

CFA Institute and PRI  
**Global ESG Integration Study**

Sage Advisory  
November 13, 2019



# What is responsible investment?

Incorporates 'value' and 'values-based' investing

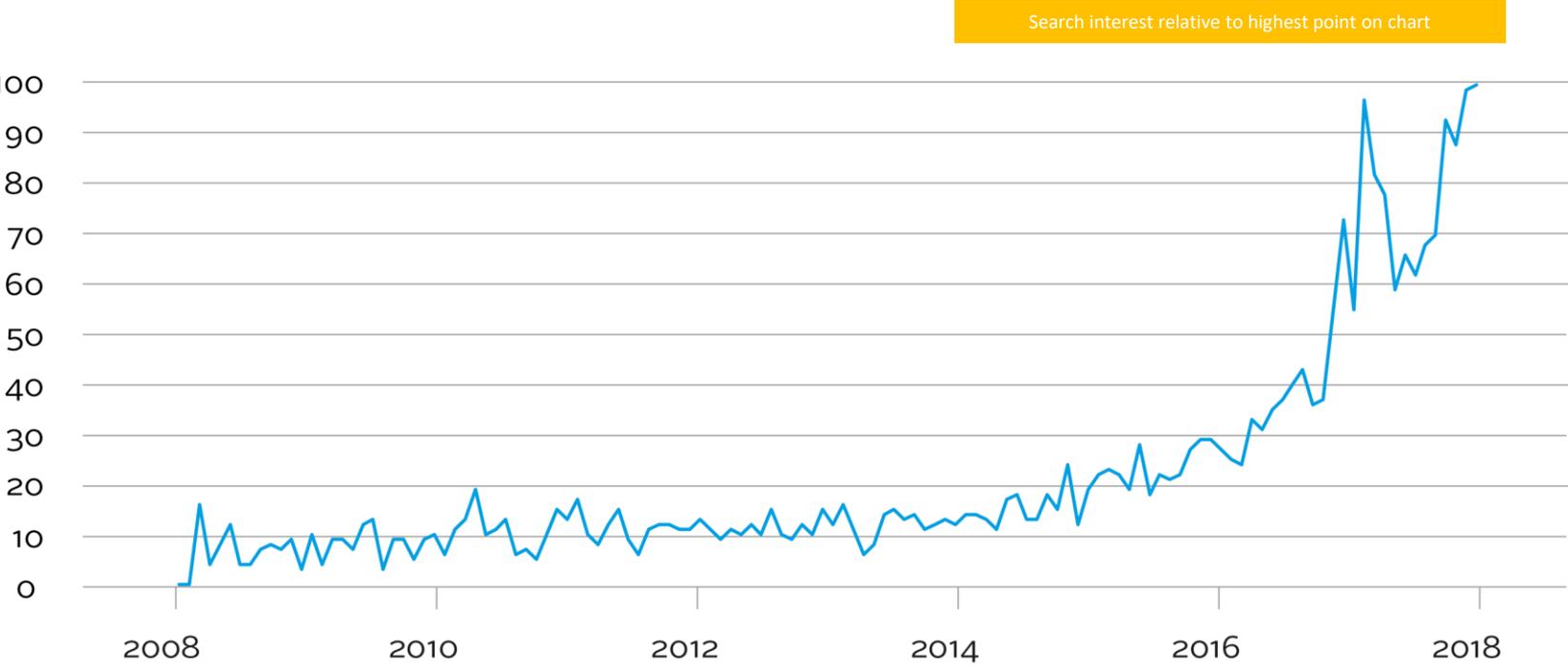
Responsible investment is a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership





# ...but interest in ESG themes has increased exponentially

Global google search trends of 'ESG' in a financial context over time



Source: Google Trends (08/2018)

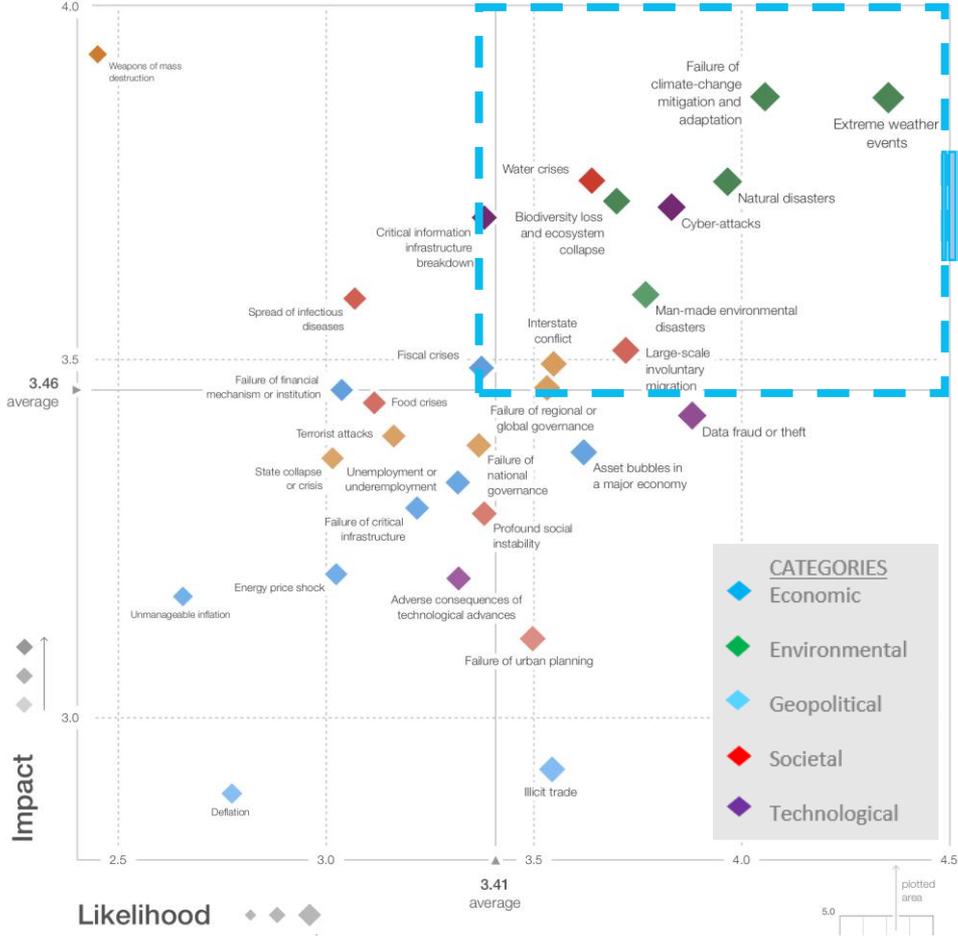
# Why practice responsible investment?

