MODULE 11

Investing With An ESG Lens

This module helps students digest ESG and impact investing, explores the different types of ESG investing and show students examples of successful ESG firms.

We teach social investing through stories, and look at the history of ESG to gain historical perspective on why it has gained prominence for investors and society as a whole.

POWERED BY

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Key Takeaways From This Module

Guiding Questions

- What Is ESG?
- How has ESG grown more popular in light of greater environmental and social awareness?
- How does ESG differ from socially responsible investing norms?
- What are the different ways to invest in ESG companies?
- Are there drawbacks to the rise in ESG investing?
- How can shareholder activism shape the direction of a company?

Enduring Understandings

- ESG represents a set of qualitative benchmarks to evaluate a company based on environmental impact, social impact, and corporate governance.
- Specific company documents and third party ratings can help you evaluate ESG performance.
- Shareholder activism is crucial and impactful.
- Companies that adopt ESG policies are well positioned to pivot to changing environmental guidelines and consumer behavior trends.

So What Is ESG?

Environmental, Social and Governance (ESG) standards are set of qualitative criteria used to evaluate the holistic impact of companies. Institutions and individuals alike use the criteria to screen potential investments.

Environmental

Considers a company's **contribution and commitment to environmental innovation**. Includes:

- Climate change impact
- Air, water, soil pollution
- Resource management

Social

Considers a company's **internal and external practices pertaining to employee, consumer, and community relations**. Includes:

- Employment quality
- Customer privacy
- Community development

Governance

Considers the **composition, policies, and behaviors of a company's leadership team**. Includes:

- Board structure
- Executive remuneration
- Financial reporting

ESG is Massive!

Over the past 10 years, total US Investment in ESG has grown from roughly $1.5 trillion in 2010 to an *incredible*:

$8.4+

TRILLION!!

The Evolution of ESG

1960s

Rise of Social Responsible Investing (SRI): A niche group of investors reject the notion that a company's' only responsibility is to maximize shareholder returns, and divest from companies doing business that supported the Vietnam war.

2005

ESG is born: United Nations backed reports, "Who Cares Wins" and the "Freshfield Report", coin the term ESG, show how ESG issues impact valuations, and argue that capital markets must account for these factors in the interest of sound business practices and social good.

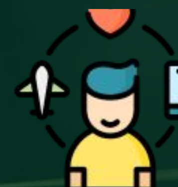
NOW

ESG goes mainstream: ESG investing now accounts for ⅓ of all assets under management in the US. This shift is caused by the rise of international reporting standards on ESG issues and significant evidence that sustainable companies are outperforming the market.

Why Has ESG Become More Popular?

Those Darn Kids

Millennials are set to inherit trillions of dollars as wealth transfers from Baby Boomers, and 67% of Millennials want their investments to reflect their social/environmental values.



Money, Money, Money

ESG investments are being shown to perform just as well as their traditional counterparts in the short run and outperform them in the long run. They also show resilience during downturns.

Straight Out of Black Mirror

Analytics and technology have made ESG metrics far more tangible and quantifiable. Web scraping and its likes are also making it easier for investors to avoid green-washing companies.

Modern Problems Require Modern Solutions

ESG issues such as climate change, data insecurity, and regulatory changes are also modern business threats. Companies with strong ESG performance are better prepared to face these threats.

Grading Companies' ESG Performance

ESG performance can be tricky to gauge. Material issues vary between industries and each rating agency has a different methodology.

A major goal for the ESG investing industry is to develop a standardized reporting and rating system but until then here are factors that most rating agencies consider:

Company Reported ESG Information

Includes information companies disclose as part of an ESG framework, as well as those that go beyond frameworks. Also includes corporate governance disclosure.

Industry and Regulatory Information

Includes anticipated and current risks associated with a product, industry, and location. It also accounts for the impact of certain events and regulations.

General Company Characteristics

Includes information about a company's product and geographic segments, revenue distribution, supply chain exposure, and workforce composition.

