Values at Work: Sustainable Investing and ESG Reporting

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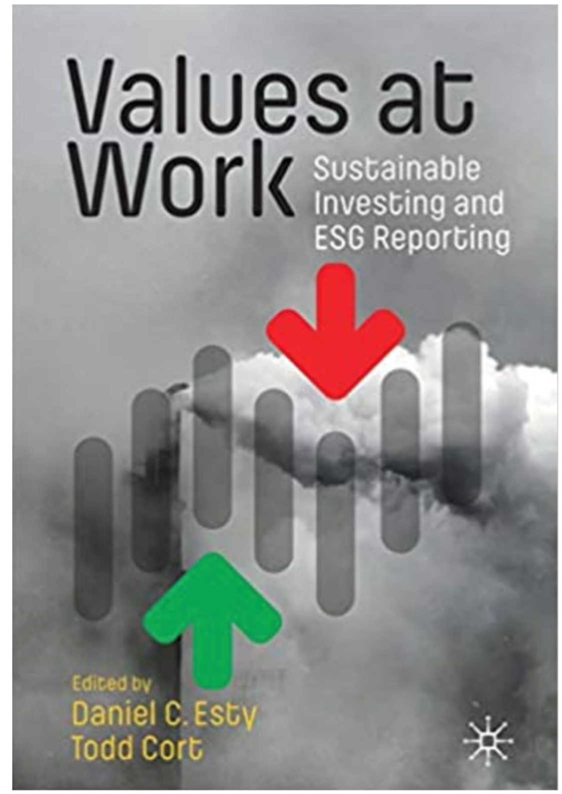


A path Towards ESG 2.0

- ESG is on the rise
- But there are challenges
- ESG needs a new evolution

ESG on the rise: AUM

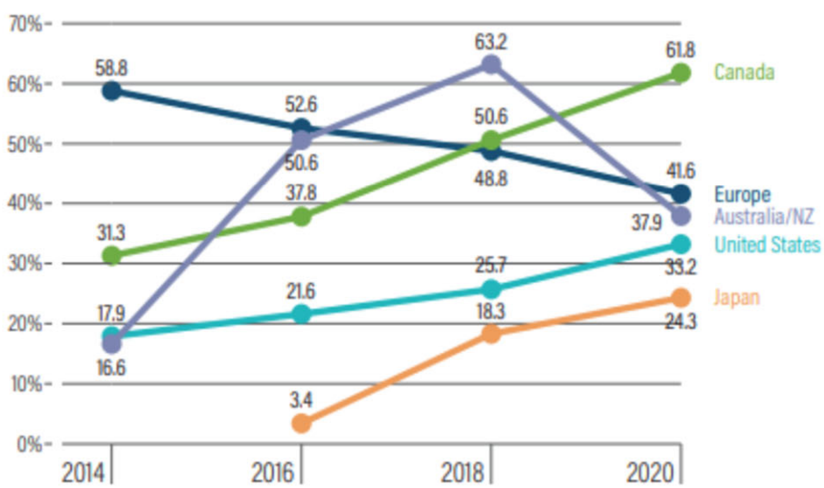
- Global Sustainable Investment Review 2020
- http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf

Figure 2. Snapshot of global sustainable investing assets, 2016-2018-2020 (USD billions)

REGION	2016	2018	2020
Europe*	12,040	14,075	12,017
United States	8,723	11,995	17,081
Canada	1,086	1,699	2,423
Australasia*	516	734	906
Japan	474	2,180	2,874
Total (USD billions)	**22,839**	**30,683**	**35,301**