Manage risks, fulfill investor duty and enhance potential returns



# ESG issues impact investments

## Global Risks Landscape



- ### TOP GLOBAL RISKS
- ◆ Extreme weather events
  - ◆ Natural disasters
  - ◆ Failure of climate-change mitigation/adaption
  - ◆ Cyber attacks
  - ◆ Water crises
  - ◆ Large scale involuntary migration
  - ◆ Man-made environmental disasters
  - ◆ Bio-diversity loss and ecosystem collapse

Source: World Economic Forum 2019 Global Risks report.

See [here](#) for more detail on the 2019 Global Risks report and its implications for PRI signatories.

# ESG risks can be material

Investors are increasingly focused on the impact of ESG factors



**“BP set to pay largest environmental fine in US history for Gulf oil spill”**  
theguardian

2010



**“Tokyo Electric executives to be charged over Fukushima nuclear disaster”**  
REUTERS

2011



**“Volkswagen Earnings Take Another Hit From Emissions-Cheating Scandal”**  
THE WALL STREET JOURNAL

2014



**“The sharing of 50M Facebook users’ personal data led to the biggest ever one day drop in a company’s market value”**  
FINANCIAL TIMES

2018



**“Share price falls 14% following a SEC suit accusing Musk of fraud”**  
Bloomberg

2018

# What are ESG factors?

Some examples of ESG issues considered by investors

<b>Environment</b> 	<b>Social</b> 	<b>Governance</b> 	
		Companies	Funds
<ul style="list-style-type: none"> <li>• Climate change</li> <li>• Environmental policy</li> <li>• Sustainability best practice</li> <li>• Environmental management</li> <li>• Water supply</li> <li>• Sustainable transport</li> <li>• Waste</li> </ul>	<ul style="list-style-type: none"> <li>• Consumer rights</li> <li>• Supply chain management</li> <li>• Health and safety</li> <li>• Product safety</li> <li>• Labour relations, inc. relationship with unions</li> <li>• Community/ stakeholder relations</li> </ul>	<ul style="list-style-type: none"> <li>• Board structure</li> <li>• Independent directors</li> <li>• Chairman/CEO split</li> <li>• Exec. pay</li> <li>• Shareowner rights</li> <li>• Accounting/audit</li> <li>• Business ethics</li> <li>• Conflicts of interest</li> </ul>	<ul style="list-style-type: none"> <li>• Fund governance</li> <li>• Advisory Committee powers and composition</li> <li>• Valuation issues</li> <li>• Fee structures</li> </ul>

# Why invest responsibly?

Manage risks, meet market demand and fulfil investor duty



## Materiality

Increasing recognition within the financial community that ESG factors often play a material role in determining risk and return.



## Market demand

Growing demands from beneficiaries and investors for greater transparency about how and where their money is being invested.



## Regulation

Higher levels of regulatory guidance that incorporating ESG factors is part of an investor's fiduciary duty to their clients and beneficiaries.

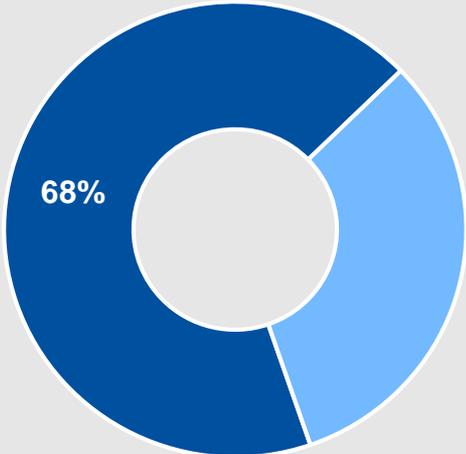


Growing academic evidence supports that  
**ESG incorporation does not come at a cost**

# Demand for responsible investment is growing

## Institutional demand

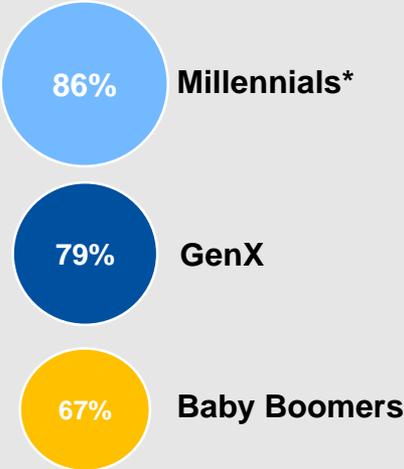
PRI asset owner signatories **actively include ESG criteria in their RfPs**



(1)

## Retail demand

Percent who feel **sustainable investing is more important** now than five years ago (2)



**\$3.9 trillion** of assets are likely to be transferred to future generations over 10 years (3)

\*Millennials are born between 1983-2000, GenX 1978-1982, Baby boomers 1949-1967

Sources: (1) PRI 2018 Reporting Framework responses, (2) “Global perspectives on sustainable investing – Global Investment study” Schroders, 2017 (3) Wealth X and NFP Wealth Transfer Report, 2016

# ESG incorporation does not come at a cost

Growing academic evidence

## Meta-study (December 2018)

OUT OF  
**2,000+**  
STUDIES  
SINCE 1970



**BETWEEN A COMPANY'S ESG PERFORMANCE  
AND ITS FINANCIAL PERFORMANCE**

Friede, Lewis, Bassen & Busch  
*University of Hamburg/  
DWS*

## November 2009

"There are statistically significant positive abnormal returns associated with going long good corporate governance firms and shorting those with poor governance"

Cremers & Ferrell  
*Yale School of Management*

## November 2012

"Firms with high levels of job satisfaction, as measured by inclusion in the 'Best Companies to Work For in America', generate high long-run stock returns"

Edmans  
*The Wharton School*

## January 2012

"High-sustainability companies dramatically outperformed the low-sustainability ones in terms of both stock market and accounting measures"

Eccles, Ioannou & Serafeim  
*Harvard Business School*

## March 2015

"Responsibility and profitability are not incompatible but wholly complementary... 80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment"

Clark, Feiner & Viehs  
*Oxford University*

## August 2015

"After successful engagements companies experience improved accounting performance and governance and increased institutional ownership"

Dimson, Karakas & Li,  
*Fox School of Business/  
University of Cambridge*

## January 2016

"Firm-size-adjusted carbon emissions have a positive and significant effect on loan spreads... suggesting that spread premia are driven by environmental risks rather than investor preferences"

Kleimeier & Viehs,  
*Oxford University/  
Maastricht University*

# The PRI

Investor-led, supported by the United Nations

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice.

Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions.

**2**

**UN PARTNERS:**

UNEP FINANCE INITIATIVE  
UN GLOBAL COMPACT



**2600+**

**SIGNATORIES:**

ASSET OWNERS  
INVESTMENT MANAGERS  
SERVICE PROVIDERS



**86+**  
**US\$ trn**

**ASSETS UNDER  
MANAGEMENT**



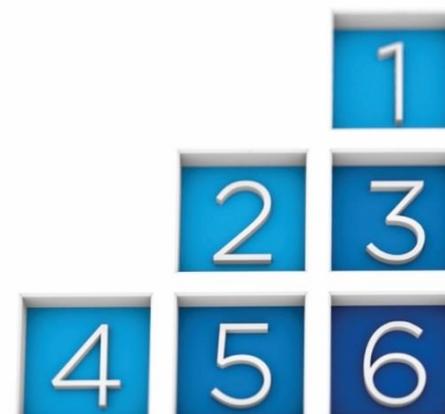
# One mission – six principles

Developed by investors

"We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."

- |          |  |          |   |
|----------|--|----------|---|
| <b>1</b> | We will incorporate ESG issues into investment analysis and decision-making processes.         | <b>4</b> | We will promote acceptance and implementation of the Principles within the investment industry. |
| <b>2</b> | We will be active owners and incorporate ESG issues into our ownership policies and practices. | <b>5</b> | We will work together to enhance our effectiveness in implementing the Principles.              |
| <b>3</b> | We will seek appropriate disclosure on ESG issues by the entities in which we invest.          | <b>6</b> | We will each report on our activities and progress towards implementing the Principles.         |