The UN Principles for Responsible Investment

The PRI are a set of opt in principles developed in 2005 as an initiative led by former UN Secretary General, Kofi Annan, and was adopted by a group of large institutional investors. It includes:

Investment Analysis	ESG issues are incorporated into valuation practices
Improving Effectiveness	Resource sharing to address new issues
Promotion in Industry	ESG reqs for partners and industry regulation
Disclosure Requirements	Require investment entities to disclose ESG issues
Reporting Progress	ESG activities and progress on ESG issues are reported
Ownership Practices	ESG issues are incorporated into ownership policies

ESG vs Socially Responsible Investing(SRI)

ESG

Uses specific metrics to identify how ESG factors affect performance. Companies are analyzed holistically and a balance is struck between corporate performance and investor values.

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SRI

Shares similar goals but is a broader, less defined concept Its focused on creating a portfolio that reflects the investors values. Companies are screened out if they engage in certain practices or operate in certain industries.

Example

An SRI investor interested in public health would instantly screen out a tobacco company for its industry.

An ESG investor might proceed with the investment if it meets ESG criteria such as sustainable resource management, fair wages, transparent leadership etc

Origins of Impact Investing

Socially responsible investing, as we know it today, began in 1960s. as Vietnam War protests demanded for university endowment funds to divest from defense contractor companies. **This worked at many schools and helped lead the way for future socially responsible investing across the globe…**

1977
Congress passed the community reinvestment act which forbade discriminatory lending practices in low-income neighborhoods.

1984
Chernobyl and the Three Mile Island disaster caused fear about the environment and led to the creation of the U.S. Sustainable Investment Forum.

1985
Students at Columbia University demand the school stops investing in companies that do business with South Africa due to Apartheid. $625 billion was diverted from 1985-1993.

2006
The UN released the United Nations Principles for Responsible Investment, which helped lead to $45 trillion in signatories' assets.

Profitable (and less risky?)

Data Talks!

$17.1 trillion
US domiciled sustainable AUM in 2020

42% growth
for sustainable AUM over 2018-2020

70%
Of ESG funds outperformed counterparts in Q1 2020

Companies with strong ESG focus foresee and address modern business threats and public relations scandals, and tend to have management teams with a holistics outlook.

Cautionary Tales

Pacific, Gas, and Electric Company

PG&E declared bankruptcy after suffering losses due to wildfires that they were severely unprepared for

Nike

Nike's reliance on child labor and sweatshops sparked a global boycott in the 1990s

How Can You Be an ESG Investor?

ESG Integrated Mutual Funds and ETFs

These are collections of stocks and bonds from companies with high ESG ratings. These instruments allow you to diversify your portfolio and save you the time of choosing stocks/bonds.

- **Vanguard's Global ESG Select Stock Fund (VEIGX)**
- **Nuveen ESG Large Cap Growth ETF (NULG)**

Individual Company Analysis

You can build your own ESG portfolio based on personally defined performance and value metrics. For this, you may rely on your own research or analyst ratings from third parties such as:

- **Corporate Knights Global 100**
- **MSCI ESG Ratings**

Elimination of Certain Industries (SRI)

Eliminating problematic industries, also called "screening", is a popular gateway to ESG investing. You can invest in specific companies or in exclusionary ETFs/Mutual Funds like :

- **Vanguard's ESG US Stock ETF (ESGV)**
- **Parnassus Mid Cap Fund Investor (PARMX)**

How Have Companies Adapted?

Sustainability Roadshows

Roadshows are a series of presentations by a company to current and potential investors. While they have always existed, ESG focused presentations are becoming increasingly common

Disclosure Practices

In 2013, only 23% of the S&P 500 disclosed ESG information. That number has since risen to 85% as companies are increasingly engaging in ESG related activities

Company Messaging

Individual investors, like you, are pushing ESG's growth. This means that companies are going beyond financial reports and centering their ESG efforts in marketing and hiring.

BRAIN BREAK:

HSBC Green Bonds!

