ESG and sustainable investing
Challenges and opportunities

WILSON WILLIS

FEBRUARY 2020

A ROUNDTABLE REPORT

Report produced in association with

Scotiabank

Scotiabank is a leading financial services provider in the Americas. We are here for every future: we help our customers, their families and their communities achieve success through a broad range of advice, products and services, including personal and commercial banking, wealth management and private banking, corporate and investment banking, and capital markets. With a team of more than 100,000 employees and assets of over $1 trillion (as at October 31, 2019), Scotiabank trades on the Toronto Stock Exchange (TSX: BNS) and New York Stock Exchange (NYSE: BNS).

We believe that the long-term success of our Bank and the world around us are fundamentally intertwined. Through our Sustainable Business Strategy, we strive to ensure we are addressing the environmental, social and governance (ESG) topics that matter most to our business and to our stakeholders. By paying careful attention to the areas where we feel we can have the biggest impact we create economic, social and environmental value for our customers, employees, communities and our planet, while also delivering returns for our shareholders.

In November 2019, Scotiabank launched its enterprise-wide climate change strategy: the Scotiabank Climate Commitments. This strategy outlines five tangible ways the Bank will support the transition to a low-carbon, more resilient economy and accelerate climate solutions through our core business activities, including the commitment to mobilize $100 billion by 2025 to reduce the impacts of climate change. For more information on Scotiabank's approach to sustainability, please visit http://www.scotiabank.com/sustainability.

Scotiabank Global Banking and Markets (GBM) conducts the Bank's wholesale banking and capital markets business with corporate, government, and institutional investor clients. We were proud to demonstrate our leadership in green bond financings by participating in more than 30 green bond offerings across six currencies, totaling more than CAD $18 billion equivalent, over the past two years.

Scotiabank GBM is also contributing valuable information to the ESG dialogue since launching an ESG investment research team within the Canadian division of Global Equity Research in November 2018. Scotiabank GBM held its inaugural ESG Conference in May 2019, and published its second annual ESG report in December 2019. These reports may be accessed via the following links:

- The Rise of ESG in Investment Research – In Search of the Right Elements
- An Attendee's Notebook – Lessons Learned from the Inaugural Scotiabank ESG Conference
- Circling the Globe to Better See the Unseen in ESG

For more information, please visit www.scotiabank.com

WILSON WILLIS

Contents

Introduction

Neil Wilson

John Willis

One of the dominant themes in financial markets at the present time is the rapidly rising demand for sustainable investing based on a closer examination of environmental, social and governance (ESG) factors.

In part, this is no doubt to do with rising consciousness among investors and the public at large about specific environmental issues such as climate change – and the perceived need to act with urgency to address them. And a similar rising awareness about social issues, such as exploitation of workers in supply chains or inequality of treatment based on gender or race.

Asset managers have been responding with increasing vigour to the demand for action to address these issues. Many, if not most, now offer ESG-based strategies or claim to build ESG into their investment process. A huge proportion of the world's assets are now managed by firms that have signed the United Nations Principles of Responsible Investment (UNPRI).

A rising array of academic studies also seem to show that investing in a more ethical or ESG-based manner seems to deliver better returns – with the pleasing implication that 'good' companies perform better and hence, as an investor, you also perform better by investing with a more ethical approach.

There are, however, many questions raised by the trend. To what extent, for instance, is it a genuine phenomenon – or in reality just a PR box-ticking exercise that is effectively 'greenwashing'? And is that apparent outperformance simply driven by the sheer weight of money shifting into ESG? To what extent might that, arguably, distort markets – in ways that may not be so beneficial in the longer run? Ultimately, is this ESG trend itself sustainable?

Clearly, the various factors in E, S and G are driving different investors and asset managers to act in a variety of ways. While all sorts of different ratings and rankings have been emerging, we are at this stage still far from a consensus on the data that should be used – or how to analyse it – to introduce or adopt meaningful, widely accepted standards in ESG.

There was therefore much to discuss at this roundtable, held at the London offices of Scotiabank in late 2019. To participate in the discussion, we were delighted to bring together such a diverse group of individuals – including speakers from one of the biggest investment institutions in Canada, one of the world's biggest investment consultants, and all sorts of different asset managers from some large and mainstream firms to others that are more alternative or focused on impact investing.

Those taking part all felt it became a fascinating and illuminating discussion. We hope you find this report on their discussion insightful.

Neil Wilson John Willis

Panellist biographies

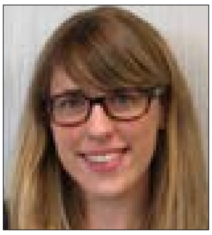
Daniel Avigad Lansdowne Partners

Daniel is a Partner & Portfolio Manager at Lansdowne Partners. Daniel joined Lansdowne Partners in April 2006 and in 2018 Daniel joined the Management Committee as a portfolio manager representative. Prior to joining Lansdowne, Daniel worked for 5 years in the Pan-European telecoms services team at Dresdner Kleinwort Wasserstein which was ranked 1st in the 2005 ExtelSurvey. Daniel holds a Master's degree with distinction in Information Technology and a first class honours for his bachelor degree in Mechanical Engineering with Mathematics from the University of Nottingham. Daniel is a Chartered Financial Analyst.

Patrick Bryden Scotiabank

Patrick Bryden joined Scotiabank GBM's energy team in Calgary in early 2010, covers exploration and production companies, and led the initiation of ESG (environmental, social, and governance) investment research for the firm in 2018. Mr. Bryden has worked in equity research and institutional sales since 1997. He has ranked first nine times in the annual Brendan Wood International and Greenwich Associates institutional surveys as an oil and gas analyst. Mr. Bryden served on the Natural Gas Expert Group for the Alberta Royalty Review and advised the province of Alberta on the calibration of its Modernized Royalty Framework. Mr. Bryden has raised more than $130,000 for the Movember Foundation and Ovarian Cancer Canada in his time at Scotiabank GBM. He has a Bachelor of Arts (Honours) degree from the University of Calgary and was awarded the CFA designation in 2001.

Blythe Clark Connor Clark & Lunn



Blythe Clark leads the Engagement & Stewardship team at Connor, Clark & Lunn Financial Group (CCLFG). With roots dating back to 1982, CCLFG has grown to become one of Canada's largest privately owned asset management firms with its affiliate teams collectively managing over $76 billion in assets from offices located across Canada and in New York, Chicago and London. The Engagement & Stewardship team supports CCLFG's active ownership activities including engagement with issuers, proxy voting and collaboration with other shareholders and advocacy organizations. Prior to joining CCLFG, Blythe worked at Bloomberg LP in London. Blythe obtained a BA from the University of British Columbia and an MSc International Political Economy from the London School of Economics.