Source: GSIR 2020

Figure 3. Proportion of sustainable investing assets relative to total



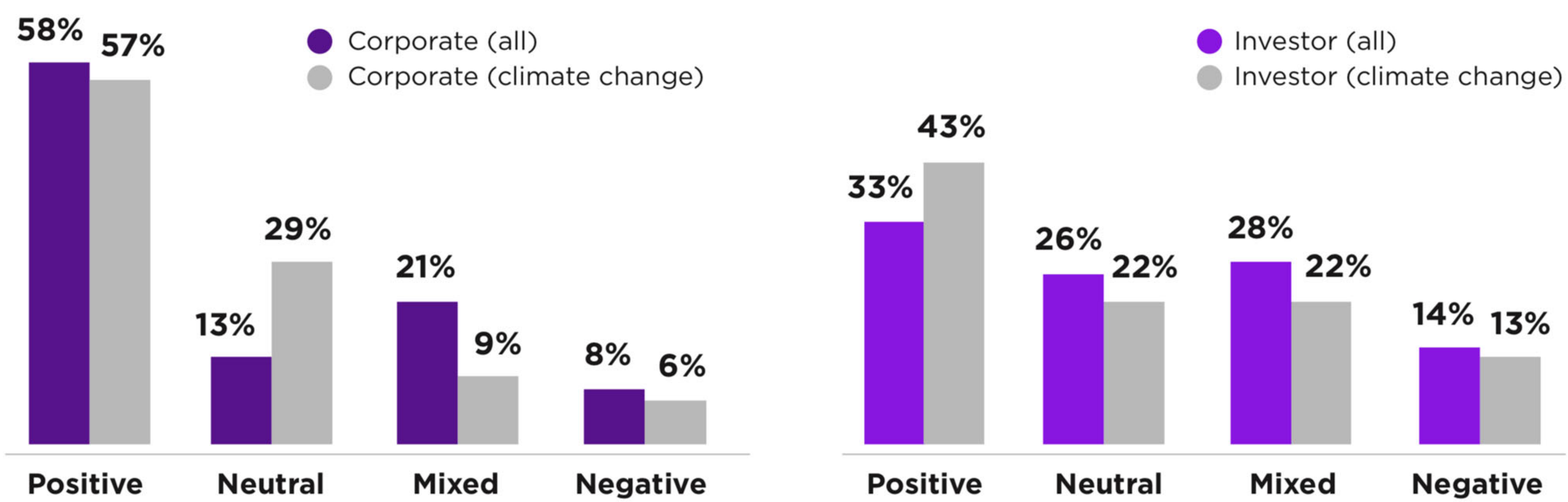
Source: GSIR 2020

ESG on the rise: because of evidence of correlation with returns

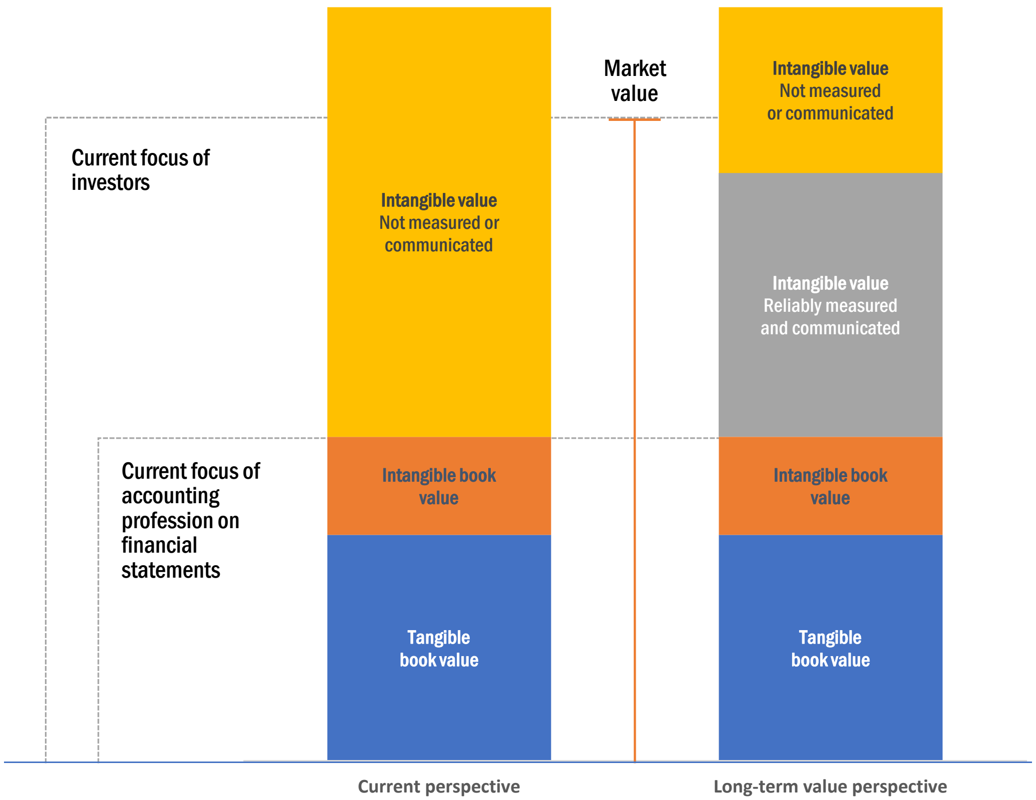
Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 – 2020

By Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark, CFA

Figure 1. Positive and/or neutral results for investing in sustainability dominate. Very few studies found a negative correlation between ESG and financial performance (based on 245 studies published between 2016 and 2020) .



ESG on the Rise: We hypothesize that the return is in large part associated with intangible value



Intangible assets represented **17%** market value in **1975**, having risen (in some sectors) to **87%** by **2015**.

2017 Institute of Chartered Accountants in England and Wales

ESG on the Rise: assumes imperfect price information

Bond

$$P = \frac{\boxed{C}}{\boxed{Y}}$$

Equity

$$P = \frac{\boxed{Earnings}}{\boxed{r} - \boxed{g}}$$

Idiosyncratic Risk

Systematic Risk (Interest Rate)

But there are challenges: data

- Scope and Boundary Issues
  - Operational vs Reputational
  - Forward-looking vs Backward-looking
  - Footprint vs Handprint
  - Opportunity vs Risk
  - Material vs Insignificant
  - Inconsistent boundary and coverage
- Methodological Challenges
  - Measurement Consistency
  - Regulated vs Voluntary
  - Monitored vs Estimated
  - Verification
  - Gap-filling
  - Normalization
  - Timeframes and Updating

Esty and Cort, Journal of Environmental Investing, 8(1), 2017

But there are challenges: bias

As Dr. Noël Amenc, CEO of Scientific Beta, said: "Claims of positive alpha in popular industry publications are not valid because the analysis underlying these claims is flawed. These results question the way in which ESG providers, and the investment industry more generally, promote ESG.

