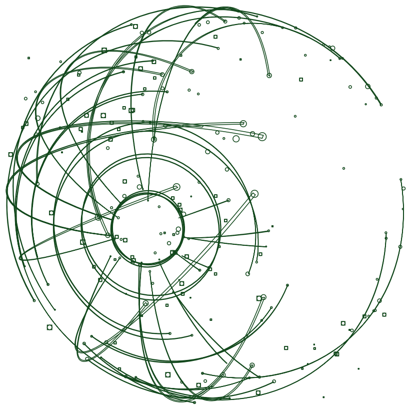
WRAP-UP REPORT

P&I | CONFERENCES
Virtual Series



ESG INVESTING
VIRTUAL SERIES

Environmental, social and governance investments performed as well or better than traditional investments amid the volatility that swept through the financial markets in the first half of 2020. That has underscored that ESG investing is not only good for the planet but also good for returns, said asset owners and asset managers at *Pensions & Investments'* **2021 ESG Investing Virtual Series**. At a number of sessions, both veteran ESG investors and newcomers to ESG investing discussed a range of key issues from the ever-changing alphabet soup of acronyms to best practices in internal ESG policies and how to incorporate external metrics.

ESG has inarguably moved into the mainstream, as companies prioritize sustainability both within their organization and within their portfolio, said panelists. They shared their insights on the challenges and opportunities that ESG investing presents for investors today, in terms of both financial and non-financial risks.

Sessions delved into the details that make ESG such a dynamic area of investment, including the existential threat of climate change on an investment portfolio and the impact that the lack of diversity can have on corporate performance. This virtual series wrap-up report offers highlights from the conference as well as audience poll results that provide insight into institutional allocators' thoughts on key issues.

To access the recorded sessions, go to
www.pionline.com/ESG2021Replay

ALIGNING WITH STAKEHOLDERS

While the concept of stakeholder capitalism is not new, it has evolved significantly in recent years. Panelists said that the needs of stakeholders and those of shareholders often align, particularly on ESG perspectives, and over a longer time horizon. Much of that evolution reflects a greater availability of data, which has proven the case for the materiality of ESG issues for corporations. There's no longer a debate over whether corporate responsibility and sustainability practices improve businesses.

Investors have also evolved in their approach to ESG, moving from simple screening processes to detailed ESG analysis that's integrated within the broader evaluation of a company. That shift has made stakeholder capitalism a far more proactive philosophy held by asset owners that involves direct engagement with the companies or with their investment managers.

Corporate engagement requires multiple conversations over the long term, as investors build up relationships with senior management and boards of directors and they voice concerns both privately and publicly during shareholder meetings and votes. The goal is to make sure that companies are now considering a broader set of interests than simply those of shareholders to ensure they are operating in a way that will create long-term, sustainable value.

Hear the session: Is Stakeholder Capitalism the Answer to ESG Issues? | www.pionline.com/ESG2021Replay

AUDIENCE POLL: How has the last year affected your organization's view of ESG investing?

27% Sparked interest

27% Broadened scope

23% Strengthened conviction

23% Did not affect

CHALLENGES OF CLIMATE DATA

While Panelists said that just as the public understanding of climate change as an existential threat has evolved over the past two decades, investors' understanding of the risks that climate change present to portfolios has deepened. While there's now a widespread understanding that climate risk can materially damage investment returns over the long-term, there's also a recognition of the tremendous opportunity to invest in sustainable solutions.

While the quality of climate-related investment data has substantially increased in recent years, there is much room for improvement. Data is still largely unregulated, leaving asset managers without any recourse if the data is incomplete or wrong. Accessing comprehensive data is also incredibly expensive, making it inaccessible for many smaller scale investors, said panelists. They noted that even the best data has limitations for long-term investors, since the inputs for scenarios can shift so greatly over the course of decades.