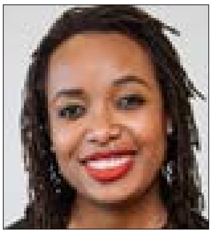
Brad Crombie Alquity

Brad Crombie is Chief Executive Officer of Alquity, a specialist Global Emerging Market ESG investment manager. Previously Mr. Crombie was responsible for all Fixed Income and LDI investing as Global Head at Aberdeen Asset Management, now a part of Standard Life Aberdeen PLC, a FTSE 100-listed asset management company. In this role, he served on the company's executive committee as well as a director of its principal UK operating subsidiaries. Prior to joining Aberdeen, Mr. Crombie was Managing Director and Head of EMEA Non-Financials Credit Research at Bank of America Merrill Lynch. He started his investing career in European High Yield. Brad also serves on the Advisory Group on McGill University in the UK and Europe. From 2015 to 2018, he was a founding member of the Advisory Council of the FICC Market Standards Board (FMSB), the body created following the UK's Fair and Effective Markets Review (FEMR), and served on its Conduct & Ethics Sub-Committee. He graduated from McGill University with a BA Degree in History and Political Science and an MA Degree in History and went on to read History in the PhD. programme at the University of Cambridge.

Martin Grosskopf AGF Investments

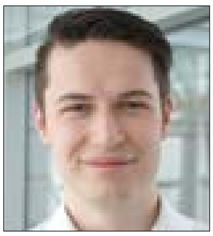
Martin is Vice-President and Portfolio Manager at AGF Investments Inc. He manages AGF's sustainable investing strategies and provides input on sustainability and environmental, social and governance (ESG) issues across the AGF investment teams. He is a thought leader and a frequent public speaker on ESG and Green Finance issues. He serves as Vice-Chair of the CSA Group technical committee on Green and Transition Finance and is a past member of the Responsible Investment Association (RIA)'s Board of Directors. Martin has more than 20 years of experience in financial and environmental analysis. He previously served as Director, Sustainability Research and Portfolio Manager with Acuity Investment Management Inc., which was acquired by AGF Management Ltd. in 2011. Before joining the financial industry, Martin worked in a diverse range of industries in the areas of environmental management, assessment and mitigation. He was a project manager with CSA International from 1997 to 2000 and, prior to that, served as an environmental scientist with Acres International Limited. Martin obtained a B.A. from the University of Toronto and an MES from York University, and earned an MBA from the Schulich School of Business.

Marisa Hall Willis Towers Watson



Marisa Hall, MSc, FIA, is a Director in the Thinking Ahead Institute, a global not-for-profit research network of more than 40 of the world's largest asset owners and asset managers, with the aim of mobilising capital to secure a sustainable future. She has been widely recognised as a thought leader and advocate for change, writing several articles featured in the media, thought pieces, research papers and as a speaker at a number of global events. Prior to joining the Institute, Marisa was a Senior Investment Consultant in Willis Towers Watson's investment advisory business, providing advice to clients on the financial management of their pension arrangements, including investment strategy, journey planning and dynamic de-risking, manager selection and monitoring, and liability hedging. Marisa is on the board of London Women's Forum, on the standing committee of Investment 20/20 and is on the steering committee of #talkaboutblack, a powerful movement sponsored by The Diversity Project that aims to improve progress on ethnic diversity. Marisa is a Fellow of the Institute and Faculty of Actuaries (FIA) and holds the Investment Management Certificate (IMC). She has a MSc (Distinction) from CASS Business School, London and a first class honours degree in Mathematics from the University of the West Indies.

Michel Léveillée Caisse de depot du placement du Quebec



Michel Léveillée is Advisor, Investment Stewardship at CDPQ. The Investment Stewardship group ensures that environmental, social and governance (ESG) factors are considered in investment analyses and engages with portfolio companies on ESG matters. In his role, Michel is one of the architects of CDPQ's climate strategy and now acts as a climate change expert to support the institution's leadership in this area on the world stage. Michel holds a business degree and a master's degree in finance.

Panellist biographies

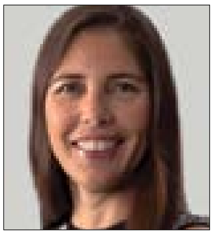
Tal Lomnitzer Janus Henderson Investors

Tal Lomnitzer is a Senior Investment Manager on the Global Natural Resources Team at Janus Henderson Investors, a position he has held since 2019. Prior to this, he was deputy head of global resources and fund manager at Colonial First State Global Asset Management from 2011 where he led the team's ESG integration and engagement efforts. He launched and ran various global resources and energy funds at Merchant Capital, NewSmith Capital, and ORN Capital, where he was a partner from 2010, 2007, and 2004, respectively. Tal began his career in 1998 at Morgan Grenfell/Deutsche Asset Management and holds first class BA and MA degrees in economics from Cambridge University. He holds the Chartered Financial Analyst designation and has 21 years of financial industry experience. Since 2018 Tal has been a Trustee of the Sir Hubert Von Herkomer Arts Foundation.

Joseph Porterfield Monterone Partners

Joseph Porterfield leads Investor Relations and Corporate Sustainability at Monterone Partners LLP. He has more than 20 years' experience working with institutional investors, corporations and private equity firms in the formation and servicing of investment products for institutional investors. Prior to joining Monterone, he was the Director of Tor Capital, an advisory firm working exclusively with sustainably oriented investment managers. Joseph graduated summa cum laude from the University of Maryland in 1992 with a BS in Finance, from the University of Chicago, Graduate School of Business in 1994 with an MBA and from Institute d'etudes politiques de Paris in 1994 with a diploma.

Vivienne Taberer Investec Asset Management



Vivienne Taberer is an investment specialist and portfolio manager in the Global Emerging Market Debt team at Investec Asset Management, where she is responsible for Latin American bond and currencv markets. Prior to joining the firm in 2002, Vivienne worked at Standard Bank in London for seven vears, initiallv specialising in South African fixed income before moving into sales and trading across the whole spectrum of emerging market debt. Prior to this, she worked at Mizuho International in London and First National Bank trading South African bonds, bond options, FRAs and swaps. Vivienne graduated from the University of the Witwatersrand with a Bachelor of Commerce degree and a Bachelor of Laws degree, and has completed the London School of Business Investment Management Programme.

Chapter 1

WHAT'S DRIVING THE TREND – AND IS IT FOR REAL?

SUMMARY POINTS

- Investor awareness, new regulations and performance drive the trend
- How much of it is 'greenwashing'?
- Is the flood of money distorting markets?

Participants at the roundtable pointed to various reasons why demand for 'sustainable investing' based on environmental, social and governance (ESG) criteria has become such a major trend in markets. Factors cited included rising pressure from investors as well as from government and regulators – and of course increasing evidence that you also seem to perform better by adhering to an approach based on ESG criteria.

On the other hand, some also raised concerns about the trend, such as to what extent it is largely just a box-ticking or 'greenwashing' PR exercise; or to what extent it may be distorting markets – with who knows what unintended consequences. Nevertheless, there was plenty of agreement that there is indeed a genuinely powerful trend.

Various participants highlighted fiduciary duty as a key factor driving ESG among institutional investors such as pension funds. Until recent years, the fiduciary duty for such investors to seek the best returns in order to fund their liabilities had arguably diverted them away from 'socially responsible' strategies, on the basis that this may add costs or reduce returns.

But increasingly the tables have turned, with fiduciary duty forcing such investors at least to take into account ESG factors and their potential longer-term financial costs. Over time many have been moving on to conclude that, far from adding costs or reducing returns, taking account of ESG appears to do the opposite and actually enhances returns – which has of course become a major driver of the trend.

Offering the perspective of one major end investor was Michel Léveillée, a member of the Stewardship Investing Group, which is in charge of integrating ESG factors into investment decisions at Caisse de dépôt et placement du Québec (CDPQ). In addition, he has been deeply involved in CDPQ's climate change strategy.

