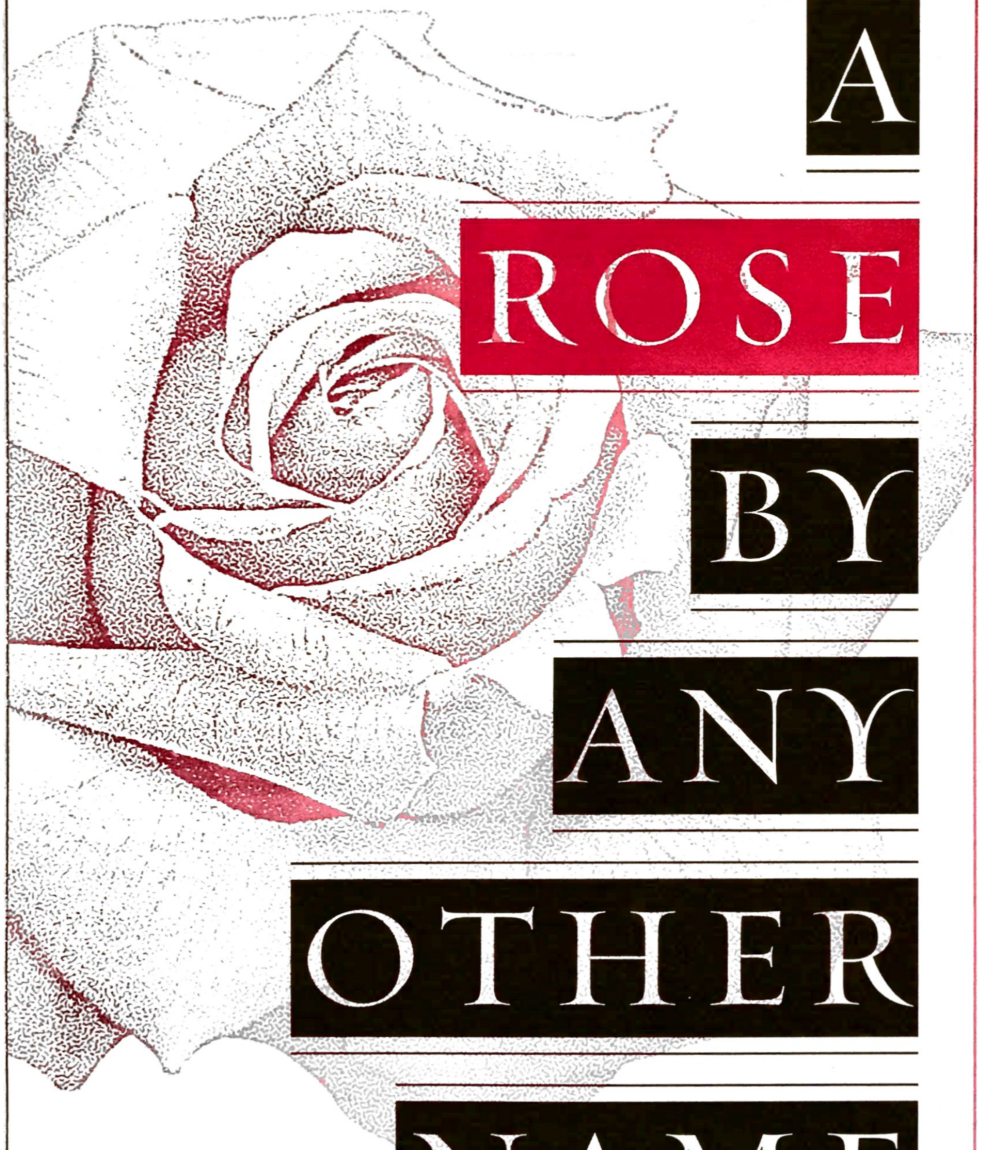
SUSTAINABLE STRATEGIES



A ROSE BY ANY OTHER NAME

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WHAT MATTERS IS NOT WHAT'S IN A NAME BUT THE ESSENCE OF THE THING ITSELF. IN THE ESG SPACE, HOW MANY UN PRI SIGNATORIES ARE ACTUALLY STANDING BY THEIR SUSTAINABLE PRINCIPLES?

Does wearing a flag pin make someone a patriot? Are chicken eggs labeled 'organic' in the grocery store by definition farmed in an environmentally responsible and humane way? On the 10th anniversary of its founding, I ask if signing on to the United Nations Principles for Responsible Investment (PRI) is sufficient to identify a financial services firm as sustainable and its offerings environmental social and governance (ESG)-compliant. It seems like a good first-layer litmus test for gatekeepers seeking ESG strategies to sift out firms that are not serious about the space. But, what does being a signatory really tell you?

The PRI report a community of signatories spanning 1,500 entities and more than $60 trillion in managed assets. The world would be a different place if that much wealth was fully activated for social and sustainable purposes. Asset owners have a variety of motivations for becoming signatories. Rather than attempting to employ the status of signatory as a simple proxy for ESG integration, I suggest using the PRI as a framework for evaluating how deep the commitment actually runs.

