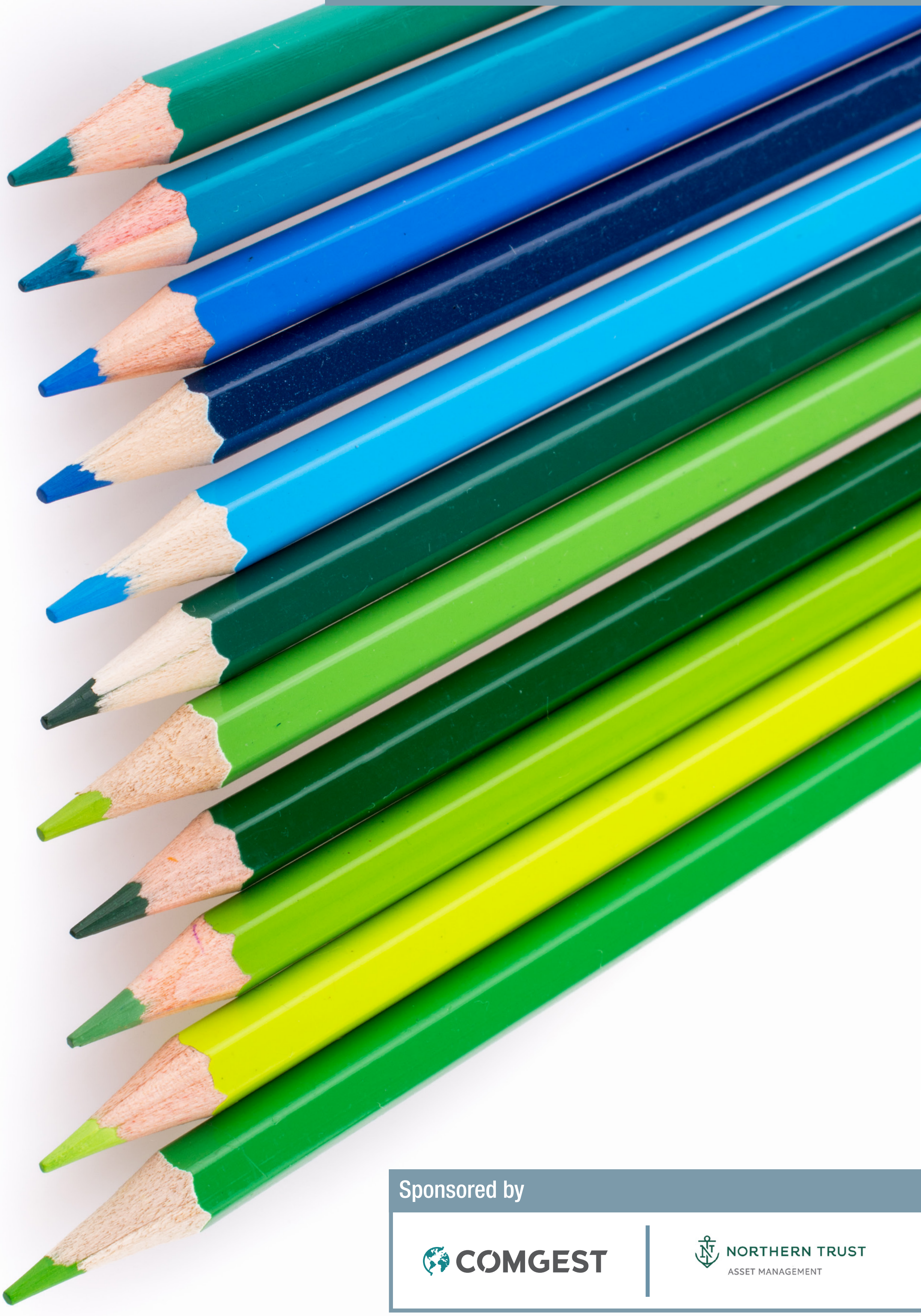
CAMRADATA

Responsible Investing Roundtable

Responsible Investing – Building a Sustainable Future

Roundtable Whitepaper
June 2017



Sponsored by

COMGEST

NORTHERN TRUST
ASSET MANAGEMENT

Clear and Independent

Institutional Investment Analysis

We provide institutional investors, including pension funds, insurance companies and consultants, with data and analysis to assess, research and report on their investments. We are committed to fostering and nurturing strong, productive relationships across the institutional investment sector and are continually innovating new solutions to meet the industry's complex needs.

We enable institutional investors, including pension funds, insurance companies and consultants, to conduct rigorous, evidence-based assessments of more than 5,000 investment products offered by over 700 asset managers.

Additionally, our software solutions enable insurance companies to produce consistent accounting, regulatory and audit-ready reports.

To discuss your requirements
+44 (0)20 3327 5600
info@camradata.com

Find us at
camradata.com

Join us on LinkedIn

Follow us on Twitter @camradata

Contents

3 Introduction

4 Roundtable Participants

10 Responsible Investing – Building a Sustainable Future

Articles

16 Comgest

18 Northern Trust Asset Management

A Reminder About Our Aims

Responsible Investment is a long standing theme that remains an unwavering hot topic in the asset management and pension industry. Undoubtedly, its emphasis is broadening while the terminology associated with it, is swelling - anyone for ethical investing, sustainable investing, triple-bottom-line investing, green investing?…the list goes on. With all these terms, many interchangeable and few universal, it can be a confusing space, so what is Responsible Investing as it stands today? And how are we, or should we be, applying it?