"ESG has been considered at CDPQ for a very long time, but we were looking at opportunities to take the next step in 2016 and 2017," he explained. "We researched extensively to figure out what we could do better as an institution. In October 2017, we

> **There's now a tsunami effect. From 20 years ago it is a very dramatic change**
>
> **Martin Grosskopf**

> What you find is that ESG levels are very highly correlated with the GDP per capita
>
> **Vivienne Taberer**

published our climate strategy. Basically, what we found was that it is possible to measure and integrate climate change into all our investment decisions and drive leadership internally and externally. Our strategy includes two quantitative targets – reducing our overall portfolio's carbon intensity by 25% and increasing our green envelope by 80%. The achievement of these targets now impacts the remuneration of all employees at CDPQ."

Léveillée also noted the need for investment institutions like CDPQ to focus on ESG issues in order to address potential longer term financial risks: "Mostly because we think of it as managing risks and opportunities as a long-term asset manager. We need to position our portfolio today to address growing issues, such as climate change."

He was one of a number of participants to note the rising demand from consumers also driving the trend: "A labelling rule is a great example. If you go to the drug store and you're trying to choose a shampoo, for instance, there currently is virtually no information to help consumers choose a brand in line with their values. If there was information on the carbon content of the product or ESG matters in general, that would probably drive change [in consumer behaviour]."

A broader perspective on investor motivations was offered by Marisa Hall, director of the Thinking Ahead Institute at Willis Towers Watson, a research network bringing together 45 of the world's largest asset owners and asset managers currently advising over $12 trillion. Its mission is to mobilise capital to secure a sustainable future.

> We think of it as managing risks as a long-term asset manager
>
> **Michel Léveillée**

An unstoppable train?

"ESG / sustainable investing is something that we, in the Thinking Ahead Institute, describe as an unstoppable train that is increasingly picking up speed," said Hall. "Alongside areas such as culture and purpose, and diversity and inclusion, sustainability requires integration at the very core of an investment organisation. This goes beyond having a sustainability focused fund – it needs to be integrated in all investment strategies. We work with asset managers and asset owners around the world to understand how they differentiate themselves from others in doing this."

> If we are distorting markets, the propensity for missteps is huge and profound
>
> **Daniel Avigad**

Hall cited a few reasons for the trend: "We know that trust in the credibility of the investment industry has been battered in the past. Asset managers and asset owners are increasingly trying to balance doing good while also doing well – contributing positively to big societal issues without compromising on their financial responsibilities. Sustainability is therefore high on the agenda."

Hall agreed the trend was indeed about investment returns – but also more than that: "Previously we used to say, 'We're creating value in this for shareholders and clients.' There needs to be a shift in this thinking [to] where we increasingly consider our responsibilities to employees, wider society and the planet. Investment and fiduciary duty historically have been framed as solving risk and return – we need to consider a third dimension of impact, where we consider the impact of our investment decisions."

She also cited some of the world's biggest investment institutions such as GPIF in Japan and Norges in Norway, who are so large they simply cannot diversify away from the market: "They have to deal with borderless issues, such as climate change. These funds are really pushing the boundaries as to the minimum standards on sustainability."

"Finally, there's the investment performance element," Hall went on. "There are tailwinds supporting that train I talked about. With lots of caveats aside, the fact is that there's a real long-term premium – we estimate 0.5% to 1.5%, depending on governance – for investing and thinking long-term."

Offering the perspective of one large asset management firm was Vivienne Taberer, a portfolio manager on the emerging markets fixed income side at Investec Asset Management, soon to become Ninety One Asset Management.

"Clients are driving it," said Taberer. "Our process is gradually evolving – gradually emphasising ESG more – delving more into governance, the social side and the environmental impact. Ultimately, this should drive better returns over time. As investors, what we would like to do is invest in countries that are improving stories – and, ultimately, see the returns come through from that."

The challenge can be very different for

> Clearly, there's a lot of demand and particularly from the younger generation. Millennials are pushing for this, and maybe even willing to give up some of their return for impact goals
>
> **Joseph Porterfield**

ESG has gone from being an ethical or moral factor to one with a massive weight of money behind it

Tal Lomnitzer

different types of asset managers, Taberer pointed out. "A lot of the discussion today [on ESG] is around the corporate side. Where we are coming from, looking at the sovereigns, it's much more complex. And what you find, obviously, is that ESG levels are very highly correlated with the GDP per capita across countries."

Offering the perspective of another large asset manager was Tal Lomnitzer, senior investment manager at Janus Henderson, where he runs around $600 million in resources funds investing in mining, energy and agribusiness.

"It's the confluence of a few things, not least of which is improved disclosure that facilitates better assessment of ESG factors and how those can then be measured against performance of share prices," said Lomnitzer. "There's also been changes of regulations. We're now getting UK legislation, potentially, coming through for pension funds asking how these things are now accounted for. That is a big shift."

Lomnitzer also cited social forces at work and the general rise in awareness of environmental factors: "There's clearly something happening with the millennial investor, whereby they care increasingly about the non-pecuniary aspects of their investments."

"ESG has gone from being an ethical or moral factor to one with a massive weight of money behind it," Lomnitzer argued. "That starts to feed into share prices and you are starting to see a self-reinforcing effect, where money's attracted into companies performing well from an ESG perspective causing their share prices to do relatively better."

Lomnitzer went on: "Five years ago we were talking about mitigating risk via consideration of ESG factors. Now we're moving into an opportunity phase, where you can actually generate better returns, because there is a growth thematic that's driving revenues and expanding margins for certain companies."

Martin Grosskopf brought the perspective of a portfolio manager at AGF Investments in Toronto who runs a thematic sustainability fund. He has been involved with that fund for about 20 years and also provides assistance on ESG integration with other teams at AGF.

"It's part of a 20-year evolution," Grosskopf said. "I was involved in the work program at the UN back in 2002/3, and at that time we didn't even have ESG as an acronym. We used the terms 'responsible' or 'ethical investing' – and were often getting thrown out of investment committees as these issues were perceived as unrelated to financial results. That ESG term really came about to destigmatise the concept and allow it to become part of a risk lexicon. And it has been extremely successful as a way to describe the issues in the financial context."

Grosskopf also referred to the United Nations Principles for Responsible Investment (UNPRI) as a factor helping to drive the trend: "What started to catalyse the investment industry was the PRI, even though back in 2004 or 2005 the PRI was viewed as kind of a 'motherhood and apple pie' initiative and there wasn't a lot of initial feeling that it would get much momentum."

Echoing earlier comments, Grosskopf also cited social pressures from everyday investors: "Whether it is climate change, auto sector emissions, supply chain issues or more broadly income inequality – the financial industry is really struggling to prove its contribution, from a societal standpoint."

"So I think these issues are now at the point where there is a tsunami effect, where there is a desire by institutions to demonstrate not just returns but impact. From 20 years ago to now this is a very dramatic change."

Grosskopf also highlighted the investment opportunities related to this: "As regulations get tighter and societal pressures get more intense, there is a tremendous opportunity in directing

Whether climate change or income inequality – the financial industry is really struggling to prove its contribution, from a societal standpoint

Martin Grosskopf

capital to companies that are benefitting."

