

“Does ESG guarantee a good return?”



Therese Niklasson

Therese is head of global ESG at Investec Asset Management. She works with investment teams, client groups and operations teams on ESG policies, research, corporate governance and engagement.

5 ESG: the next generation of investing

SUMMARY: Environmental, social and political issues have moved to centre stage recently and significant steps are being taken by many to bring ESG integration into mainstream investment practices. However, sceptics remain on the role of ESG factors in generating alpha. Drawing on ESG panel at our most recent Institute Forum in London, this article outlines some practical examples of how ESG is transforming investment philosophies and practices around the industry.

ESG and investments in context

Therese Niklasson, Global Head of ESG at Investec Asset Management

The last three years have seen an explosion of policies and regulations for asset managers, asset owners, governments and stock exchanges. It's critical that we understand and prepare for these new policies and regulations to ensure we abide by them. Beyond simply complying with these stewardship codes, the real challenge is sustainable development for our industry and the companies that we invest in. For example, if we do not begin to reduce carbon emission before 2020, we are going to struggle to keep global warming below two degrees, which may devastate to the planet and its economy.

To respond to this challenge, we put integration at the forefront of what we do. We need to rethink how markets work and shift to a long-term conversation.

We work directly with the different investment teams to help them understand how ESG is relevant to the investment horizon, to the liquidity characteristics of their asset class and the markets that they are investing in. As an emerging market investor, you can imagine the environmental, social and corporate governance challenges we are facing.

We're aiming to deliver some real practical progress for our clients, the pension funds, to show them that we are actually doing the work on the ground.

ESG vs. SDG

SDG stands for Sustainable Development Goals, a term that is being used interchangeably with ESG. However, SDG complements rather than replaces ESG. We aim to contribute to these goals in the way we invest, particularly in Africa, which is a very exciting development.

HSBC: political will and vision are key

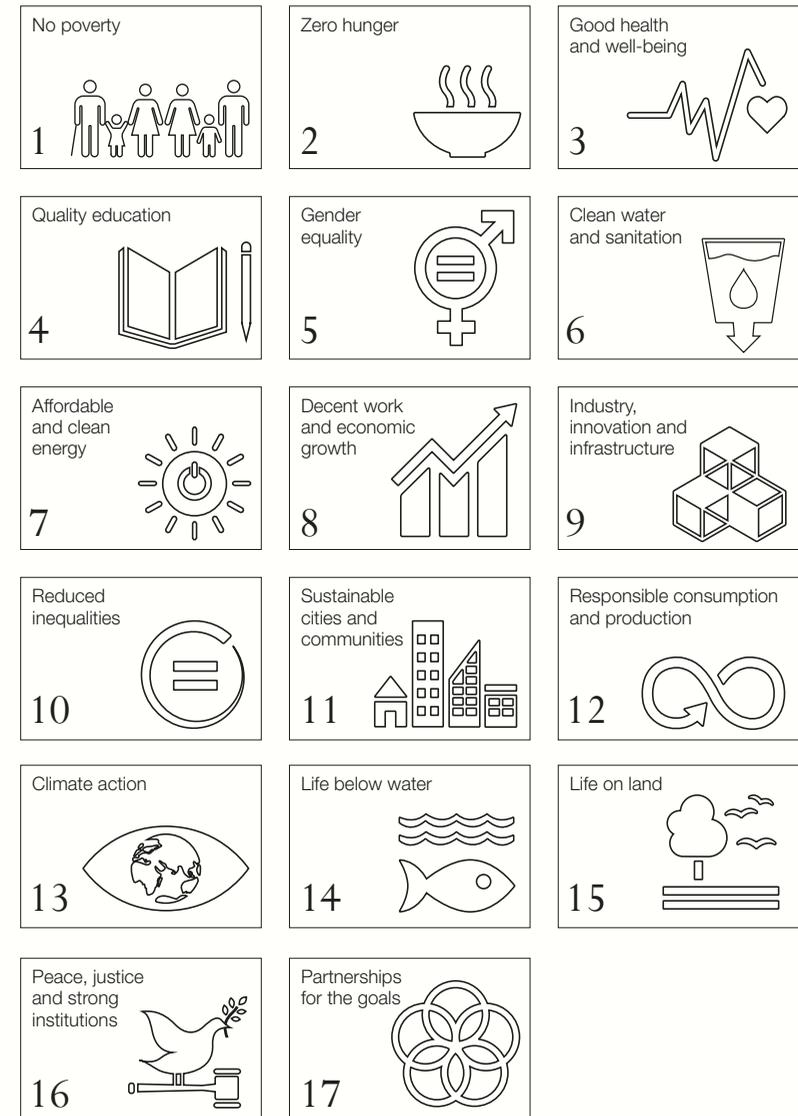
Stuart White, Head of Strategy at HSBC Global Asset Management,
Trustee of HSBC's £33 billion UK pension trust