"The results show that the quality factors (high profitability and low investment) make pronounced positive return contributions to most types of ESG strategies," the report added.

Furthermore, the report said ESG strategies have significant sector biases, especially towards technology stocks that have delivered huge returns since the GFC.

"There is no outperformance of the ESG strategies when applying standard risk adjustments," the report stressed. "This finding shows that ESG ratings do not add value over information contained in sector classifications and factor attributes."

ScientificBeta
An SGX and EDHEC Venture

In the research, the authors – Scientific Beta's Giovanni Bruno, Mikheil Esakia and Felix Goltz – studied the performance of 24 ESG strategies between 2008 and 2020 and found the majority did outperform by up to 3% a year.

However, when assessing the drivers of returns, the research found ESG strategies are heavily exposed to companies with high profitability and low investment, i.e. the quality factor.

Elsewhere, the report added that the increasing interest in ESG has inflated returns since the GFC. Interest in ESG ETFs, for example, has skyrocketed in recent years with the segment collecting more inflows than their non-ESG ETF counterparts in Europe last year.

"Investors can easily overestimate long-term ESG returns when considering short time periods with rising attention to ESG."

For example, the US ESG strategy delivered 5% performance during periods when ESG received much attention versus 1.3% performance in periods of low attention.

But there are challenges: fundamentals

Unfortunately, I now realize that I was wrong. If the COVID-19 pandemic has taught us one key lesson, it's that we must listen to the scientific experts and address a systemic crisis with systemic solutions. Reacting instead with denial, loose half-measures, or overly rosy forecasts lulls us into a false sense of security, eventually prolonging and worsening the crisis. And yet Wall Street is doing just that to us today with the far more dangerous threat posed by climate change, craftily greenwashing the economic system and delaying overdue systemic solutions, including those intended to combat rising inequality and the insidious political risks it creates. It's clear to me now that my work at BlackRock only made matters worse by leading the world into a dangerous mirage, an oasis in the middle of the desert that is burning valuable time. We will eventually come to regret this illusion.

A New Evolution: Strategic Standard Development

LANDSCAPE

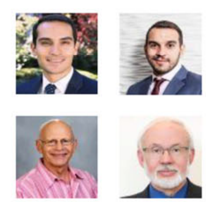
Players across accounting bodies, standard-setters and reporting initiatives, academia, consultancies, and communities are advancing progress in sustainability but no one's addressing the system holistically

STANDARD-SETTERS & REPORTING INITIATIVES

ACCOUNTING & REGULATORY BODIES

RESEARCH, COVERAGE & RATINGS

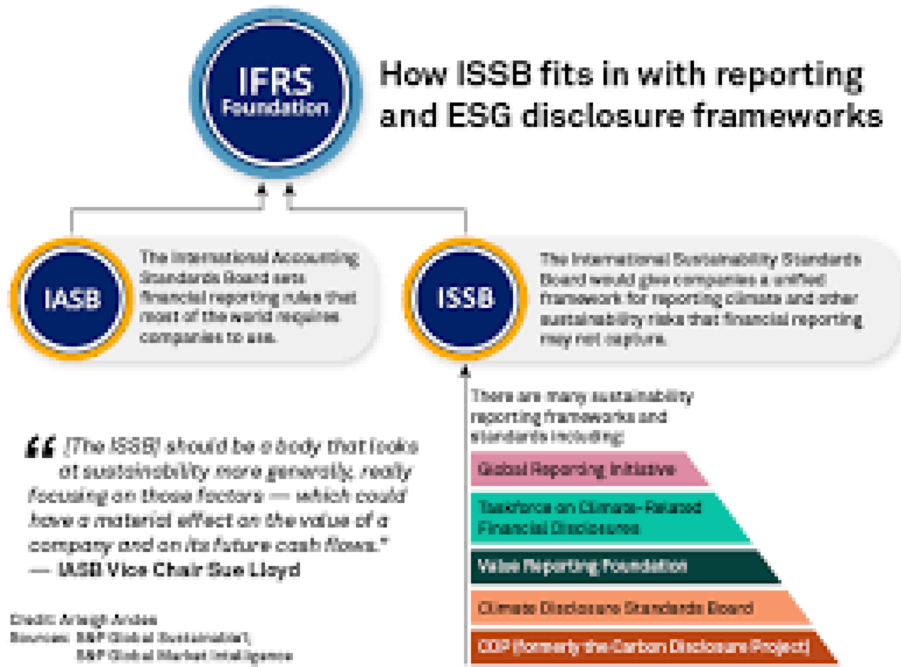
ACADEMIA & THINK TANKS



CONSULTANCIES & IMPLEMENTATION GROUPS

CONSORTIUMS, ASSOCIATIONS, & COMMUNITIES

A New Evolution: Accounting Standards



A New Evolution: Rise of Regulation

A New Evolution: New Metrics