Patrick Bryden, Calgary-based director and energy analyst in the Equity Research Group at Scotiabank Global Banking and Markets – where he launched ESG coverage for the firm for active research – provided some context on the trend from two major annual reports he has produced.

"When we started to investigate these trends, one of the things we noticed was the growth of assets under management under the UNPRI," said Bryden. "It's around $86 trillion now.[1] That represents about three quarters of the world's institutionally managed money. If you add sovereign wealth and high net worth etc., it's still almost a third of global assets.

"The trend doesn't mean all of those funds are going into wind turbine funds, but it does mean money is being invested according to certain principles," he noted. "When I try to understand what's behind that, I think it's to do with the empowerment of individual investors who are having their money managed. It's very grassroots driven."

Millennial demand

However, various participants also raised questions about how genuine all the investment into ESG really is. One was Joseph Porterfield, who leads investor relations and sustainability at Monterone Partners, an equity long/short manager with $360 million under management in a concentrated portfolio of listed west European stocks.

"There is a lot of progress in front of us that needs to be made. We have a lot of road to cover and that's challenging – but people are up for it, so that's good," Porterfield said. "Clearly, there's a lot of demand and particularly from the younger generation. Millennials are pushing for this, and maybe even willing to give up some of their return for impact goals."

He added: "I think there are three drivers behind this, and they're all important: regulatory pressure, client demand, and the recent acceptance that 'ESG' includes material risks that impact the performance of investment securities."

However, Porterfield also emphasised: "When we talk about the AUM that's signed up to PRI, you can't assume that all those assets are managed sustainably. They're not. In reality, it's a small amount of the total that is managed according to what we would term an ESG integrated policy."

Another who queried the nature or depth of the trend so far was Blythe Clark, who leads the stewardship and engagement activities at Connor, Clark & Lunn Financial Group, one of Canada's largest privately-owned asset management firms, based out of Toronto.

"It's really challenging to say what ESG is and what ESG isn't," Clark argued. "So, is it possible to be fully compliant? What is 'compliance'? Because as of now there are no universally accepted standards. And because there's no 'right way to do ESG' that opens the Pandora's box for greenwashing."

There was thus plenty of debate about to what extent ESG as practiced in the market at the current time is 'for real' – and to what extent it is effectively greenwashing.

"That's a very valid question," admitted Bryden of Scotiabank. "In my walk of life, we do follow the dollars and we try and understand what's happening. We are also often served well to be skeptical in our quest for the truth, so over time we will see whether various market participants are genuine or not. My belief is that those who do not truly 'live it' will quickly be exposed."

Bryden cited a study by Causeway Capital, Harvard Business School and Northwestern University[2], which quantified where you can see the companies that were over-disclosing items not relevant to their business – and under-disclosing items that were relevant. "The market could actually see that," Bryden argued. "Conversely, the businesses that were disclosing the appropriate amount of information on relevant factors and not wasting time by disclosing irrelevant factors were also seen as doing such – delivering what shareholders wanted to understand, which ultimately drove better shareholder returns."

"From my standpoint, disclosure is key behind this and governance is key behind disclosure," Bryden concluded. "So greenwashing is a risk, but ultimately I think the market will figure out what's real and what's not."

Another to comment on the greenwashing issue was Brad Crombie, CEO of Alquity Investment Managers, a specialist UK-based ESG equity investment firm, investing only in ESG strategies combined with an impact business model.

"Many people are convinced [by ESG] and believe in it. But I think you shouldn't forget there's still quite a lot of cynicism in the outside world, and there is good reason to be cynical," Crombie argued. "I believe one of the reasons is because we are in a state of ESG acceptance, but ESG chaos, because every firm is telling every client that they do ESG too."

Another driver, Crombie argued, is that active asset managers have witnessed fee compression across virtually all strategies – and the big move by investors into passive and index investing via exchange-traded funds (ETFs): "That makes managers think more about how can we stay relevant? I believe that ESG is, in many ways, what you could describe as the new active."

Crombie continued: "I think that in five years from now, we will all look back at the asset

ESG/sustainable investing is an unstoppable train that is increasingly picking up speed

Marisa Hall

We are in a state of ESG acceptance, but ESG chaos, because every firm is saying they do ESG too

Brad Crombie

“

Because there’s no ‘right way to do ESG’ that opens the Pandora’s box for greenwashing

Blythe Clark

Lauri Rantala / Flickr (CC BY 2.0)

growth into ESG and conclude that 95%-plus was greenwashing, at least as it will be defined in future. I’m not sure if we’d call it greenwashing now, but I think that in itself is part of the problem.”

“There are good reasons why UNPRI wanted to keep the bar relatively low, to get as many people to come into the tent and then raise the standards once they’re inside. But this stat of $86 trillion? There’s only a very small portion of that hitting any standard we can agree to.”

ESG outperformance

One of the key attractions of ESG has been the rising perception – backed up by an increasing number of academic studies – that companies (and hence funds that invest in them) which score highly on ESG measures also tend to outperform those that are lesser rated by ESG criteria.

As Scotiabank’s Bryden put it: “When you look at the performance case over a big enough sample set, the literature is very persuasive. Over a 20-year timeframe, whether you look at total shareholder return or return on assets, the multiplier of high sustainability characteristic companies versus low sustainability characteristic companies on a value-weighted basis was 1.6 times, in terms of raw tonnage of performance.[3] Those are significant numbers.”

To many investors, this appears to make sense – on the basis that ‘good’ companies which behave like responsible corporate citizens will surely perform better over time. But to others, there remains a nagging feeling that there must be some cost to ‘doing the right thing’ and perhaps that the studies so far only reflect the sheer weight of money flowing into ESG-based approaches – and in ways that are likely to cause distortions to the market over time.

One giving voice to some concerns was Daniel Avigad of Lansdowne Partners, which is best known as a major hedge fund group, but where he runs a European long-only equity strategy in a concentrated form.

“One of my concerns about this trend is that it’s very complicated, in terms of the implications for capital allocation,” argued Avigad. “My sense is that some of the distortions on the demand side that central banking have created over the last 10 years are now potentially going to be amplified on the supply side – through further interventions for the good of the planet.”

“It’s very hard to say what probable outcomes are,” he continued. “The probability of a very adverse outcome in the long run means we should be acting today, but that doesn’t mean I know exactly what we should do. I think the goodwill is there, but unintended consequences of goodwill can be as bad as intended consequences.

“We have to ask ourselves, for this to be successful, for us to save the planet: Are we going to do this in a way that means the trend towards ESG is persistent and sustainable?”

Avigad added: “My sense is that’s a far less sure point than it appears. So all this momentum [for ESG] could easily be checked, if we don’t do this the right way. If we are distorting markets and capital is being completely misallocated, the propensity here for missteps is huge and profound. So I think we should be much more circumspect about how we do this, rather than focusing on how big it can become.”

“

When you look at the performance case over a big enough sample set, the literature is very persuasive

Patrick Bryden

---

[1] UNPRI

[2] Khan, Mozaffar and Serafeim, George and Yoon, Aaron, “Corporate Sustainability: First Evidence on Materiality” (November 9, 2016). *The Accounting Review*, Vol. 91, No. 6, pp. 1697-1724.