The notion of 'Returns' take a malleable definition when considered in line with Responsible Investing. Do we view positive returns as being financial or non-financial? Stand alone; can we note carbon reduction or improvements in education to be a positive return? Or can the two, financial and non-financial, be achieved in tandem? Increasingly, this is looking to be possible. The positive impact of key Responsible Investing allocations is becoming the focus over the age old importance of the exclusion list. More and more, investors are requesting a deeper knowledge of not just what is omitted, but more clarity on the types of positive influences the selected companies are having on, for example, health services or climate change. Is it now less about avoiding 'bad', but more ensuring sustainability? Essentially, less 'do no further damage' (commonly associated with SRI) but 'do good' (Impact Investing)?

Impact Investing is often noted to be the fastest growing branch of the Responsible Investing umbrella. With an aim to find this golden key balance between investments that are generating real and measurable positive economic and social impact while also bragging a financial return. But, is this truly possible in equal measure? Or must one always 'choose a side'? Or perhaps more telling, do investors really care?

There is a case to argue, especially by the strictest devotees, that the mainstreaming of the 'Responsible Investing' badge through these different avenues is a dangerous space, allowing the term to be a blanket one and diluting its core value. However, is the rebuttal that the wider use of its principles by a diverse mix of asset managers is encouraging not only vital industry wide critique but also diversity of approach and therefore, innovation?

CAMRADATA's Roundtable will seek to find out how investors are interpreting Responsible Investing as a focus today, in addition to the likelihood that this should and will play an increasingly greater role within their portfolios.

"The positive impact of key Responsible Investing allocations is becoming the focus over the age old importance of the exclusion list."

Participants

Sébastien Thévoux-Chabuel

ESG Portfolio Manager and Analyst

Sébastien Thévoux-Chabuel joined Comgest in 2013 and is an ESG Portfolio Manager and Analyst, responsible for the ESG coverage of developed markets including Europe and the USA; meeting and engaging with company management alongside the firm's investment Analysts, and preparing in-depth ESG reports. Sébastien is also a member of the firm's Whitepaper Committee. Starting his career as a buy-side Analyst at Deutsche Bank in 1998, Sébastien later became a Portfolio Manager at BFT Gestion (Crédit Agricole) before moving to Oddo Securities where he was initially a technology Analyst before assuming the role of Sustainable and Responsible Investment (SRI) Analyst, a position he held for five years before joining Comgest. He graduated from the ESCP business school in Paris in 1997 before completing a post-graduate degree in Financial Engineering at the Sorbonne University.

COMGEST

Simon Jones

Senior Investment Consultant

Simon is a Fellow of the Faculty of Actuaries and Senior Investment Consultant with Hymans Robertson. Simon has over 20 years pensions and investment experience and currently advises a number of private and public sector clients on a wide range of investment matters including the development of objectives and strategy, asset allocation and implementation.

Simon also leads on Responsible Investment at Hymans Robertson and has a keen interest in the impact of the natural world on investment matters. He is a member of the Institute and Faculty of Actuaries Resource and Environment Board and is currently studying for a MSc in Ecological Economics at the University of Edinburgh.

HYMANS ROBERTSON

Diandra Soobiah

Head of Responsible Investment

Diandra Soobiah is the Head of Responsible Investment at NEST. She joined the company in 2010 and is responsible for the delivery and implementation of NEST's Responsible Investment approach. Diandra ensures NEST's investment approach factors in material environmental, social and governance risks and opportunities, fulfils its role as a responsible steward of its members' assets in order to deliver the best financial outcomes for members. Diandra played a large part in launching a climate aware fund that addresses climate change risks and opportunities across NEST's investment approach. Diandra has 14 years investment experience including at Nedgroup Investments and Russell Investments. BA (Hons) in Business Studies and French from Queen Mary University of London and has passed CAIA and the IMC.

Julia Kochetygova

Senior ESG Research Analyst

Julia Kochetygova is the Senior ESG Research Analyst for Northern Trust Asset Management. She is responsible for ESG research, product innovation and thought leadership across all asset class capabilities. Her past positions include Head of sustainability indices at S&P Dow Jones Indices, Head of the Corporate Relations function at MDM Bank in Russia, and Head of Corporate Governance Ratings at S&P Ratings.

She holds a PhD in Economics from the Institute of Economics, Russian Academy of Sciences, and MSc. in Economics of Industry from the Moscow Institute of National Economy.

Participants

Emma Jane Joyce

ISIF Senior Manager, Strategy & Responsible Investment

Emma Jane is a Senior Investment Manager with the Ireland Strategic Investment Fund (ISIF) where she leads the Fund's Sustainability and Responsible Investment activities.

Emma Jane has extensive investment experience and has held a variety of investment roles within the National Treasury Management Agency (NTMA), including leading the development of the ISIF Business Plan and Investment Strategy.

Emma Jane joined the NTMA from Mercer Investment Consulting. She is a graduate of both Trinity College Dublin and the UCD Michael Smurfit Graduate School of Business.