A bright spot in climate investing has been the collaboration between institutional investors throughout the industry, working together to hold companies accountable and pressure them to reduce their carbon footprint. There has also been an increase in accountability of asset managers in demonstrating engagement, as asset owners are paying closer attention to proxy votes and other behavior that can indicate whether an asset manager is actually investing for climate change, or simply saying that they are.

Hear the session: Investing for Climate | www.pionline.com/ESG2021Replay

AUDIENCE POLL: How does your organization currently approach climate related issues?

Investment opportunities related to the green transition........24%

We do not currently prioritize climate within our investment portfolio........23%

Engagement with managers/portfolio companies........18%

Divestment........6%

Combination........29%

FOCUS ON THE S IN ESG

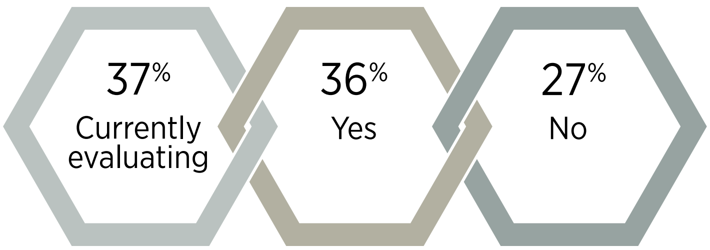
The events of the past year have pushed the 'S' in ESG to the forefront for both asset owners and asset managers, according to this panel. Using social as a factor for investing decisions, however, means different things to different organizations. It changes over time, with some investors focusing more on diversity and inclusion and others looking more closely at equity in healthcare access and career opportunities.

Panelists said that no matter how they define 'S,' it should not be considered in a silo, but rather as a pillar that overlaps with both the 'E' and the 'G.' That's the view not only in the investment community, but also among other corporate stakeholders as well. Compared to a few years ago, consumers and employees now have heightened expectations that the companies where they work, spend, or invest their money will act sustainably and in the best interest of the community.

One challenge that remains for investors is the difficulty of measuring companies' performance on social metrics. Many social metrics are more qualitative than quantitative, but panelists said they see progress as more companies publicly share their diversity data and wage and salary information.

Hear the session: Focusing on the 'S' in ESG | www.pionline.com/ESG2021Replay

AUDIENCE POLL: Does Your firm currently have a DEI policy as it relates to investment managers and their underlying holdings?



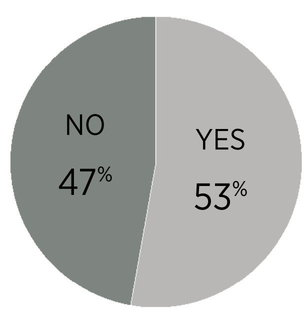
EMPHASIZING THE MATERIALITY OF ESG DATA

With the amount and quality of ESG data available on companies growing every year, panelists said it's become increasingly important for asset managers and owners to understand both the limitations and the potential of the data that they're using to inform their investment strategy. It is critical for investors to understand the materiality of ESG data points and whether, and how, each data point will have an ultimate impact on a company's performance. Different portfolio managers, even within the same investment firm, may take a different approach to defining that materiality, based on their overall investment strategy and the broader trends in the sector in which they invest.

Panelists said that they expect to have even more reliable and standardized data to help with this task as the regulatory scrutiny and industry requirements spur more company disclosures on ESG metrics. Even asset managers who already have an established framework driving their investments suggested that they expect to refine it further as companies continue to make progress on existing measures.

Hear the session: Qualifying as ESG: How to Spot a Wolf in Sheep's Clothing | www.pionline.com/ESG2021Replay

AUDIENCE POLL:
Have you encountered marketing materials in the past year that you believe to be misleading about that firm's ESG practices?



DIFFERENT ASSET OWNER PRIORITIES

Pension plans have embraced ESG integration in recent years as part of their overall investment strategy and risk-adjusted return analysis, and some follow the earlier adoption of ESG-focused investing by foundations and endowments and family offices, noted panelists. However, unlike foundations and family offices, which often prioritize their values or impact considerations along with potential returns, pension plans maintain a duty to focus first and foremost on the financial impact of ESG.