[3] Robert G. Eccles, Ioannis Ioannou, and George Serafeim, “The Impact of Corporate Sustainability on Organizational Processes and Performance,” *Management Science* 60, no. 11 (November 2014): 2835–2857.

Chapter 2

THE E, THE S AND THE G – THE KEY FACTORS

SUMMARY POINTS

- Environmental factors increasingly driving markets, but governance still at the core
- Social factors less high profile, but increasingly measured – and seen as a driver for investing
- Pressures to divest or to engage – to encourage better outcomes

While ESG has become an increasingly popular concept in the investment industry, the relative weight or importance of each factor has also been evolving over time – as well as perceived inter-relationships between the three.

Governance, the G, has long been a major issue in markets, highlighted from time to time whenever there have been spectacular corporate failures such as of Enron or WorldCom or the unmasking of fraudulent actors like Bernie Madoff.

Environment, the E, has been rising in the consciousness of investors due to increasing awareness about the potentially huge financial costs of climate change, as well as other problems like plastics in the oceans and pollution more broadly.

Social factors, the S, have meanwhile been bubbling up too due to rising awareness about various issues from exploitation of workers in the supply chain to discrimination within the corporate world based on gender or ethnicity.

Brad Crombie of Alquity argued that the G was still at the core of it all: "If asset managers already had the G in their DNA, if they believed in governance, if they believed in stewardship, that was the door they went through to look at E and S. If you see asset allocation decisions being made, which are ESG, ask yourself how many of them are not related to governance? So I think governance issues are very important – there's an ultimate link through governance."

"There is a lot of focus on the environmental now," Crombie continued. "The one that seems to be the least focused on is the social. It's the least measured, and probably the least understood. And in our view, that's probably the reason why we believe that impact should be focused, first and foremost, on the S. Because if you empower more people, bring more people from the informal to the formal economy, make them more responsible consumers, enhance domestic consumption, and growth in one of the emerging markets, you're creating a big multiplier effect."

Martin Grosskopf of AGF felt the E has become the leading factor at the current time –

> **E, S and G are all interlinked and what connects them all is culture**
>
> **Tal Lomnitzer**

> The E is extremely material – it is front and centre for investments in various segments of the economy
>
> **Martin Grosskopf**

Martin Grosskopf

and not without good reason, he argued: "The environmental side has been an emerging driver of investment themes over the last 20 years, but the momentum has only really picked up in the last three to five – such as in the auto industry with companies like VW putting $60 billion into new electric vehicle models. The regulatory pressure coupled with technological improvements is driving CapEx within significant industries in the global economy."

Although climate change has become such a key driver for investing, many investors were still not allowing it to guide their strategy as much as they could, Grosskopf argued. "I sometimes hear investors say, 'It's a nice thing to do, and it's important, and perhaps it's part of the overall value proposition for owning the company.' But it is actually far more than that. It is a defining feature of investing in certain sectors, whether long or short."

Grosskopf continued: "The E, from my perspective, is extremely material – and in many cases can be quantified in terms of assumptions for cashflow over time. It is front and centre for investments in various segments of the economy."

Michel Léveillée at CDPQ also wanted to highlight the importance of the E factor for CDPQ: "It's important to understand that we are under pressure by some to divest from fossil fuel. We choose to exercise leadership in helping achieve a low-carbon economy through engagement with our portfolio companies. The Investor Leadership Network and our commitment to the Asset-owners Net-Zero Alliance are good examples of commitment to leadership which aligns with our climate strategy."

Vivienne Taberer at Investec felt the G was at the core, especially for a strategy like hers focusing on emerging market sovereign debt. "Over time, you want the trend to be in the right direction, and if so surely you will get better returns," she argued. "With governance, maybe it's easier [to analyse] – for example, in terms of whether you're meeting your fiscal targets or not. Once you start looking at some of the social and environmental issues and policies, they can be quite difficult to measure and the timelines to good policy leading to higher returns are much longer."

"The E part has got a lot of press recently – and around climate change," Taberer went on. "But how do you tell a government that's struggling to bring a large proportion of its population out of poverty that they should be spending more on the environmental budget – and less on education? How do you evaluate that and how do you make investment decisions around it? These are very complex issues and can be very subjective, particularly on the sovereign side."

Taberer concluded: "For emerging market sovereigns, the social side is incredibly important to driving the sustainable development, going forward."

> For emerging market sovereigns, the S is incredibly important to driving sustainable development
>
> **Vivienne Taberer**

Patrick Bryden of Scotiabank felt social factors were potentially much more significant than he had at first expected: "When we started down this path, I did feel the S was by far the most nebulous concept and likely to be the most difficult to measure," he said. "I have come out of this process as a believer that it might be the most potent of all business forces to capture, in terms of opportunity and ultimately corporate performance."

Bryden cited the example of a well-known study called *Diversity Matters* led by Vivian Hunt of McKinsey[1]: "This showed connectivity between top quartile diversity and outperformance in all organisations, across all industries, across all geographies. I think it's very intuitive – all of us would understand and appreciate that anything that challenges authority and goes against group think is likely to generate a sharper debate and better decisions."

Another example cited by Bryden was a study called *Orchestrating Impartiality*[2]: "It looked at auditions of players for orchestras over time. You could see up until the 1970s, there was only about 5% female participation in orchestras – until they started to do blind auditions. So, instead of being able to see the player visibly, they just listened to them – and lo and behold, the gender percentages got much more proportionally representative."

Among the other participants, Daniel Avigad agreed this study of blind auditions was very insightful – but that it was important to draw the correct conclusions from it: "The point about the blind audition to me is that it's the creation of a market. So, we're freeing the market to determine who is best. The converse of that, where you're asking the policymaker to determine, top down, what is best, will get us very different results."

MONUSCO/Sylvain Liechti (CC BY-SA 2.0)

Mining in the Democratic Republic of the Congo

Blythe Clark at Connor Clark & Lunn was another who highlighted S factors: "I would absolutely agree that the social issues are extremely important and arguably more difficult to deal with. The environmental side may be easier to measure, and we know the governance side has been around for a long time, but social issues perhaps remain less well-addressed."

Clark continued: "For us at CC&L Financial Group and our affiliate fund managers, gender diversity has been a significant priority. The Canadian Gender & Good Governance Alliance released a report that shows only around 14% of TSX-listed company board seats are held by women, which is frankly still low. So, over the past two years, we have begun voting against the chair of the nomination committee when a board has no female representation."

Marisa Hall at Willis Towers Watson also talked at some length about the importance of the S factor, saying: "We see culture as a unique differentiator that influences the way organisations think and behave."

Hall pointed to a distinction between 'cognitive diversity' and simple representational diversity: "When you start thinking about things like gender, race and age, what you really tap into is that diversity isn't just about improving business performance," she argued. "It is also about respect for individual identity, fairness, being socially responsible and even also about the UN Strategic Development Goals (SDGs). These are tied into an organisation's broader values. The goals of organisations need to combine three things: structuring the diverse array of people that make up the organisation – 'diversity'; treating them with decency – 'inclusion'; and using the power of cognitive diversity to improve business success."

Hall concluded: "Climate change continues to be one of the defining topics of our time, but people shouldn't forget that you can't solve climate change without also addressing social issues like inequality."