HSBC is relatively conservative and we needed to transform our mindset within the trustee board. First we set up an ESG steering group to examine our policies about three years ago. We outsource everything to third-party



Sustainable development goals

17 goals to transform our world



Source: UN Sustainable Development Goals, undp.org.



managers. We expect them to manage money in the best interests of our members as well as apply some of our beliefs.

Initially we added a policy about climate change around 18 months ago, based on our support of the United Nations Framework Convention on Climate Change. Then we looked at how we monitor and engage with our managers.

We came up with a set of ESG gradings that reflect the extent to which they incorporate ESG into their processes. We also had a scoring system on climate change policy from market-leading to not doing much of anything. We've been engaging with managers across the board and have encountered a variety of responses, but we are seeing widespread progress.

We also wanted to use asset allocation to reflect ESG. This is complicated by freedom of choice now, so we focused on our lifestyle default. It took a long involved effort to get an ESG view embedded into the default, but we eventually succeeded last year. It took considerable will, vision and flexibility to overcome the sceptics, but we finally got there.

Local government pension partnerships: a complex challenge

Fiona Miller, Chief Operating Officer of the Borders to Coast Pensions Partnership

The partnership brings 12 schemes together managing over £40 billion, representing 2,500 employers and 1.2 million members. Each scheme has its own approach, views and style, making ESG a bit of a challenge. Despite one asset pool, each scheme has its own stewardship policy, and often local politicians are involved. We were about 85% compliant when we began to attempt to take all the schemes up to the 'premium' level and drive through positive change in terms of responsible investing. We focus on engagement, leveraging the lobbying body the Local Government Pension Fund Association, which acts on behalf of the 89 funds.

The pool has a responsible investing policy at a high level, then once approved we take this to the individual funds to ensure their policies align. While we generate efficiencies of scale, we still need to give local members a voice in this process.



While we would like to take a longer-term view when it comes to how we invest, some of the accounting rules make this very difficult. Perhaps this is the next thing to consider when attempting to tackle short-termism.

A practitioner's perspective

Rhynhardt Roodt, Co-Head of 4Factor™ at Investec Asset Management

It has taken a long time to get people on board with these issues at investment team level.

First, we asked why we should integrate ESG into a successful investing process at all. You can imagine that there might be scepticism as we all felt our first job was picking stocks that make money for investors, rather than asking what impact they may have on the environment. But we now do it because it's the right thing to do. But the debate, alpha vs. ESG no doubt will continue to crop up.

Second, we had to decide how to do it without sacrificing returns. This is more complex than it seems, but the simple answer is that you integrate it throughout the process. We did a lot of back-testing on ESG factors and the results weren't that great initially. But ratings began to improve and data sets got richer, which improved the back tests.

It turns out that integrating ESG factors at the fundamental analysis stage is probably the right way to do it. You don't want this to be an afterthought. So we then undertook a long process of understanding what the key issues were for particular sectors, regions or companies.

Finally, we considered company engagement. We had to decide what drove the agenda: ESG or company returns? Do you focus on large companies that are unlikely to listen to us anyway, or smaller companies where you have more meaningful stakes?

We are not in a perfect position yet, but each year we get better and we are well along on this journey.