Given the long-term horizon inherent in investing for retirement, ESG is a natural fit for many defined benefit plans, panelists pointed out. As long as the incorporation of ESG factors emphasizes their financial impact on the portfolio, it does not conflict with plan sponsors' fiduciary responsibility, they noted. One pension plan executive said that her organization integrates ESG factors into all of their decision-making as part of a holistic approach to investing. The fund regularly engages with their asset managers to understand how they review investments from an ESG perspective. Another pension fund manager said they take a more passive approach to their public investments but they work closely with their private investment managers to ensure they're aligned on the importance of ESG and sustainability.

While studies show that defined contribution plan participants overwhelmingly want access to ESG investments, most 401(k) plans still do not offer such options to their participants outside of the occasional self-directed brokerage window. The hesitation among DC plan sponsors reflects confusion over how to interpret the Department of Labor guidance on whether ESG factors are, in fact, financial factors that ERISA fiduciaries need to consider when making plan investment decisions.

Hear the session: ESG + Retirement | www.pionline.com/ESG2021Replay

FOCUS ON MANAGING RISKS

From a fiduciary perspective, ESG considerations are an important tool for investment managers to meet their primary focus of reducing the risk of underperformance, said panelists. In addition, ESG integration in an investment approach also helps investors manage myriad other risks, both financial and non-financial, they noted. Well-managed companies with positive ESG metrics tend to have lower levels of reputational risk, lower employee turnover, lower climate risk impacts, and lower levels of potential liability due to environmental lawsuits. Their stocks may exhibit lower volatility, as illustrated by the outperformance of ESG stocks when compared to their peers during the market swings of 2020, panelists said.

One asset manager said that he considered ESG as a means of managing long-tail risk, since poor sustainability practices may not have an immediate, material impact but can serve as a drag on a company's value over time. As more governments commit to climate change initiatives and consumers demand socially conscious and environmental action from the companies where they work or shop, ESG factors become a more crucial consideration for institutional investors, even if the way that asset managers measure ESG performance continues to evolve.

While risk management is a primary goal, according to all the panelists, ESG factors also contribute to their ability to generate alpha. That dual-objective approach is becoming more common as a growing share of investors recognize that they don't need to give up returns to align investments with their personal or organizational values and use their portfolio to create sustainable economic development

Hear the session: Risk Management? Alpha Generation? What Can a Comprehensive ESG Strategy Get Me?
www.pionline.com/ESG2021Replay

AUDIENCE POLL: What has been You Firm's Primary Motivation for Exploring ESG?

- Return Enhancement.......27%
- Pressure from board/stakeholders.......27%
- Risk Management.......18%
- Finding opportunities in economic trends related to ESG.......18%
- Ethical/moral considerations of firm's mission.......9%

MARKET STRATEGIES

The availability of abundant ESG data on public companies has led to the perception that these companies may be better ESG investments than private enterprises, said this panel. However, while many public companies that score high on ESG factors do offer attractive risk-adjusted returns, there are many benefits to taking an ESG lens to private investments, they noted.

One panelist said that while many public fund managers may say that they emphasize ESG investing and take ESG data into account when making investment decisions, it is not always an integral part of their process. So, it's important for asset owners to really engage with public investment managers to get a true understanding of their investment process. In addition, while the industry has made significant progress in terms of the availability and standardization of data, panelists said there are still shortcomings in terms of coverage.

While collecting ESG data on private companies may require more legwork by managers, it can bring other benefits. Investors often have higher levels of engagement with private company executives, for example, and can influence ESG progress in ways that they might not be able to with a public company. One public pension fund executive said they have an entire team dedicated to company engagement on improving corporate performance on ESG measures.

Hear the session: ESG in Private & Public Markets – What Vehicles Get You Where You Need to Go
www.pionline.com/ESG2021Replay

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ACKNOWLEDGEMENTS

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