The first three principles speak to how ESG informs their investment activities. Of those $60 trillion in assets, how much of it is catalyzed and actually invested sustainably, having a consequential impact on the behavior of companies, issuers and markets?

PRINCIPLE 1:
WE WILL INCORPORATE ESG ISSUES INTO INVESTMENT ANALYSIS AND DECISION-MAKING PROCESSES.

Gatekeepers are always challenged to separate the window dressing from truly integrated aspects of portfolio management. Are ESG issues incorporated in a single strategy or comprehensively across all offerings? Which ESG issues are in fact under consideration? How do these issues influence the outcome of securities analysis and consequently investment decision-making? Is there a materiality threshold? These are questions meant to get at some simple truths – the percentage of total assets where decision making is influenced by ESG considerations, and the extent to which that influence meaningfully changes the trajectory of security selection and ownership. Are ESG considerations a mile wide and an inch deep, or truly used to structurally change investment processes?

PRINCIPLE 2:
WE WILL BE ACTIVE OWNERS AND INCORPORATE ESG ISSUES INTO OUR OWNERSHIP POLICIES AND PRACTICES.

This principle speaks in large part to the impact investment managers can and ought to have by exercising the ownership franchise through activism and engagement. Is there a policy governing the inclusion of ESG factors in voting proxies? What is the relationship of those ESG factors to traditional financial factors when deciding the vote? Does the firm actively engage with company management teams on ESG issues? Is there any proactive involvement in regulatory and legislative initiatives to address areas of ESG concern? How does the firm report on the outcome of their efforts? Is engagement constrained to just ESG strategies or utilized as a tool across the firm's assets? How does the firm address internal conflicts between teams that may stand on opposite sides of a proxy or other ownership issue? This is one of the clearest expressions of an investment firm's intent when it comes to ESG.

Asking securities analysts to gather ESG data is one thing. The proof as to how that data is actually utilized in investment decisions is somewhat subjective. A firm's proxy voting record and engagement footprint, however, are easily observable and measurable.

PRINCIPLE 3:
WE WILL SEEK APPROPRIATE DISCLOSURE ON ESG ISSUES BY THE ENTITIES IN WHICH WE INVEST.

Financial services firms have been at the forefront of driving transparency and disclosure far beyond where financial regulation has taken us. Is the firm an active participant individually or in partnership with other firms in compelling issuers of public securities to be transparent in disclosing performance on a wide range of ESG factors? Does the firm participate in standard setting to clarify and simplify disclosure and concentrate on information that is material and measurable? Will the firm actively engage with companies that fail to meet thresholds for transparency and change investment decisions based on the result of that engagement? With the help of organizations such as the Sustainability Accounting Standards Board, the standards for disclosure are reaching a level of rigor and systemization that makes it not just commercially viable but advantageous for issuers of public securities to be transparent on ESG issues.

The second three principles speak to how they are perpetuated in terms of bringing more signatories into the fold, but even more importantly in terms of how many assets are activated in ESG terms. As an industry, are our own incentives, supply chains and transparency commensurate with what the first three principles demand of the investments we make?

PRINCIPLE 4:
WE WILL PROMOTE ACCEPTANCE AND IMPLEMENTATION OF THE PRINCIPLES WITHIN THE INVESTMENT INDUSTRY.

Essentially, this principle is geared to creating a culture of sustainability in our industry that goes beyond carbon offsets for air travel and blue recycling buckets under our desks. Does an investment manager hold its own vendors, suppliers and partners, from market data providers to IT infrastructure to third-party distributors of their products, to elevated ESG standards? Is the manager constructively engaged with trade groups, regulatory authorities and lobbying efforts to further the principles?

PRINCIPLE 5:
WE WILL WORK TOGETHER TO ENHANCE OUR EFFECTIVENESS IN IMPLEMENTING THE PRINCIPLES.

The market is competitive, but there are benefits to collaborating for mutual advantage. To what degree is the manager involved with organizations and convening bodies that bring a broad range of market participants together to advance ESG business practices and further the adoption of sustainable investment strategies? Is the manager connecting with peer organizations but also other asset owners such as family offices, foundations and endowments to socialize best practices, seek industry standards and otherwise help foster a vibrant market for ESG?

PRINCIPLE 6:
WE WILL EACH REPORT ON OUR ACTIVITIES AND PROGRESS TOWARD IMPLEMENTING THE PRINCIPLES.

To close on a cliché, what is good for the goose is good for the gander. If a manager does indeed adopt the first three principles, they are holding their portfolio investments to account for ESG practices, transparency and disclosure. Does the manager do the same for their own stakeholders and investors?

Are they reporting to clients on their proxy and engagement activity? Do they systematically explain their processes and the ESG outcomes? Are there metrics for disclosing social and environmental impact, such as the carbon intensity of a portfolio?

The PRI is meant to be a simple and clear expression of a commitment to sustainable and responsible investing for the asset owners, investment managers and service providers that make up the global community of signatories. Becoming a signatory is a public embrace of those principles, and therefore it is entirely appropriate to utilize them as a rubric for evaluating the character of a manager and their commitment to ESG.