Kaori Shigiya

Private Sector Policy, Financial Sector

Kaori has been at Oxfam since 2015 in its private sector team, working with, and challenging, the financial sector on inequality and climate change issues and promoting sustainable capital markets. She was the 'Behind the Brands' Transparency Lead in 2016, rating top 10 food and beverage companies on their disclosure of sourcing of materials, supply chains, tax and lobbying activities. Prior to that she worked at Linklaters, Norton Rose, Lehman Brothers and Nomura, and has 15 years experience in capital markets, corporate governance, business management and sustainability. Kaori is a qualified lawyer with a first degree in Economics and Accounting and an MBA from INSEAD, plus she has gained a Postgraduate Certificate in Sustainable Business from Cambridge University and a Certificate in Impact Investing and Social Enterprise Management from Middlebury Institute of International Studies.

Honor Fell

Associate, Manager Research Team

Honor is an Associate in Redington's Manager Research team. Honor is responsible for the research, selection and monitoring of equity managers as well leading Redington's Responsible Investment work. She works in conjunction with the Investment Consulting team to provide advice to a range of trustee and sponsor-side clients.

Honor joined Redington in 2013 after receiving an undergraduate degree in Geography from Cambridge University.

REDINGTON

Andrea Marandino

Sustainable Finance and Corporate Risk Manager

Andrea Marandino is a Sustainable Finance and Corporate Risk Manager at WWF-UK. Her team engages with banks, investors, and regulators to help integrate environmental and climate considerations into mainstream finance and lending, and to help shift capital away from high-carbon, unsustainable activities. Prior to that, she was a Senior Policy Advisor on low carbon finance at E3G conducting research and advocacy into innovative financial instruments and challenges involved in securing finance for energy efficiency investments. Andrea is Brazilian and has a background in Economics (BA), European Politics (MA), and Corporate Governance and Ethics with a concentration in environmental issues (MSc).

WWF

Participants

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Responsible Investing Roundtable

Building a Sustainable Future

The fourth annual CAMRADATA roundtable on Responsible Investing began with a discussion on sources of information. Where do participants get their information on Responsible Investing and ESG?

This is not a trivial question. Responsible Investing can be an echo chamber in which maxims and cautionary examples, notably BP's Deepwater Horizon disaster, can be voiced repeatedly without every speaker understanding the portfolio impact of these episodes. Incorporating Environmental, Social and Governance (ESG) factors into financial analysis takes extra time, human resources and proper sources of information.

Andrea Marandino, sustainable finance and corporate risk manager at WWF, mentioned Environmental Finance and Responsible Investor as two useful websites, and Ceres, the US sustainability network, and ShareAction in the UK; although Marandino reminded the panel that WWF is not an investor per se. Its financial team for Europe, however, includes more than 30 people with experience in the financial and economics sector. "We know we cannot win this battle on ethical grounds," said Marandino.

Marandino noted that ESG ratings and rankings, even from research firms respected in the discipline, do not always provide satisfactory conclusions. She believes there is still a lot of "greenwash" accepted because of poor methodologies, for example that award points to companies merely for producing a sustainability report but not accounting for scope 3 emissions.

Julia Kochetygova, senior ESG research analyst at Northern Trust, one of the world's top investment management companies, with $1 trillion of AUM, agreed that there were topics such as corporate governance where assessment of public data – including all the standard company announcements on independent directors, succession policy and remuneration committees - did not suffice. She gave GMI, now part of MSCI ESG Research, as an example of a data provider that held a lot more insightful information on companies than public disclosures alone could tell.

Kochetygova added while MSCI has positioned itself strongly in this space, other specialist providers such as Sustainalytics, CDP and GRESB deliver valuable insights.

"ESG ratings and rankings, even from research firms respected in the discipline, do not always provide satisfactory conclusions."

> “ShareAction was recognised by several panellists as not merely a source of information but an effective campaigner.”

Honor Fell, a research associate at London-based consultancy, Redington, which has £400bn in assets under advice, said that she got a lot of information by conversations with asset managers - her job is to rank and recommend asset managers to pension fund clients. Fell mentioned Style Research, a boutique which analyses the strength of factors in stock indices and portfolios and includes exposures to a range of MSCI ESG data. She added that she had access to a Bloomberg terminal, which carries a lot of financial and ESG data.

This was a talking-point for Diandra Soobiah, head of responsible investment at NEST, the biggest master trust for auto-enrolment in the UK, with almost 6m members. Soobiah said that many pension funds have access to a Bloomberg terminal so that’s already a growing set of ESG data right there. Resource constraint and small funds can inform themselves without the need to pay separately for ESG information. She agreed that more asset owners, not just those the size of NEST, could better inform themselves about ESG issues by subscription to the right kind of publications, joining initiatives like the PRI and engaging with fund managers.

Cost, however, is an issue. Kaori Shigiya a private-sector policy analyst of Oxfam focusing on the financial sector, said the NGO could not prioritise paying for premium subscription services especially when most of them still adopt a box ticking approach and fall short of Oxfam’s ethical standards. When Oxfam is considering a partnership with a company, Shigiya said she often carried out due diligence on the company herself. Sources of information she did use include negative news search, SRI Connect, Corporate Critic - from the Ethical Consumer Research Association – and reports and rankings produced by NGOs such as ShareAction, Fair Finance Guide and Move Your Money UK.

Oxfam, like WWF and other campaigning NGOs, is itself not just a consumer but a popular source of information. Its French office has recently put out a report on the tax paid by French multinationals in Africa[1]. It is also collaborating with ShareAction on the Workforce Disclosure Initiative, which calls on all quoted companies to reveal data on major concerns such as injuries in the workplace and employee turnover.

ShareAction was recognised by several panellists as not merely a source of information but an effective campaigner. “They are out there to shake things up,” said Soobiah.