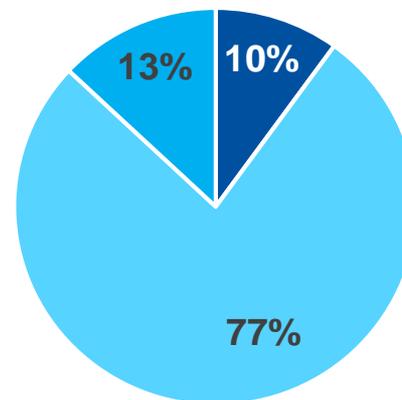
## PRI in the US

**513** Signatories – PRI's single largest country, representing ~ 20% of global signatory base.

**49** Asset Owners

**402** Investment Managers

**62** Service Providers



- Asset Owners
- Investment Managers
- Service Providers

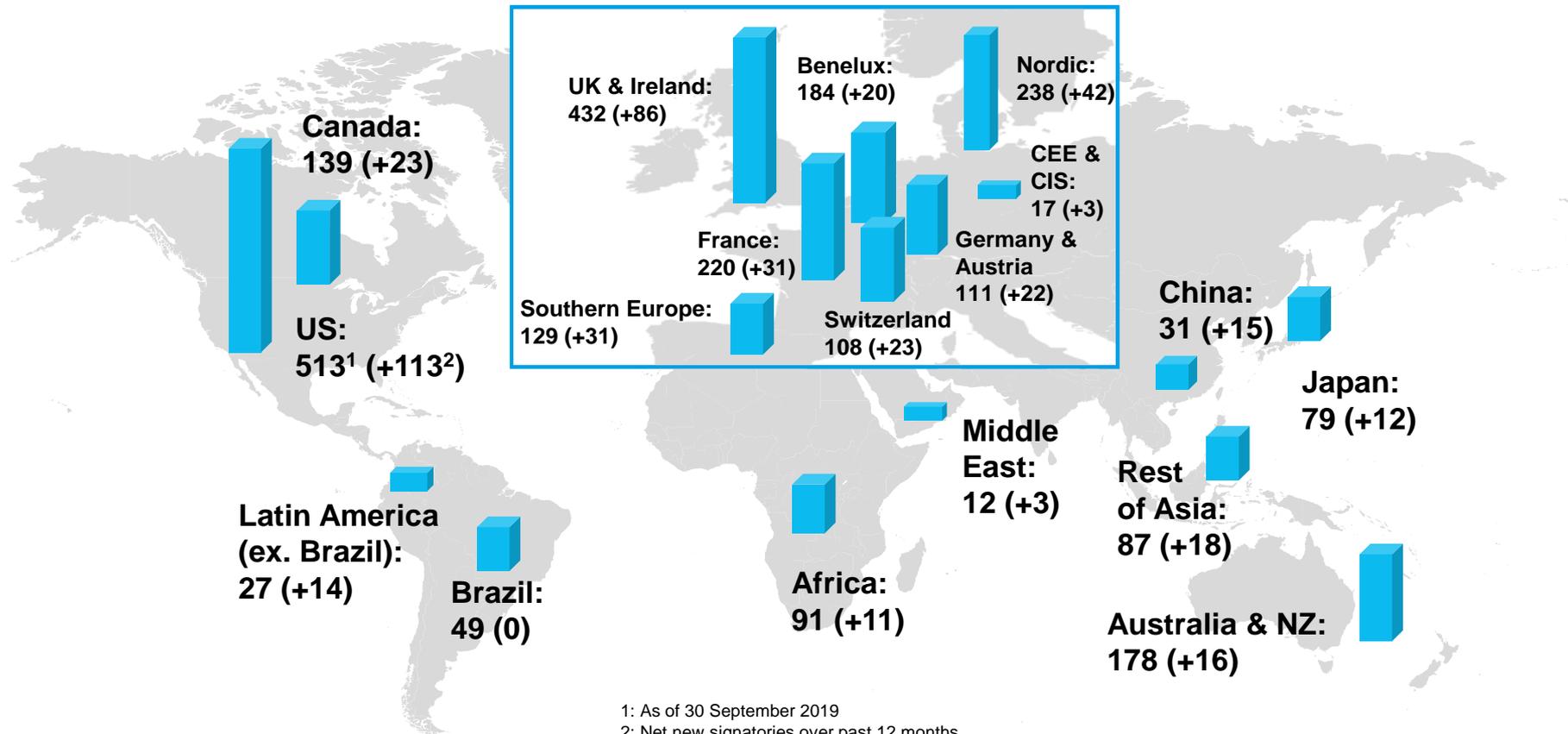
# US Asset Owner Signatories

Signatory Name	State
Humboldt State University Advancement Foundation	CA
Los Angeles County Employees Retirement Association	CA
Los Angeles City Employees Retirement System	CA
San Francisco Employees Retirement System	CA
Sierra Club Foundation	CA
Loyola Marymount University	CA
California Public Employees' Retirement System CalPERS	CA
California State Teachers' Retirement System CalSTRS	CA
University of California	CA
Connecticut Retirement Plans and Trust Funds (CRPTF)	CT
World Resources Institute	DC
World Bank Group Retirement Benefit Plans	DC
SEIU Pension Plans Master Trust	DC
International Finance Corporation (IFC)	DC
AFL-CIO Reserve Fund	DC
United Nations Foundation	DC
Employees' Retirement System of the State of Hawaii	HI
Northwestern University	IL
Wespath Investment Management (General Board of Pension and Health Benefits of the United Methodist Church)	IL
Office of the Illinois State Treasurer	IL
City of Chicago Treasury	IL
Presbyterian Church U.S.A. Foundation	IN
Unitarian Universalist Common Endowment Fund, LLC	MA
Middletown Works Hourly and Salaried Union Retirees Health Care Fund	MA

Signatory Name	State
Harvard University Endowment	MA
The University of Maryland Foundation, Inc	MD
Maryland State Retirement and Pension System	MD
Montgomery County Employee Retirement Plans	MD
UAW Retiree Medical Benefits Trust	MI
Minnesota State Board of Investment	MN
Mercy	MO
Mercy Investment Services, Inc.	MO
Reinsurance Group of America	MO
University of New Hampshire Foundation	NH
New York State Local Retirement System	NY
Teachers' Retirement System of the City of New York	NY
New York City Employees Retirement System	NY
United Nations Joint Staff Pension Fund	NY
Nathan Cummings Foundation	NY
The Pension Board-UCC, Inc.	NY
Rockefeller Brothers Fund	NY
United Church Funds	NY
Treehouse Investments, LLC	NY
Bloomberg LP Retirement Plans	NY
The Episcopal Diocese of New York - Diocesan Investment Trust	NY
Friends Fiduciary Corporation	PA
Vermont Pension Investment Committee	VT
Seattle City Employees' Retirement System (SCERS)	WA

# More than 2,600 investors worldwide

Have adopted the Principles for Responsible Investment



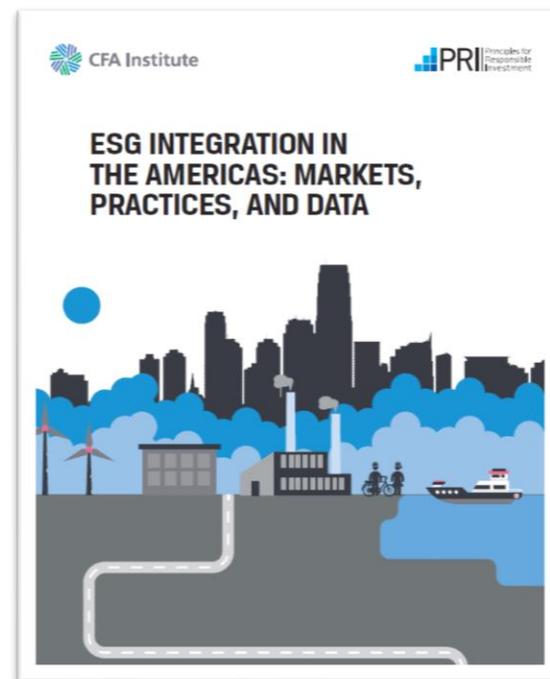
1: As of 30 September 2019

2: Net new signatories over past 12 months

# CFA Institute and PRI

## Overview

- In 2017, CFA Institute and Principles for Responsible Investment (PRI) set out to create a best-practice report and three regional reports to help investors understand how they can better integrate ESG factors into their equity, corporate bond, and sovereign debt portfolios
- The best-practice and Americas reports were released in September 2018. Two more reports covering EMEA and APAC were subsequently released.



## Methodology

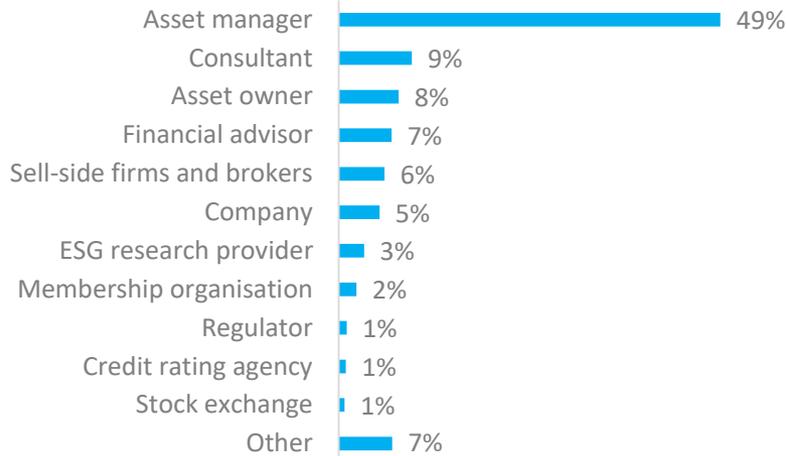
- Surveying over 1,100 financial professionals, predominantly CFA members, around the world;
- Running 23 workshops in 17 major markets;
- Interviewing many practitioners and stakeholders;
- Publishing more than 30 case studies written by equity and fixed-income practitioners;
- Analyzing Bloomberg’s ESG company disclosure scores; and
- Reviewing data from the PRI reporting framework, the largest global database of information on investors’ ESG practices.