Tal Lomnitzer at Janus Henderson was another who put the S factor high on the agenda – given the importance of a company's overall culture when considering an investment: "Diversity may be a driver of strong performance, it may well be a contributor, but for us E, S and G are all interlinked and what connects them all is culture."

"We spend a lot of time on the road, going to visit the companies, to get a sense of culture beyond the numbers," Lomnitzer continued. "Additionally, considering non-financial performance via ESG means looking at things like safety, fatalities, environmental spills or fines, board diversity, remuneration, emission policies, water usage, and much more. With the culture of an organisation, you can get that much more effectively by going and talking to people in the field like line managers or shift bosses, who are not in the executive suite."

Lomnitzer went on: "One of the frustrations of running a fund focused on the extractive sector is often getting a blanket 'no' from a lot of people to the whole sector, which is to the detriment of vast swathes of the global population that need to see economic development. If you just say, 'No, we're not going to invest in Congolese copper assets,' that's not such a good thing for a vast population there."

There was some debate about investor 'exclusion lists' – which oblige managers to ignore or divest from certain types of companies – and the best ways to engage with companies seen as having poor environmental or social standards in order to achieve better outcomes.

Joseph Porterfield of Monterone Partners was one who challenged the utility of exclusion

We have begun voting against the chair of the nomination committee when a board has no female representation

Blythe Clark

How can one influence a company's position unless one engages and is in dialogue?

Joseph Porterfield

> It's important to understand we are under pressure to divest from fossil fuel
>
> **Michel Léveillée**

Emissions testing

lists: "You can't engage if you've not invested with the company, or not had an audience with the management. How can one influence a company's position unless one engages and is in dialogue with them?"

Porterfield went on: "That includes existing things that different industries are doing poorly – where there are companies that desire to do them in a better fashion but can't find capital because they're in a sector that investors are increasingly excluding.

"An example are oil service platform companies. Though this is an industry in which Monterone Partners would not invest, there are some today that operate with far fewer toxic materials and in a much better fashion than others. And yet, as they are a part of the fossil fuel sector, because of the divestment, they are going to see less and less capital. I think we're missing a big trick here."

Unintended consequences

Avigad of Lansdowne warned in this context again about the dangers of unintended consequences – due for instance to 'second order' effects – such as the rising demand for lithium to produce electric cars, which may itself then cause both environmental and social problems in countries like the Congo where it is produced.

Going back to the example of Volkswagen and its enormous investment in electric vehicles, Avigad said: "One of the problems here, in the long run, is that the way in which carbon emission requirements for auto companies are being set is forcing capital to flow in a way it wouldn't otherwise – into a specific technology, which, when we measure that in the future, will be completely different to how we measure it today. That investment of $60 billion may very possibly be capital misallocated when we see the full cycle effects."

On the other hand, Lomnitzer argued there was not necessarily any alternative to the sort of regulatory actions now being taken to drive investor behaviour: "I think the genie's out of the bottle, to some extent," he said.

"There's been a decision taken that the carbon price needs to go up, and certainly in Europe carbon prices have gone up dramatically in the last 18 months. Suddenly everyone's talking about decarbonisation. It's a very blunt instrument that could have unanticipated longer-term consequences, but I fail to see how behaviour will be changed otherwise."

Grosskopf at AGF was also keen to emphasise that capital was still very much needed to drive the newer, less polluting and more decarbonising technologies for the future: "Some greener industries are still very starved of long-term capital, let's not forget that," he emphasised.

Grosskopf added: "In terms of directionality, capital does need to move from traditional industries into newer industries. It's not so much about complete divestment, but we do need a refocus of investment in areas that are part of a longer-term solution."

> You can't solve climate change without also addressing social issues like inequality
>
> **Marisa Hall**

---

[1] McKinsey & Company; https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity

[2] Claudia Goldin and Cecilia Rouse, "Orchestrating Impartiality: The Impact of 'Blind' Auditions on Female Musicians," *American Economic Review*, 90 (4): 715-741 (September 2000).

Chapter 3

AMONG ASSET MANAGERS, WHO IS DOING WHAT?

SUMMARY POINTS

- Challenges and opportunities for asset managers across the spectrum – from smaller players and hedge funds to the energy sector and emerging markets
- Activism and engagement
- Impact investing and ESG

The roundtable brought together all sorts of asset managers active across many strategy areas, with varying approaches to how they try to apply or accommodate ESG criteria in the ways they invest.

This gave rise to debate about issues such as whether ESG approaches can be embedded as effectively in alternative strategies such as hedge funds as they can in more traditional long-only or longer-term strategies such as private equity or real assets. Whether there is a positive role for activist investing in ESG. Or whether impact investing provides the most effective and appropriate way forward.

Daniel Avigad talked about the complexity of these issues for investors generally and not just for asset management firms like Lansdowne that run long/short money alongside long-only. But he argued that ESG definitely offered opportunities on the short side as well as on the long side, which should suit many hedge funds – if taking short positions were not blocked as they often are by investor exclusion lists.

"The implication of ESG on the demand side is that the utility of a good produced by a company is disconnected in the future from its past, as consumer preferences change to accommodate sustainability," said Avigad. "So there's obsolescence risk both for previously growing industries and for previously value industries."

On the supply side, there are two effects, he added: "The first is that if one prices in the cost of externalities and sustainability in factors of production, that can completely shift the cost curve of an industry in a way that then has meaningful implications for demand. Maybe the airline industry is a classic example of that in the future versus today."

Avigad went on: "The second would be within the cost curve of an industry – which, after pricing in sustainability, will look very different. From the perspective of an investor, that offers both long opportunities and short opportunities.. [But] we're still in the foothills with respect to how are we going to deal with these things."

> **We retain a seat at the table and seek to increase the pressure on companies to do the right thing**
>
> **Blythe Clark**

> From the perspective of an investor, there are both long and short opportunities
>
> **Daniel Avigad**

Daniel Avigad

Joseph Porterfield of Monterone Partners offered the perspective of a long/short manager which is somewhat smaller – and hence without an existing army of personnel to generate policies and process on ESG. "We're an equity long/short manager focused on West European listed securities, mainly large and mid-cap," he said. "So we're part of the hedge fund industry, which many view as the laggard in adopting or embracing ESG and sustainable investment."

"Perhaps there are some challenges unique or different to being a smaller manager, mostly because of the fact that you have fewer resources," Porterfield went on. "In a small firm, even if there are nominally fewer resources, everyone wears many hats, so there's often less red tape or politics and an ability to respond faster to change."

Monterone, he said, had decided to formalise articulation of how these factors are included in its investment process with him joining in 2019 – and he is helping with the integration of ESG, as well as leading business development and investor relations.

Porterfield explained: "For us, it is relatively straightforward. We are a fundamental value investor and hold a very concentrated portfolio for our clients – 12-13 long positions, which have been heavily researched, sometimes for years, by the team and we intend to hold those positions for a long period of time... It may be somewhat easier for us than others as our portfolio is concentrated and we know our portfolio companies very well."

Tal Lomnitzer of Janus Henderson offered the contrasting perspective of a very big mainstream asset management firm but where he runs funds focusing on the energy and resources sector – often viewed as very challenged on environmental grounds.