1 Transparence des industries extractives: les comptes surprenants de Total en Angola et d’Areva au Niger

Hymans Robertson is a UK pension fund consultancy with approximately £185bn in assets under advice. The firm has been building its approach to advising clients on RI issues over the last 18 months and, over the course of 2017, has focused on developing its approach for evaluating managers. Simon Jones, Head of RI at Hymans Robertson, said that the firm had started with a blank sheet of paper and, following consultation had agreed four broad criteria for assessing managers RI credentials. The four are: culture, integration, stewardship and transparency.

Culture includes the ownership of RI policies by leadership and Key Performance Indicators for executives, assessing whether RI is a pervasive element in the firm or merely an option for clients.

Integration considers how ESG factors are incorporated into decision-making processes. Interestingly for the CAMRADATA panel, this topic includes where asset managers are getting their data from. Stewardship reflects how managers exercise the responsibilities that come with asset ownership, through dialogue with investee companies but also voting records, including votes against management. The fourth criteria, transparency, assesses how an asset manager devotes itself to explaining its process and outcomes to clients.

The process Hymans is developing is most relevant to the CAMRADATA roundtable. Pension funds that don't possess a Bloomberg terminal as part of their own arsenal would expect consultancies such as Hymans to have that knowledge. Jones noted that Hymans would be including manager ratings in its client reporting but acknowledged that there is a commercial aspect to the development of its services, which have to meet the needs of clients. Those needs are, however, changing as clients become increasingly interested in RI.

Fell commented that Redington has taken a slightly different approach: rather than creating a separate ESG rating to sit alongside the existing rating, the consultancy decided to integrate ESG as one of the 10 key selection factors they assess when recommending asset manager to their clients. Redington is also assessing ESG across all asset classes rather than equity only. This integrated approach means that all clients will have access to the research team's view on each individual manager's approach to managing ESG risk.

> "firm had started with a blank sheet of paper and, following consultation had agreed four broad criteria for assessing managers RI credentials. The four are: culture, integration, stewardship and transparency."

An active manager with ESG woven into its investment process, Paris-based Comgest uses a variety of external feeds. BoardEx, MSCI, Trucost, RepRisk, Bloomberg and Sustainalytics were a few names cited by Sébastien Thévoux-Chabuel, ESG portfolio manager and analyst at Comgest. He qualified, however, that the most popular use of these sources is to verify what the firm has already discovered. “Ninety per cent of what they do is not adding value because their methodologies are based on public disclosure by companies,” he said. “So it’s checking what we know.”

> “We can spend years familiarising ourselves with a potential investment in order to build a thesis”

As a boutique with E23bn in global equities under management, Comgest devotes a lot of time itself digging into what a company does. “We can spend years familiarising ourselves with a potential investment in order to build a thesis,” said Thévoux-Chabuel, who explained that Rolls-Royce, the UK aircraft engine manufacturer was one target that Comgest had tracked for ten years but never invested in. The primary source of information remains what a company says in its Annual Reports. Not just for one year but overtime, through different Annual Reports to identify what is changing and what is not. This helps shape a thesis about the “character” of a company. “After the thesis, we check for contradictions. We build an antithesis using information from unions, NGOs, suppliers and the likes of Glassdoor,” he continued. “Finally, we spend a lot of time with the board, middle management, and even former staff for the synthesis.”

This all flows into Comgest’s valuation methodology, which aims to find those remarkable companies that can compound earnings at 10% a year sustainably. In seeking such Quality Growth, ESG factors account for 50% of the Quality factor.

Emma Jane Joyce is senior manager, Strategy & Responsible Investment at the E8.1bn Ireland Strategic Investment Fund, a sovereign development fund managed by the National Treasury Management Agency. She too mentioned Responsible Investor as a good source of news: the PRI as a forum for collaboration (a view endorsed by Fell and Thévoux-Chabuel) and the Carbon Disclosure Project (CDP). Joyce is chair of the CDP Ireland Network for 2017. She described the organisation in its early days as being “more than just a data provider. It was a movement.”

CDP has expanded the program to include Water and Forests. Joyce reminded the panel that when CDP began, there were no data – CDP has grown by responding to the needs of investors and analysts. Its global report claimed 1,089 companies disclosed Climate Change data in 2016, representing 12% of global emissions.

But for Marandino there was less to this number than meets the eye. She indicated that even very few CDP signatories give an adequate report of their carbon footprint. Kochetygova agreed. “Only 57 companies out of the MSCI World Index said they were reporting Scope I and II emissions on their full spectrum of operations (based on Bloomberg data)” she said, noting that these emissions account for only about 27% of total emissions anyway. She added that it was almost impossible to get reported Scope III emissions, covering both the supply chain and product life, and investors have to use a combination of what is reported and the estimates. “There is a very long way to go, but useful information is there for investors’ benefit. You just need to use it with caution,” she admitted (NB only 7% of asset owners disclose carbon emissions in their holdings via the Asset Owners’ Disclosure Project).

Joyce was well aware of how much ground remains for CDP to cover. Less than one-quarter of the companies listed in Dublin on the ISEQ disclose to CDP. She said that in Ireland, trying to be perfect dogged some companies’ reporting efforts. “There are some great companies who don’t have all the information and so would rather not disclose than be given a scoring or label that is inaccurate,” she said.