ESG Success Stories: HSBC's Green Bonds

Green bonds are financial instruments which disperse raised capital into a portfolio of companies that meet well-defined sustainability criteria.

In 2019, ***HSBC became the largest issuer of green bonds in the world***, well ahead of other financial institutions like JP Morgan and Credit Agricole CIB.

Criteria for Investments

- Companies must have 90% of their revenue come from sectors like efficient buildings, renewables, and clean transport
- Exclusion of sectors such as nuclear power generation, adult entertainment, alcohol, and weaponry
- A Use of Proceeds agreement is drawn out for each investment and tracked by HSBC's Green Asset Register

Performance

°C CICERO Dark Green Rating (highest rating)

95% Growth in sustainability bond issues from 2018-2019

ESG Success Stories: Patagonia

Patagonia, founded in 1973, is an American clothing company focused on sustainable outdoor clothing and gear.

Patagonia has been at the forefront of incorporating ESG policies through its supply chain, employee practices, and corporate governance.

This has resulted in an extremely loyal consumer base which has helped them outperform the general retail market sustainably, showing that profits do not have to come at the cost of the environment.

Core ESG Policies

- Committed to 100% carbon neutrality, sustainable packaging, and recycled fabrics by 2025
- Strong supply chain standards to ensure fair working conditions and a living wage across own and contracted facilities
- Supported and partnered with numerous ESG minded organizations such as Fair Trade USA and 1% for the planet

Performance

4x Increase in profits over the last decade

$1B Valuation as of 2018

Understanding Shareholder Activism

Company Shares

Shareholder activism is when a shareholder - or a coalition of shareholders - with a significant portion of shares seek to determine the company's course of action. They do this through **voting out management**, **submitting proposals**, or **hedge fund activism.**

Engine No 1 vs Exxon Mobil

In 2020, Engine No 1, an investment firm with a stake in Exxon Mobil, called for the company to pledge net-zero greenhouse gas emissions by 2050. Despite its coalition holding only 0.2% of company shares, it has been able to apply pressure on the company and gain support from larger investors like BlackRock.

In the end, Engine No. 1 pushed Exxon to change its board's composition and include more ESG focused individuals. They were successful and ended up electing three directors to the company's board.

Engine No. 1 did not just stop there though. After seeing their success with Exxon, they decided to create a $100 million ETF focused on ESG engagement. The goal of this fund will be to focus on shareholder voting and active campaigns.

Why does this matter? Shareholder activism means that ESG investing doesn't just determine which companies receive capital but also allows investors to change companies from within.

A Quick Note On Conscious Capitalism

Conscious capitalism is a philosophy created by John Mackey, co-founder of Whole Foods Market (see image)

It is defined as a "way of thinking about capitalism and business that better reflects where we are in the human journey, the state of the world today, and the innate potential of business to make a positive impact on the world."

While still pursuing a profit, conscious capitalism emphasizes that they want to consider the interests of every stakeholder. These stakeholders include the environment which can't speak for itself.

The philosophy didn't hold Mackey's company back, seeing that **Whole foods was sold for $13.7 billion to Amazon.**

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RELEVANCE FOR YOU

- Consumers and Shareholders alike can pressure corporations to adopt ESG compliant policies
- You as an investor can choose to invest in socially responsible and climate friendly companies, aiding their mission and success

Additional Videos & Resources

5 ESG Trends to Watch in 2021
https://www.msci.com/our-solutions/esg-investing/2021-esg-trends-to-watch

How ESG Became A Trillion Dollar Investment
https://www.cnbc.com/2020/06/25/what-is-esg-and-socially-responsible-investing.html

50 ESG Stocks To Research
https://www.investors.com/news/esg-companies-list-best-esg-stocks-environmental-social-governance-values/

Understanding ESG Ratings & How They're Formed
https://www.msci.com/esg/deconstructing-esg-performance

Efforts To Standardize ESG Ratings Across the Globe
https://www.greenbiz.com/article/can-we-finally-standardize-esg-standards