AMER	APAC	EMEA
Brazil	Australia	France
Canada	China	Germany
United States	Hong Kong	Netherlands
	India	Russia
	Japan	South Africa
	Singapore	Switzerland
		United Arab Emirates
		United Kingdom

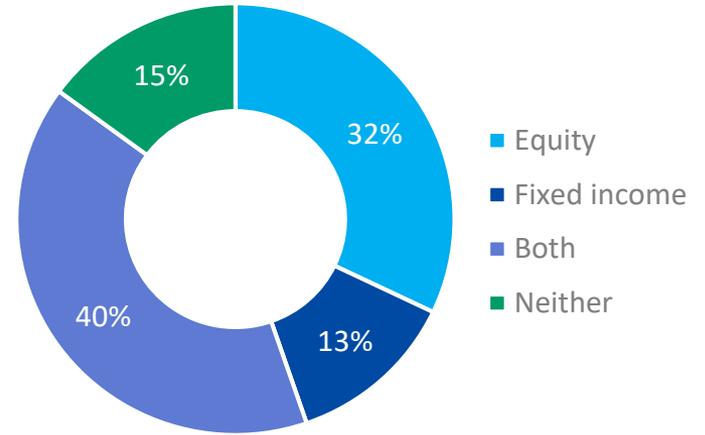
*Abbreviations: AMER, Americas; APAC, Asia Pacific; EMEA, Europe, Middle East, and Africa.*

# Overview of survey respondents

## Organisation type



## Asset classes covered/overseen

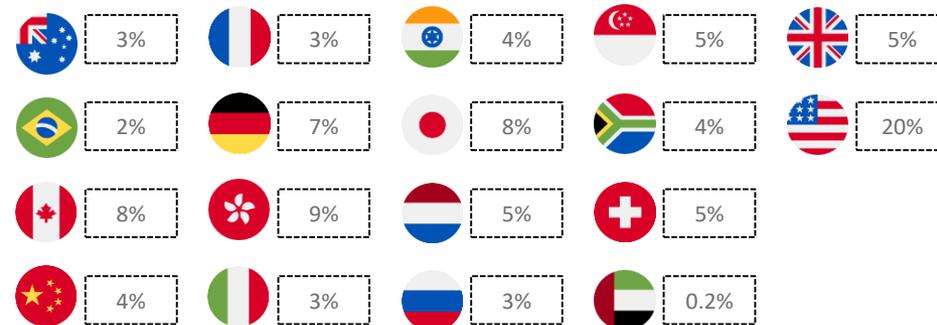


## Job title



\* "Other" includes roles such as Corporate Financial Analyst, Traders, Economists, Regulators etc.

## Location



Q1. Which of the following best describes the type of organisation you work for?

Q2. And what is your job title?

Q3. Which of the following asset classes do you cover/oversee?

Q4. In which of the following countries are you based?

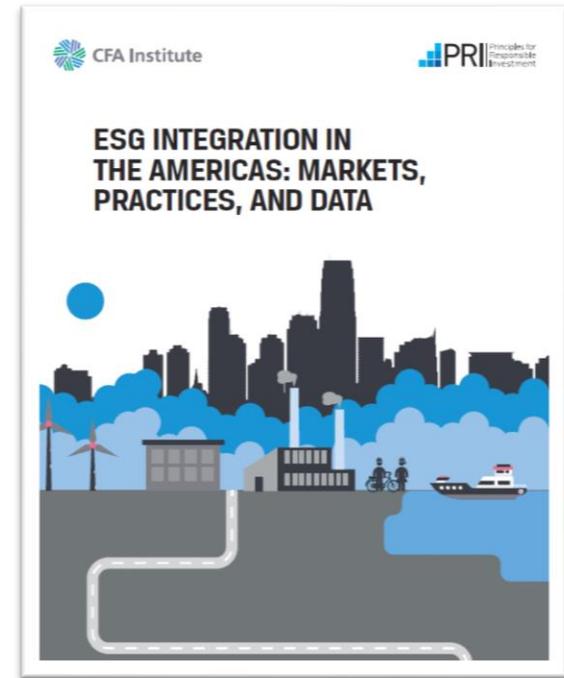
Base: All respondents (1,100)

# The ESG integration framework



# ESG Integration in the Americas: Markets, Practices and Data

Overview of major findings



## Regional findings: Americas

- There is no “one best way” to do ESG integration and no “silver bullet” to ESG integration.
- Governance is the ESG factor most investors are integrating into their process.
- Environmental and social factors are gaining acceptance, but from a low base.
- ESG integration is farther along in the equity world than in fixed income.
- Portfolio managers and analysts are more frequently integrating ESG into the investment process, but rarely adjusting their models based on ESG data.
- The main drivers of ESG integration are risk management and client demand.
- The main barriers to ESG integration are a limited understanding of ESG issues and a lack of comparable ESG data.
- Investors acknowledge that ESG data has come a long way, but advances in quality and comparability of data still have a long way to go.
- It would be helpful for issuers and investors to agree upon a single ESG reporting standard that could streamline the data collection process and produce more quality data.
- Many workshop participants were concerned that ESG mutual funds and ETFs offered to investors may be driven by marketing decisions and may not be true ESG investment products.

