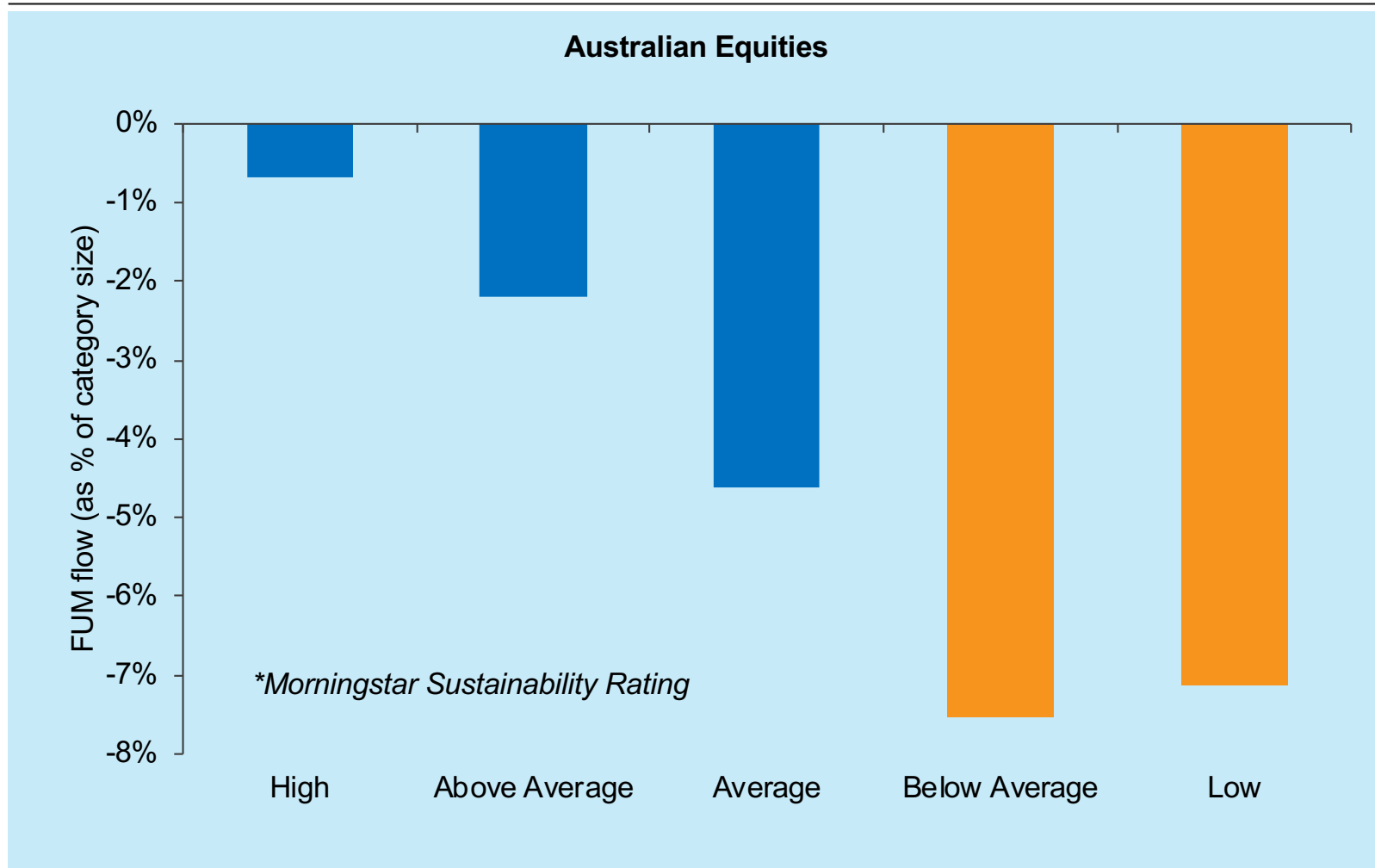
AUM employed in primary strategies (\$bn)



# ESG Funds in Australia



Fund outflows concentrated in funds with poor sustainability ratings



Source: Morningstar, July 2019

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