Joyce explained further: companies may choose not to disclose if they are concerned about a poor score or label - however all companies publish very detailed financial information in annual reports, because they are confident it will stand up to scrutiny. The logical deduction is that they do not have the same confidence in climate change data and are concerned it won’t stand up to scrutiny - hence the common choice to not publish or disclose.

So, there are concerns around CDP and the diverse reasons for low levels of reporting on emissions more generallly: some investors see inadequacy of data as their problem while others exploit it for greenwash. But these concerns illustrate the broader issue of evaluating sources informing ESG decision-making. While the worlds of business and finance move fast towards greater data disclosure, many information points remain buried in the dark. Here Kochetygova said Northern Trust analyses a lot of information, particularly when doing risk calculations for medium-sized pension funds who want a better holistic sense of the dangers and opportunities facing their portfolios. With $60bn assets under management in ESG strategies, Northern Trust has the resources and commitment to answer clients’ concerns.

“While the worlds of business and finance move fast towards greater data disclosure, many information points remain buried in the dark.”

Orientating investment strategy starts from clients' beliefs, as Jones reminded the panel. But then strategy requires data. On climate change, Kochetygova quoted UN statistics that transitioning spend of $36trn is required by 2050 for an 80% chance of limiting global warming to 2 degrees. On current trends, there is an annual $200bn shortfall in financing renewable electricity alone as part of this climate change mitigation.

Crosshead: Engage or Avoid

> "On current trends, there is an annual $200bn shortfall in financing renewable electricity alone as part of this climate change mitigation ."

Investing in renewables is part of the remedy (second only to energy efficiency, according to the IEA). But what were the panellists' views on companies that were not spending enough on the transition from fossil fuels to renewables, ie those responsible for that $200bn shortfall each year? None of the investor panellists were in favour of dumping such companies' stock. "You can divest but then you miss the opportunity to influence companies's strategies. Those who are part of the problem today, can become part of the solution tomorrow," said Kochetygova.

Marandino agreed to some extent: "I believe engagement is a better form to affect corporate behaviour but, to be effective, it needs to be accompanied by the threat of divestment." She said that in some sectors, fossil fuels in particular, it was becoming increasingly difficult to justify continued engagement in face of little action and the urgency to act on climate. "History has proved that divestment campaigns can be powerful tools to stigmatise sectors, change consumer's perceptions, and encourage governmental policy," she said.

Comgest's style, however, means it has almost no exposure to miners, energy companies or car manufacturers and consequently a carbon footprint 60% lower than a mainstream global equities index.

For the other investors on the panel, engagement with these sectors was very much the order of the day. The majority of NEST and Northern Trust's equities follow index-like strategies. An example is NEST's latest mandate, which is a climate-aware fund with quantitative tilts towards companies helping mitigate climate change and away from those with worse than average carbon dioxide emissions. Soobiah made the point that the fund, which NEST has seeded, offers incentives to energy companies to align themselves with climate change mitigation. And because of NEST's stature among UK pension funds, the strategy itself is likely to gain greater weight.

Fell commented that first movers such as NEST and the HSBC pension fund (Redington worked with the HSBC pension fund during the development of another factor-weighted index with a climate 'tilt') are crucial to getting the conversation started. However, the next stage of adoption requires investment consultancies to support smaller clients who have a lower governance budget and smaller mandate sizes.

Northern Trust also offers a 'climate tilt' strategy, which has a lower carbon footprint than the standard MSCI World Index while maintaining low tracking error to the Index.

Then there is Northern Trust's low-carbon strategy with a Quality factor input that purports to improve risk-adjusted returns, based on the demonstrated performance. Kochetygova then listed a number of existing indices from major index providers that offer every permutation of Low Carbon and Renewables exposure. Perhaps the question is whether investors wish for a low-cost, rules-based strategy or they trust an active manager such as Comgest, which holds fewer than 50 stocks in its global equities portfolio (of course, it would be possible to mix the two).

Soobiah was keen to scotch the old criticism that passive investing means an absence of shareholder pressure. And to be precise, NEST's new mandate is not passive but rules-based. To coin a phrase, it is smart passive. Soobiah gave SSE as an example of a utility that has promised to end its coal usage by 2025 and for that been rewarded with greater exposure in the Climate Aware Fund.

Companies do change strategy, however. Thévoux-Chabuel cited BP in its 'Beyond Petroleum' campaign and US carmakers under Obama's presidency, as examples of companies that appeared to be going green but then chopped their promises. Were this the case with SSE on coal, however, then the criteria of the Climate Aware strategy would automatically sell some of its stock.

Soobiah further explained that NEST likes to exercise its voting rights at investee companies. It employs a proxy voting agency, Manifest, to coordinate this activity across equity portfolios. One of NEST's policies, most relevant to the energy sector, is that it votes against any company that makes political donations. Soobiah made the point that with six million members already, NEST had to be sensitive to popular campaigns because it looked after far more people's savings than most pension schemes.

"However, the next stage of adoption requires investment consultancies to support smaller clients who have a lower governance budget and smaller mandate sizes."

CROSSHEAD: Ireland’s Impact Investor

As a Sovereign Development Fund with a ‘double bottom line’ objective, The Irish Strategic Investment Fund is answerable to a range of stakeholders including parliamentarians and media.

The Fund’s legislative mandate requires all investments to support economic activity and employment in Ireland and generate a commercial return.

> “For the CAMRADATA roundtable, the significant development is how Joyce is developing an ESG / Responsible Investment framework for the Irish portolio.”