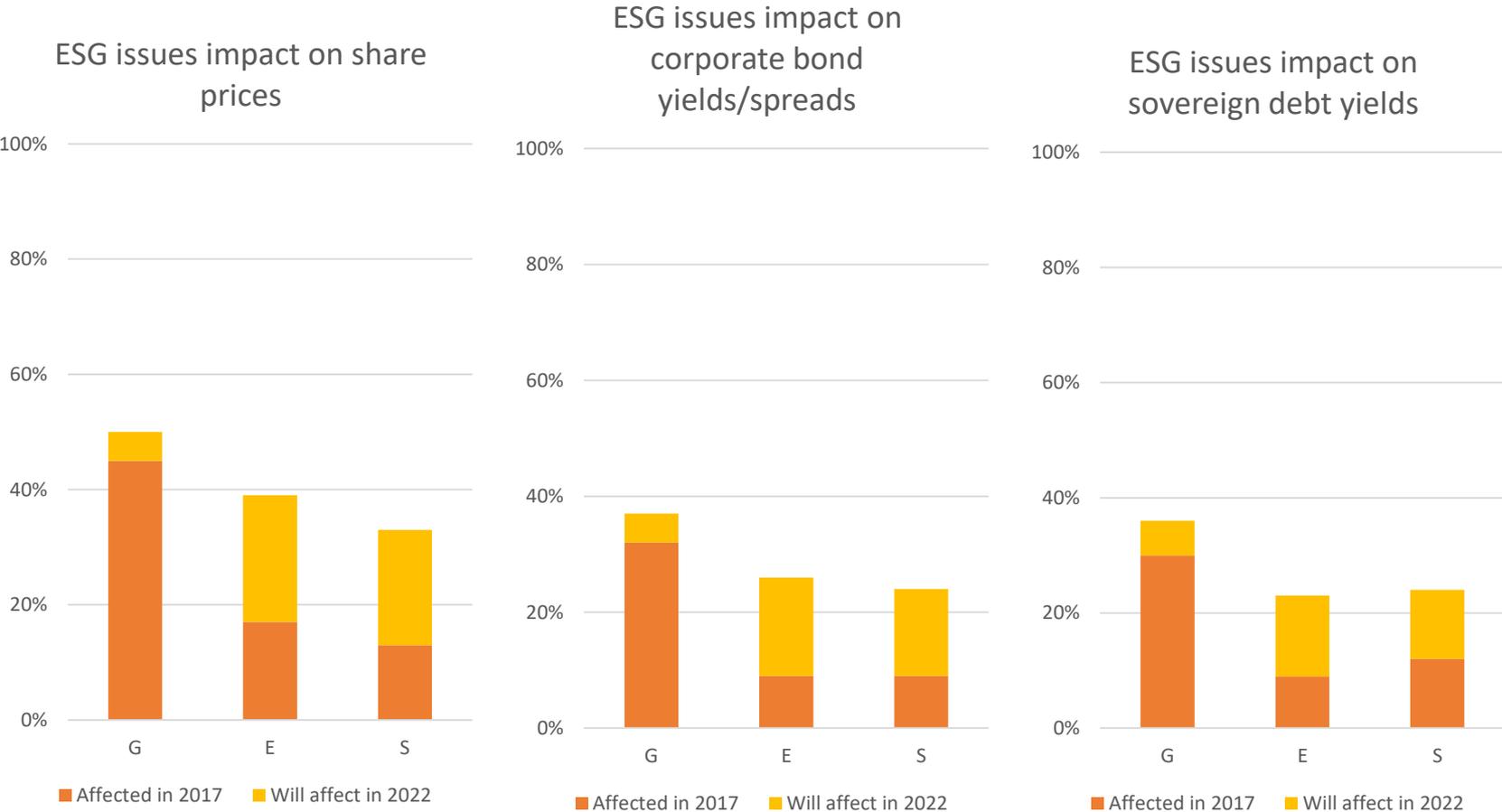
# Regional findings: United States

## Overview

- In contrast to their impact on share prices, social issues are seen to affect sovereign debt yields more frequently than environmental issues do, both in 2017 and in 2022. Social and environmental issues are considered to affect corporate bond yields/spreads at roughly the same frequency.
- Although fewer fixed-income practitioners than their equity counterparts are performing ESG integration techniques in the United States, the sophistication of the ESG integration practices performed by fixed-income practitioners is similar to that of the ESG integration practices performed by equity practitioners.
- Listed companies in the United States in every sector other than financials have seen an increase in their ESG company disclosure from 2011 and 2016.

# Regional findings: United States

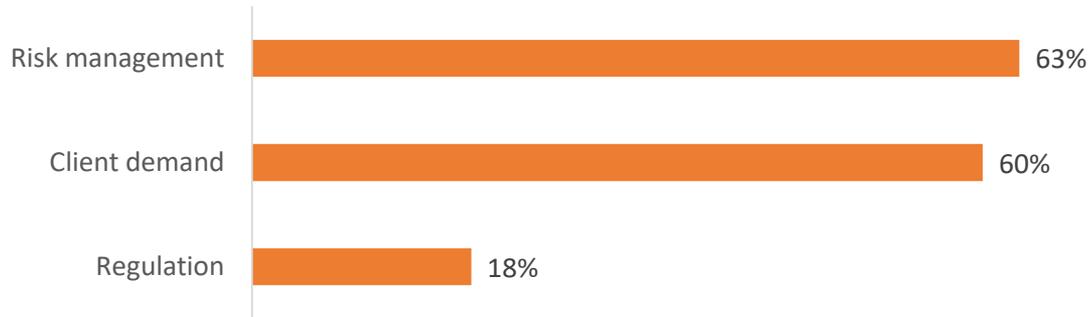
The impact of ESG issues in 2017 and the expected impact in five years' time (2022)



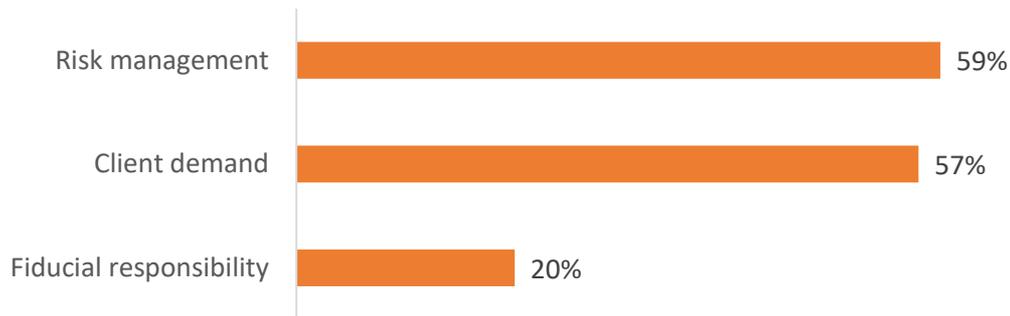
# Regional findings: United States

Drivers of ESG integration in US capital markets

## Main drivers to integrating ESG issues into investment analysis of equity investments



## Main drivers to integrating ESG issues into investment analysis of fixed income investments

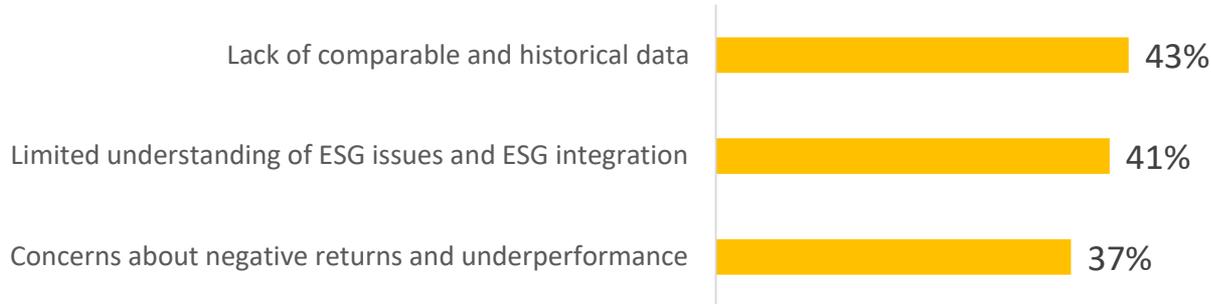


Note: Percentages represent those who thought each item was a main driver. Survey respondents could choose more than one answer.