"For the resources team at Janus, where the rubber meets the road is an oil and gas company which is veering its spend towards building an integrated gas, power and renewables business – so it can become 'an energy company' as opposed to an oil and gas company," he said. "That's a process that can take a decade to play out. The question then becomes whether it is palatable in the world we seem to be moving into – where the investors say, 'Well, it produces oil and gas. I don't really care that it's transitioning, because that's bad.' In our view that would be counterproductive."

Lomnitzer went on: "I don't claim to have all the answers. But gas is a useful transition fuel, and if the entire world switched from coal to gas tomorrow, we'd be a long way towards achieving the 2° [temperature rise] limit scenario. We wouldn't be fossil free and wouldn't be decarbonised, but it would be a lower carbon future."

Vivienne Taberer of Investec Asset Management offered the perspective of another big mainstream firm, but one where she focuses on the rather different area of emerging market fixed income.

"ESG is becoming a bigger and bigger part of our process," she said. "We'll sit down with the finance minister and we'll discuss what's happening on the fiscal budget for the year, what's happening to GDP. At the next stage down, in terms of understanding sustainability of future returns, we are then looking at fiscal transparency, and how much of the budget is being spent on education. Is that education spend being well spent or not really getting much bang for the buck? And gradually building in these longer-term Sustainable Development Goals into our thinking."

Taberer added: "Gradually, sitting down with other investors who are doing the same thing, we have more impact on those policies going through government."

Taberer made a strong case for activism

> The last ten years has been about the effect of ESG on your portfolio. The next ten is about the impact of your portfolio on the world
>
> **Brad Crombie**

WEC Energy

Some companies have shown great improvements on integration of climate change into their strategy and risk management

and engagement to encourage improvement and progress where needed: "I think we need to engage," she said. "To not engage with governments – to not look for better policy to come out of it, to not invest and push investments in the right area – is counter-productive. By not engaging or investing we take away the opportunity for those countries to develop and improve."

In emerging market fixed income, Taberer felt the evidence was that sovereigns do indeed perform better for investors where they score better on ESG. "I think the results are there," she said. "Generally, if you look at rankings through Sustainalytics, for example, the higher your country ESG score, the higher your GDP per capita. So, the returns will come through over time. But measuring them over a short-term time horizon is much more challenging."

Blythe Clark at Connor Clark & Lunn was another who felt disengagement was not the best way forward: "I agree [with Vivienne] it can be counterproductive to divest in a blanket manner. Our focus at CC&L Financial Group and our affiliate investment managers has been not to simply divest. We retain that seat at the table and then seek to increase the pressure on companies to do the right thing."

Michel Léveillée of CDPQ was another who argued against disengagement: "Divestment is something that we prefer not to do – except for the obvious areas, such as coal. We prefer to engage with companies and we would like to do more in that regard. We want to push companies to be more transparent. We also want to see them fully integrate climate change [considerations] into their organisation and their strategies. In this perspective, the TCFD helps with sound and practical recommendations."

Léveillée also cited the example of WEC Energy: "Through the CA 100+, we had discussions with WEC Energy and met with the CEO. WEC Energy released their first climate change report in 2019 in which they set their own carbon intensity reduction target of 80% on power generation. They also showed great improvement on the integration of climate change into their strategy and risk management."

Marisa Hall talked about how Willis Towers Watson assesses managers based on their approaches to ESG. "When our Manager Research Team researches investment managers, they will ask: How exactly are you building in these ESG factors into your investment process? Because as John Sterman, the MIT Professor, said: 'There are no such things as side effects, they're just effects.'"

Hall went on: "In the asset owner space, we have a wide range of clients, so progress on sustainability is more variable. Five years ago, people would say: 'This is purely about ethical investing.' That has shifted significantly – to where asset owners are starting to challenge managers, not least because they need to report on this. As investors become more sophisticated, they will start demanding more from managers and develop better frameworks themselves – we are already seeing that."

"Correspondingly, on the asset manager side,

We prefer to engage with companies. We want to push them to be more transparent

Michel Léveillée

> ESG may be easier with a concentrated portfolio – we know our portfolio companies very well
>
> **Joseph Porterfield**

The Alquity Transforming Lives Foundation supports social enterprise in India

we see many managers with one or two 'green' products, but this integration of sustainability with investment process only plays a role in a fraction of total assets," she added. "The asset managers in response will say, 'Well, we change for client demand.' For me, it's really about intentionality and authenticity – because if you really believe in long-term value creation, sustainability should be embedded across everything and not just one or two strategies."

Brad Crombie of Alquity argued that an impact investing approach was most effective in ESG: "You have to know what the goals are," he argued. "Our perfect client is an institution or someone that has high ESG values and high ESG sophistication. As Marisa said, intentionality is absolutely critical and that is what leads us to the impact component, and why we think impact is an integrated part of what ESG managers should be doing."

Crombie offered the example of the Alquity Transforming Lives Foundation through which the firm donates 10% of its revenue and supports a social enterprise in India that intends to grow its workforce from 250 lower caste women, who are collecting flowers out of Indian temples and recycling them into other products. "They can go from 250 employees today to, they think, 5,000 employees in about three years' time," he claimed. "When you consider it, the multiplier effect of that kind of impact is pretty tremendous."

"Impact strategies and ESG strategies are both seen as worthwhile areas, and there's lots of assets going into them. But [for now] they are generally seen as being distinct areas – in different silos," Crombie continued. "A large reason is that impact investing is seen as very illiquid – better in a private equity vehicle or some form of long-term investing."

"In our view the last ten years of ESG has been about understanding the effect that ESG factors have on your portfolio as the manager. We think the next ten years is about understanding the impact that your portfolio has on the world. So we think ESG and impact will become more and more close."

Martin Grosskopf of AGF also offered some comments on impact investing in the context of ESG more broadly. "There's always been a tension between ESG generally and impact," he argued. "When ESG began to be adopted by the industry, it was about risk-return. And we still have many large asset owners who say, 'We're not here to change the world. This is about ensuring that we're meeting our liabilities.' That tension is becoming very evident now in organisations like the PRI, where there's clearly an impact component being introduced – and not everybody's comfortable with that."

But Grosskopf said he sees this as part of a wider trend: "There has always been directionality associated with ESG – not just about reducing risk, but about achieving some positive outcome related to each of the factors. How far people go along that route is going to be very, very different."

AGF sees itself as very much a leader of the trend: "One thing we can do at the fund level is to measure our environmental footprint, so we have published that data," he pointed out. "We are the only Canadian fund that actually publishes that data – on what it takes to generate a dollar of revenue in the fund in carbon emissions, sulphur, nitrous oxides, land use and water."

Though there were of course limits to what you can measure with data currently available, Grosskopf cautioned: "We know that companies we own are solutions, in terms of sustainability. But to measure that to the extent we'd like to? It's very early days to do that."

> For me, it's about intentionality and authenticity – sustainability should be embedded across everything you do
>
> **Marisa Hall**

Chapter 4

THE DATA CHALLENGES – AND HOW TO ADDRESS THEM

SUMMARY POINTS

- The need for standards on data – to measure, monitor and rank on ESG
- MSCI and Sustainalytics, SASB and ISR designations
- Taking decisions with imperfect information

There is clearly an enormous amount going on in markets related to ESG – and an increasing amount of information and data related to it. But judging from the roundtable discussion, there is also some way to go to reach a consensus on exactly what data should be used to measure or monitor, or to establish agreed standards in ESG.