The Fund aims to achieve its Economic Impact objectives by being “additional” and by avoiding displacement or financial deadweight when assessing potential investments. All investment must meet this criteria and the Fund aims to increase its impact by crowding-in co-investment while also avoiding areas of the market where ISIF believes there are already plenty of existing finance providers or solutions. These concerns relate to all three strategic themes of the Fund’s domestic exposure, which are Enabling Ireland, Growing Ireland and Leading Edge Ireland.

The first theme covers infrastructure, housing and energy. The second theme focuses on growing SMEs, agriculture and food manufacturing while the third backs innovation.

For the CAMRADATA roundtable, the significant development is how Joyce is developing an ESG / Responsible Investment framework for the Irish portolio. The Fund has just hired a new advisory firm to help ISIF incorporate ESG considerations into its domestic investment commitments. This is a significant task not only because ISIF is an impact investor by nature – it exists to benefit Irish society, not merely earn returns – but because its commitments range into illiquid ventures, far beyond the realm of most ESG data providers.

Joyce said that it does face pressures to divest and the Fund has committed to review its Sustainability and Responsible Investment policy.

As a global equities manager, Comgest faces different challenges. Thévoux-Chabuel recalled that the firm takes a long time to get to know potential investments. Sometimes, in attempting to build a thesis, it struggles when the company does not divulge sufficient information. Others are secretive. Comgest had to travel to Spain every time it wanted to know more about Inditex, parent of high-street fashion store, Zara.

All this is necessary for Comgest, as an active manager, to feel comfortable that it holds superior insights than the market and can produce superior returns than an index-tracking fund or a rules-based “smart passive” approach.

Then there is the pressure of dealing with acquisitions and mergers. There are rarely more than a few months for shareholders to become familiar with the other company in take-over situations. For a long-term investor such as Comgest, which holds its stocks for more than seven years on average, what does this mean? Thévoux-Chabuel noted his firm’s reluctance to sell its holding in semiconductor, ARM to Softbank of Japan recently, even at a share price premium of 42%. “We reckoned that the premium would have been achieved organically within six years,” he said.

Both Comgest and Oxfam shared common ground on another recently proposed acquisition of a different tone and outcome: the unsolicited, unexpected and rapidly unsuccessful £115bn bid for Unilever by fellow food giant, Kraft Heinz.

“Both Comgest and Oxfam shared common ground on another recently proposed acquisition of a different tone and outcome: the unsolicited, unexpected and rapidly unsuccessful £115bn bid for Unilever by fellow food giant, Kraft Heinz.”

For many, Unilever champions the ethos that a company is more than a revenue-generating organisation for its shareholders. “Unilever is the only one of the big ten food and drinks multinationals to have a strategy in place to raise incomes of farmers and workers and demand its suppliers make fairer deals,” said Shigiya.

Oxfam’s Behind the Brands campaign aims to inform consumers about the people at the other end of the supply chain that produces chocolate, yoghurt, breakfast cereals and coffee. Shigiya points out that farmers in poorer countries are getting less and less of the value that they create. “Across the board, cocoa farmers receive 3.5-6% of total revenue from chocolate products,” she said.”In the 1980s they used to get 16%. More and more of the share of the value created is going to multinationals and retailers.”

Not only does Unilever have strategies for its supply chain; it is the only one of ‘the big ten’ with a policy on how it pays tax, according to Shigiya. “We were horrified at the possibility of a Kraft takeover. We have worked for years with Unilever, they were unique in providing exceptional transparency by giving Oxfam access to inspect their factory in Vietnam and the liberty to write an independent report which highlighted the gap between the company’s high level labour rights policies and the reality on the ground for workers.” After Oxfam’s Vietnam report appeared in 2013, the company reviewed its factory workers’ wages globally and introduced tougher requirements for suppliers, according to Oxfam, which published a follow-up study in 2016.

Thévoux-Chabuel agreed that Unilever had found a good balance between profit and sustainability. He said Kraft was not bad but had a different philosophy. "If we don't have champions, it is harder to make progress," he said. "If all companies behave like Kraft or get bought by Kraft, then capitalism starts to eat itself. Besides, when good companies get taken over, it becomes hard to find similar good quality growth companies in which to invest the proceeds."

He noted that the UK's Companies Act of 2006, section 172 requires directors to consider the interests of suppliers, employees and customers – not just shareholders. However, currently there is no one who monitors companies' compliance with s.172 nor is there any grievance mechanism if it is breached, so in practice this section is meaningless. Oxfam responded to the Green Paper on Corporate Governance Reform demanding government set up such monitoring and enforcement capabilities.

CROSSHEAD: Unilever's Pyrrhic victory

In the case of Unilever, Shigiya is worried that damage to the company's holistic ethos has already been done. "We were relieved when the bid failed but within a few weeks it was evident that Unilever was going to make some changes," she said. Now it plans to buy back shares to make itself indebted and thus less attractive to acquire."

Such pressure from short-term investors that drives companies to adopt financial engineering proves that the current capital markets system does not incentivise the right behaviour by companies, according to Shigiya. "It is time that the system itself be looked at so that companies that balance profitability and sustainable business practices that create longer-term value for all are not penalised," she said. "Perhaps such companies should be given a level playing field by, for example, banning companies from borrowing debt in order to buy back shares or restricting companies to buy back shares before they pay their workers a living wage and fulfil their pension obligations. One cannot overlook the fact that the UK has been suffering from low productivity and low wages and the possible likelihood that this is linked to low investment by companies (in 1970s Britain, £10 out of every £100 of profit was paid in dividends to shareholders. Today £70 of every £100 are paid as dividends i.e. much less proportions are reinvested back into skills and innovation).