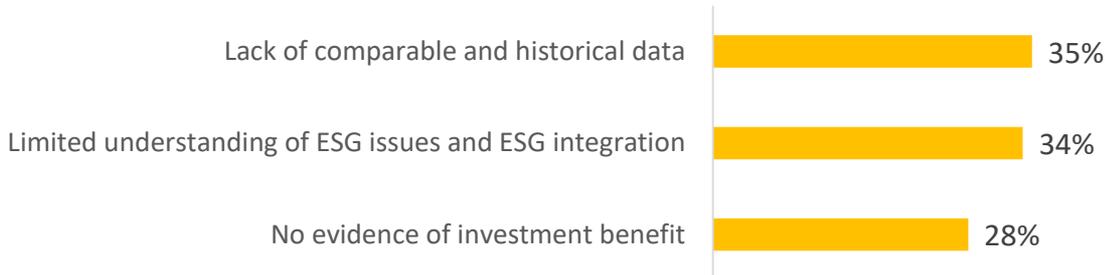
# Regional findings: United States

## Barriers to ESG integration in US capital markets

### Main barriers to integrating ESG issues into investment analysis of equity investments



### Main barriers to integrating ESG issues into investment analysis of fixed income investments



Note: Percentages represent those who thought each item was a main barrier. Survey respondents could choose more than one answer.

# Regional findings: United States

The ESG integration framework: application by US-based investors



# Guidance and Case Studies for ESG Integration: Equities and Fixed Income

Overview of major findings

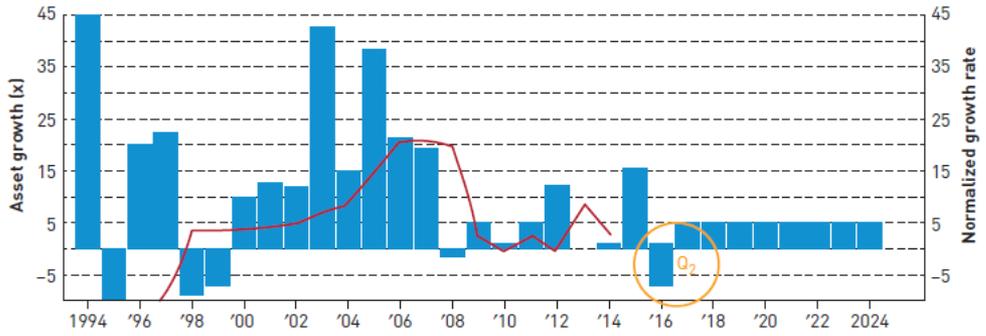


# Spotlight on equity: case study by RBC Global Asset Management

## Fundamental Material ESG Scenario Analysis

- DCF Scenario Analysis

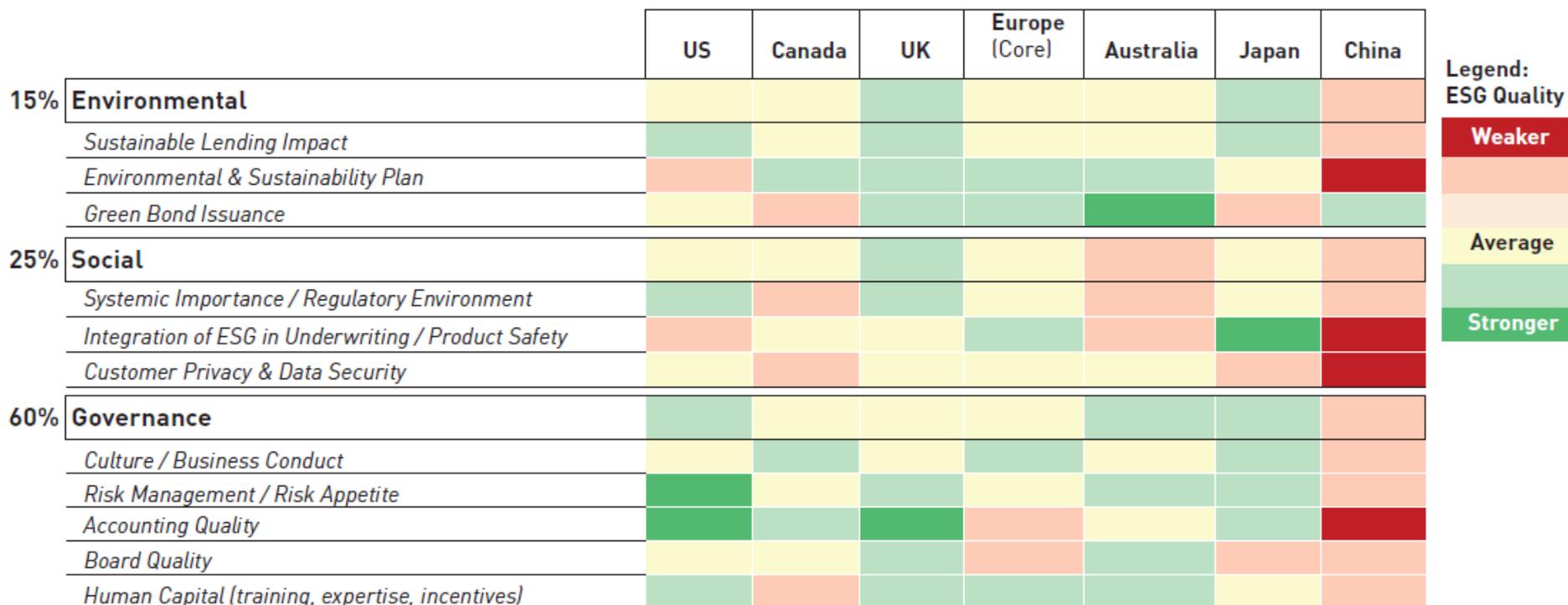
<b>Base-case DCF scenario</b> (a cash flow return on investment framework)	44% target company <b>share price</b> upside
<b>ESG asset scenario (upside scenario):</b> value generated from contingent assets through the use of big data analytics. Assumptions: Sales increased by 1–2% in years 5–10, but with similar EBIT margins and asset turns to the base case. Cost of capital remains the same.	+12 percentage point
<b>ESG liability scenario (downside scenario):</b> assuming a data breach occurs that impacts the business (sales, margins, asset growth) for a year before recovery.	-17 percentage point