As Michel Léveillée at CDPQ said: "We need standardisation. Today, when we look at carbon data, for instance, companies can disclose based on various factors, which can be inconsistent over time. We are not comparing apples to apples – because there are no clear guidelines on what companies should disclose."

This has obvious ramifications for the problem of greenwashing, as Léveillée indicated: "The issue we have today is that for many companies, ESG has become a PR exercise. Steps need to be taken so that investors can use ESG data as readily as traditional financial data."

Tal Lomnitzer of Janus Henderson very much concurred: "Over the last ten years, there has been more and better disclosure," he said. "But what I'd personally like to see is this sort of information moving from the front half of the annual report to the back half of the annual report – so it becomes a standardised requirement. Rather than it being good to disclose to where it becomes necessary to disclose."

Marisa Hall of Willis Towers Watson also argued strongly for a move towards more integrated reporting: "It's something that not enough organisations do – over multiple time horizons, looking at value created for multiple stakeholders. As an investor, I want to see the whole picture."

Brad Crombie at Alquity echoed those sentiments and highlighted the key issues as follows: "One of the problems we have now is measurement and another is materiality. ESG needs to be more measurable."

But for Patrick Bryden of Scotiabank, where there is uncertainty there is also opportunity: "We are in this chaotic phase, but as an analyst that's a very exciting time. To paraphrase the adage of one of our expert panellists on data

> **I'd like to see this information moving to the back half of the annual report – so it becomes a standard requirement**
>
> **Tal Lomnitzer**

> As an analyst, I would always vote for more disclosure – because the more you know, the more you know
>
> **Patrick Bryden**

Patrick Bryden

at our inaugural Scotiabank ESG Conference in Toronto last spring, it's a 'golden age where there's this glass half full' and really what that means is that we have all this information that has become more readily automated and searchable and sortable – and yet needs to be conforming to standards."

In framing the Scotiabank approach to research in this area, Bryden said he felt it was important not to just adopt other people's rankings on ESG, good as they might be – such as those now provided by MSCI or Sustainalytics: "We felt we needed to get right down into the nuts and bolts of the data ourselves. There are many primary data source providers, from Bloomberg to FactSet to Refinitiv, and we didn't want to rely on somebody else's rating but just look at raw data."

Bryden agreed there is a need for standards, but argued some progress was being made: "There are standards that seem to be taking root – from SASB, for example, the Sustainability Accounting Standards Board. My sense is that an end result could be the absorption of SASB into FASB, the Financial Accounting Standards Board in the US, and this would lead ultimately to integrated [ESG] reporting into financial statements. Today, we don't have that yet – we only have voluntary disclosures, particularly on the E and the S."

One critical aspect, Bryden argued, was to focus first on what matters most in each industry or sector: "We have to focus on the concept of materiality. On this front SASB again, I think, has made a great contribution by creating what's called the SASB Materiality Map®. It has about 77 specific industries, where they try to drill down to what matters for any given business."

"In oil and gas, emissions are obviously important," he explained. "But if I'm looking at a shoe apparel business, for instance, it's more about the supply chains and the ethics of where the materials are sourced and manufactured, and so on. That concept – of trying to figure out what matters – is critical."

Bryden added: "As an analyst, I would always vote for more disclosure – because the more you know, the more you know. I would like the opportunity to figure out what matters and what doesn't, as opposed to somebody telling me. So I would always vote for being able to sort through that information myself."

"With disclosure, if it could have universality that would be great, because then we could compare a Canadian business to an American business, and a Japanese business to a European business." However, for now there are still important differences over international standards on ESG, he conceded.

"Europe has led the way with the notion of a 'taxonomy'," said Bryden. "That's really setting the standard on what counts, but there is some heartburn about that too because the complexion of every marketplace is different. In Canada, for instance, we have a much more extractive resource intensive economy. Europe doesn't – and a lot of the [European] terms are pretty exclusionary to our businesses. We're suffering because of it."

In some market areas, such as frontier markets, the raw data itself is also still pretty limited – as highlighted by Vivienne Taberer of Investec: "For us, there's first a problem of standardisation of data across different countries – and some countries are much better at providing detailed, timeous data than others."

"Then there's timeliness of data," she added. "A lot of data we have access to can be almost two years out of date. In some of the smaller

> Corporations have not resolved how to produce data, nor have investment managers figured out how to report the impact
>
> **Joseph Porterfield**

Brad Crombie

frontier markets, some of the data you look at is from as far back as 2012."

Taberer continued: "It's very difficult to then use this data, so then it becomes much more of a judgment call on where we believe current policy and execution is – and this needs to be accounted for in your process and how you make investment decisions. Then how do you analyse how successful your decision was? And what time horizon do you look at it over?"

Joseph Porterfield of Monterone also commented on the complexity of the challenge: "Emissions is only one part of the E, and the E is only one part of ESG," he pointed out. "Corporations have still not entirely resolved how to produce consistent emissions data, nor have investment managers figured out how to incorporate that data into investment decisions, and then report to investors on the impact that data had on a portfolio."

And the complexity goes beyond that, Porterfield argued: "For example, whose emissions are they? In the case of a company that produces gases that can lower the emissions of steel production, is it accurate or equitable that the emissions from production of the gas are borne by the company producing the gas, while the savings in emissions are reported by the steel producer?"

Brad Crombie of Alquity, however, argued that the quality of data and rankings was already helpful to some degree – and improving: "I think both MSCI and Sustainalytics are both great forces for good, because they're helping educate all the asset management industry, and helping get people up the curve," he said. "I would liken those two firms to Moody's and S&P in the early 1980s. But I think anyone worth their salt knows that you don't make credit investments just by reading a ratings report. It'll inform you, it's a good place to start."

Crombie added: "We're only at the first stages of harnessing the data and agreeing the standards. In the absence of that, I would encourage asset owners to be seeking managers who have third party accreditation for their processes. I'm not saying third parties are perfect, but at least they're independent."

He went on: "They are probably going to be vastly improved in a couple of years' time. The one we use is the ISR designation in France, started by the French Minister of Finance, which includes a 2.5 day onsite audit. We think it's one of the highest standards out there [so far] and one that people can at least graft onto for now until other standards emerge."

Not everyone, however, felt that better, more definitive data or rankings will emerge any time soon to deliver a 'silver bullet' of standardisation.

Martin Grosskopf of AGF argued: "We're 25 years into the data challenge so this isn't new. Yes, it will improve, but there's maybe a bit too much assumption in the financial community that data will solve the problem."

"There is a lot of data out there and it can't get any better in some cases because we'll never measure every output from every factory worldwide," he argued. "We can get pretty close with assumptions, and then we have to make investment decisions on imperfect data – but that's not unusual for investment managers."

Grosskopf concluded: "Yes, we can use more disclosure, we can use more data. But ultimately, we are going to have to make decisions, in an imperfect world, in a way that ideally is improving outcomes from an ESG perspective."

> **Anyone knows you don't make credit investments just by reading a ratings report. It's a good place to start**
>
> **Brad Crombie**

> **A lot of the data we look at is from a long way back… How do you analyse it?**
>
> **Vivienne Taberer**

ESG and sustainable investing

Challenges and opportunities

WILSON WILLIS