"Such pressure from short-term investors that drives companies to adopt financial engineering proves that the current capital markets system does not incentivise the right behaviour by companies"

As defined benefit pension funds retreat from holding equities as they mature, will new shareholders be sufficiently responsible to encourage the companies they own to be sustainable in the ways outlined by Shigiya? She doubted that defined contribution schemes held the answer. “There is no pension fund trustee to hold account, there is no relationship between the individual and the fund manager and individuals are less likely to be active owners,” she observed.

Both Fell and Thévoux-Chabuel noted the power of collaboration within the PRI as one antidote. But Marandino’s judgement was less optimistic. Regarding specifically scenario-planning for mitigating climate change. Marandino said the IEA’s 450 scenario, the most commonly used in the world, is out-of-date and flawed as it gives only a 50% probability of staying below 2°C and relies on unrealistic mitigating processes such as Carbon Capture and Storage which has had little take-up. She urged the asset owners, managers and consultants on the panel to take a step back from data to their beliefs and consider the wider world: “What are we trying to achieve: a return for investors or something much bigger? What are the consequences for all of us if we don’t act? When we focus on Low Carbon, are changes too small in the face of world challenges?”

Jones replied that part of the problem is the mindset of the financial services industry. “The financial system exists as a subset of the real economy, which in turn sits as part of the natural world. But the industry too often does not acknowledge this relationship in making investment decisions,” he said.

Fell rounded up the discussion by concluding that investors are at least moving in the right direction, as the new initiatives by Hymans Robertson, Redington and NEST prove. But the panel agreed that there remains far, far more to do.

“What are we trying to achieve: a return for investors or something much bigger? What are the consequences for all of us if we don’t act? When we focus on Low Carbon, are changes too small in the face of world challenges?”

Comgest

The Hunt for Quality

For a growth investor like Comgest, focusing on quality is one of the very few practical approaches to increase our odds of investing in companies that will indeed profitably outgrow expectations already priced in their shares. But, identifying quality should not be limited to approximate yardsticks such as earnings standard deviation, a net debt / Ebitda ratio or even a slightly more elaborate Piotroski score. Instead, there is an interconnected relationship between competitive advantage and quality.

> "Assessing company culture is important for an investor as it can have a large impact on the capability to turn resources into profit"

Written by
Sébastien Thévoux-Chabuel
ESG Portfolio Manager and Analyst

When we, at Comgest, talk about the "pricing power", the earnings visibility or the exceptional franchise of a company, we are definitively talking about the quality of a business, but what is quality at its core? The UNESCO defines quality as "a measure of fitness to purpose". And as Peter Drucker wrote, a business is defined by its purpose, which is to turn a social problem into an economic opportunity. So, based on the relevance of its purpose and its fitness to fulfill it, we can start to measure the quality of a company. How do you then turn a social problem into an economic opportunity? You achieve this through innovation and differentiation. The innovation solves the social problem while the differentiation secures the economic opportunity.

To monetise a problem-solving innovation, a company needs to be strongly, sustainably and distinctively associated with it. The competitive battle between companies occurs not in the marketplace but in the mind of the customer. It is impossible to assess the quality of a company if we do not firstly understand what its purpose is and to what extent this purpose solves a social problem in the eyes of the customer. Only then can the relevance of that specific purpose for existing and potential customers be determined and evaluated.

What the customer thinks he is buying, and what he considers as value, is up for debate. Regardless, this determines what a business is, what it produces, and whether it will grow or decline. What the customer buys and considers value is never a product. It is always a perceived utility, i.e. what a product or service does for the customer. Quality in a product or service has never been what the company puts in, rather it is what the customer gets out of it and is willing to pay for. Fairness, accountability, sustainability and being a force for good are among the values that consumers increasingly seek after. Carefully understanding what the true quality of a company is one of them, which is what our style of quality growth investing is all about.

Even if startups usually do a better job than large organisations to define their culture and create a brand that makes sense and solves social problems, a firm's culture and purpose should never be an afterthought to its strategy, as it is singular and path-dependent.

The link between the quality of a company and its purpose and culture should be front and centre for the board of directors. When setting goals and assessing performances of senior executives, the board should ensure that the specific purpose of the company is clear and that everyone feels excited and accountable. Too often the question of governance is limited to the legal organisation of administrative powers and their counter-powers within the firm or the relationships between the principals and the agents. The strategic role of the board becomes even clearer if its mission actually lies in optimising the level of autonomy left to the executives to nurture their intrinsic motivations. Its responsibilities become paramount when it has to determine how to balance the company's risk appetite with the need for critical oversight.

One of the board's most critical duties is to nurture and potentially refine the business purpose and the culture of the company, and ensure those two essential aspects of a company outlive any CEO in place. Ensuring the executives have superior intrinsic motivations for the job and excellent business ethics will always beat any systems based solely on financial rewards and punishments. Based on our experience, it is one of the main reasons why family-owned businesses usually outperform widely-held companies, whose directors and executives do not have affection for the company, let alone a genuine understanding of their purpose and culture.