# Spotlight on corporate bonds: case study by PIMCO

## Integrating ESG in Corporate Credit Research

- ESG heatmap for major banks by region

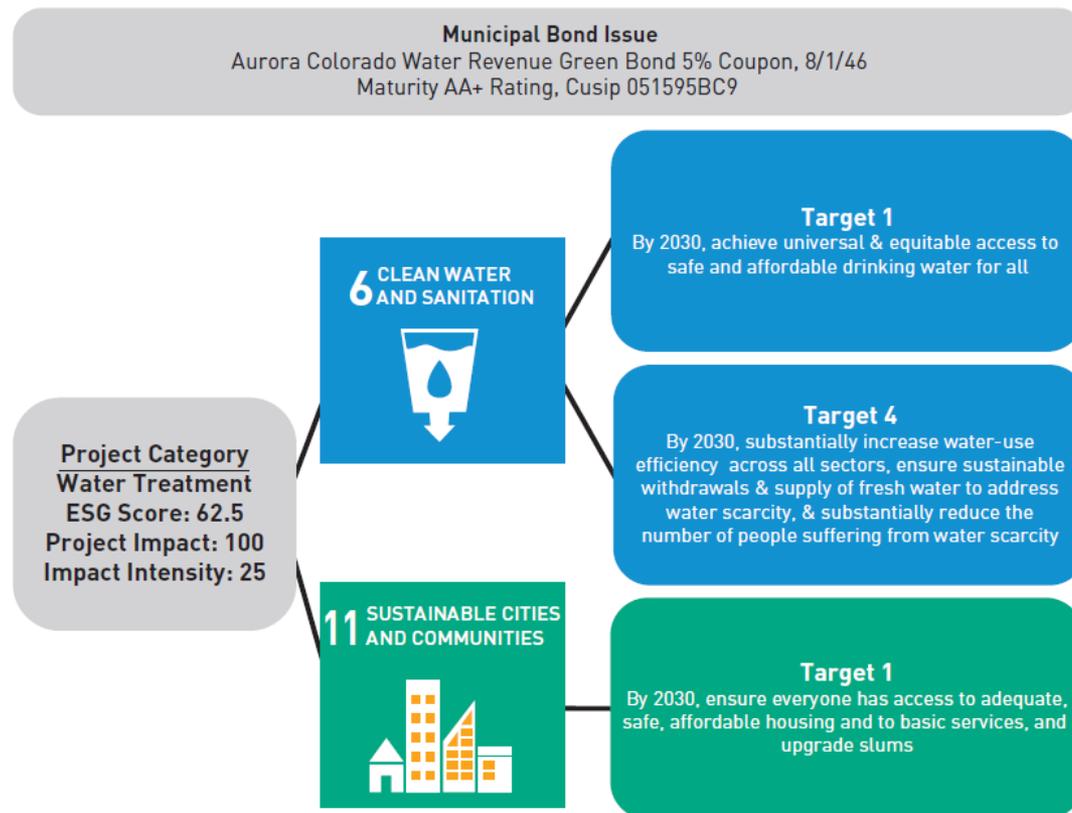


Source: PIMCO analysis as of 30 June 2018. Major banks include global and domestically systemically important banks in each region. Percentages (15%, 25%, 60%) represent the relative weighting of each ESG pillar in the overall ESG score.

# Spotlight on municipal bonds: case study by Sage Advisory Services

## The Challenges with and Lessons from Integrating ESG Issues Into Municipal Bonds

- Environmental Framework Analysis And SDG Mapping Of The Aurora Water Revenue Bond



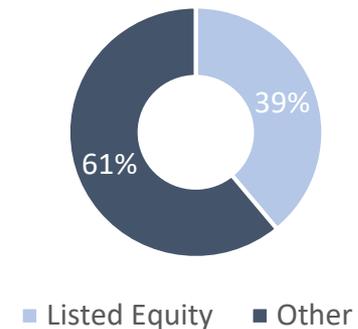
# Listed Equity

RI allows listed equity investors to make better informed investment decisions by integrating all material factors

Listed Equity program:

- ESG Integration
- Active Ownership
- Selection, Appointment and Monitoring of managers

Asset class breakdown



**A PRACTICAL GUIDE TO ESG INTEGRATION FOR EQUITY INVESTING (2016)**

*The guide contains information and case studies on integration techniques that apply to investment strategies including fundamental, quantitative, smart beta and passive investment.*

**A PRACTICAL GUIDE TO ACTIVE OWNERSHIP IN LISTED EQUITY (FEBRUARY 2018)**

*Guides investors on their responsibilities to conduct, request and monitor effective engagement and proxy voting activities.*

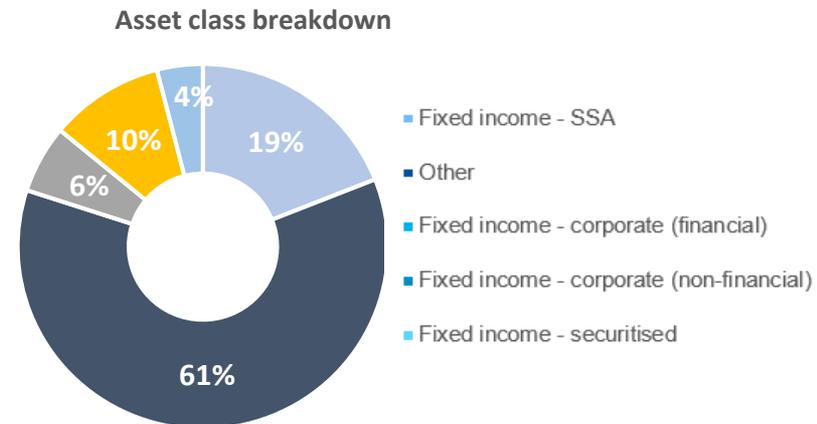
For more information visit: <https://www.unpri.org/investor-tools/listed-equity> or contact [justin.sloggett@unpri.org](mailto:justin.sloggett@unpri.org)

# Fixed income

ESG analysis provides fixed income investors with additional insight into issuer creditworthiness

Fixed Income program:

- Corporate bondholder engagement
- CFA Institute and PRI Global ESG Integration Study
- ESG in sovereign and sub-sovereign debt
- Fixed income case study series and webinars



**FIXED INCOME INVESTOR GUIDE (2014)**

*The guide helps to explain why fixed income investors should take a bottom-up approach to RI while borrowing from the experiences of other asset classes, such as listed equities.*

**ESG ENGAGEMENTS FOR FIXED INCOME INVESTORS (2018)**

*This publication explains how to engage with corporate bond issuers on ESG factors in order to identify and manage ESG-related risks, and to maximise positive ESG outcomes.*

For more information visit: <https://www.unpri.org/investor-tools/fixed-income> or contact [anna.georgieva@unpri.org](mailto:anna.georgieva@unpri.org)

# Questions