Corporate culture is nothing more than the set of moral values, social norms and implicit beliefs of a company, which shapes decisions and behaviours through the common ground all employees share and understand implicitly through verbal and nonverbal codes. Strong corporate cultures can indeed have numerous benefits. People recently hired into the firm as well as veterans of the organisation rapidly know how to take decisions and implement action plans due to clarity about how things should happen and why. Group integrity and its ethics are clearly defined and understood. It is in the culture of the company that the customer-centricity will be defined, that accountability standards are set and that key notions like trust, respect, meritocracy, adaptability and reciprocity come from.

A strong corporate culture and purpose creates a group of intrinsically motivated people brought together with an outstanding ability to give birth to genuine innovations, thanks to the trust that they share between them. It is a remarkable concept: only when individuals can trust the culture or organisation they belong to, will they take personal career risks in order to advance that culture or organisation as a whole. So in order to grow with quality, the goal is not to hire people who simply have a skill set you need nor to persuade customers who simply have money to spend it with you; the goal is to hire people who believe what you believe and who are excited to solve the problems of those clients who actually also share those beliefs. Those are the traits that enable some companies to have corporate strategies and CSR*/Sustainability strategies that are one and the same and which serve the greater good of civil society while making significant profits.

“A strong corporate culture and purpose creates a group of intrinsically motivated people brought together with an outstanding ability to give birth to genuine innovations”

ESG Investing

Giving up greenhouse gases, not performance

NORTHERN TRUST
ASSET MANAGEMENT

Carbon from burning fossil fuels is the key greenhouse gas that causes climate change, and cutting investments in carbon-emitting companies doesn't mean falling behind in performance.

Investors do not have to give up returns when hedging their portfolios against climate risks. Strategies to reduce investments in companies that produce carbon emissions or fossil fuels themselves, the culprit of climate change, can be optimized to avoid unintended risks and closely track benchmarks.

> "Cutting investments in carbon-emitting companies doesn't mean falling behind in performance"

FREE OPTION

The tracking error of optimized decarbonized indices versus conventional benchmarks can be very low, which allows seeing them as a "free option" on carbon. It means that if and when wider regulatory actions are taken on the way to mitigate climate change, the markets will re-price climate risks and such low-carbon strategies should start outperforming conventional benchmarks.

At the status quo, these strategies are expected to perform in line with their benchmarks. In many cases, however, as Exhibit 1 shows, low carbon indices have outperformed their benchmarks. Analysis finds that it mainly happens due to the stock selection effect. It does not necessarily mean that climate risks are already priced in. A more rational explanation would be that companies who have invested into low carbon technologies happen to be more innovative and more efficient companies.

EXHIBIT 1: MSCI ACWI LOW CARBON PERFORMANCE COMPARISON

Investors looking to reduce carbon emissions through their investments don't have to lose performance. Low carbon indexes in the ACWI universe have tracked well, and even outperformed, in the six years ended November 2016.

	MSCI ACWI Index	MSCI ACWI Low Carbon Target Index	MSCI ACWI Low Carbon Leaders Index
Total Return (%)	7.8	8.1	8.1
Standard Deviation (%)	13	13	13
Sharpe Ratio	0.59	0.61	0.60
Tracking Error (%) (MSCI ACWI)	0.0	0.4	0.5
Information Ratio	NA	0.65	0.53
Beta (MSCI ACWI)	1.00	1.00	1.00
Carbon Emission Intensity (tons carbon / USD $1 million in sales)	237.1	55.9	118.6
Carbon Emission Intensity: Reduction from Benchmark	0%	76%	50%
Normalized Poten-tial Emissions (tons carbon / USD $1 mln market cap)	3,727.7	257.1	1,705.1
Normalized Potential Emission: Reduction from Benchmark	0%	93%	54%

SOURCE: MSCI. Gross returns are annualized in U.S. dollars from 11/30/2010 to 11/30/2016. Carbon emission intensity represents operational emissions from burning fossil fuels. Normalized potential emissions represents carbon emissions associated with fossil fuel reserves (oil, gas and thermal coal).

Written by
Mamadou-Abou Sarr
Global Head of ESG
and
Julia Kochetygova
Senior ESG Research Analyst

COMBINING LOW CARBON WITH FACTOR INVESTING

While optimization is applied to low carbon indices for achieving the market beta, they can also be used as part of factor investing, or "alternative beta" strategies, such as quality, low volatility or dividend. For one of our strategies, we set a carbon budget at approximately 20% that of the MSCI World Index. But it comes from the premise that reducing a portfolio's carbon footprint is unlikely to be the only objective that investors have. The carbon budget it therefore wisely spent on companies that bring other benefits to the portfolio, primarily high quality. It is also looking to control other risks—such as sector, country and style factor exposures—in order to provide this portfolio at a modest tracking error to the parent index.

The MSCI ACWI Index captures large and mid cap representation across 23 developed markets and 23 emerging markets countries. The MSCI ACWI Low Carbon Target Index overweights companies with low carbon emissions (relative to sales) and those with low potential carbon emissions per dollar of market capitalization. The MSCI ACWI Low Carbon Leaders Index aims to achieve at least 50% reduction in the carbon footprint by excluding companies with the highest carbon emissions intensity and the largest owners of carbon reserves per dollar of market capitalization.

"Reducing a portfolio's carbon footprint is unlikely to be the only objective that investors have."

CAMRADATA

CAMRADATA
5th Floor, 80 Leadenhall Street,
London, EC3A 3DH

+44 (0)20 3327 5600
camradata.com

Join Us On LinkedIn

Follow us on Twitter
@camradata