

ESG Investing

TRENDS AND APPROACHES

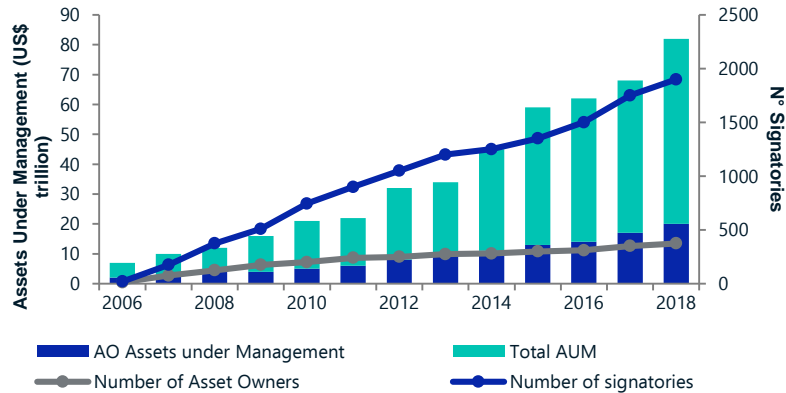
Jackie Daitchman, MSCI

Presented at Ryerson University Institute for the Study of CSR
Session on **Sustainability.Exchange -- Creating a Market for ESG Performance**, Ryerson University, Toronto

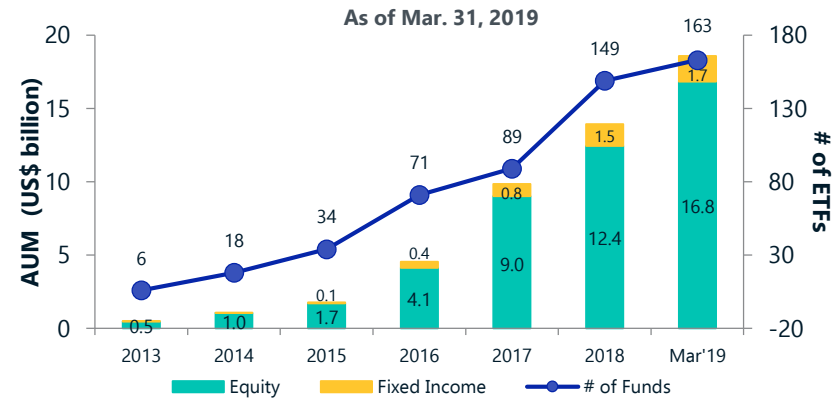
November 1, 2019

ESG investing is growing dramatically...why now?

UN PRI* Has Grown to Over 1,900 Signatories with \$81.7 Trillion In AUM



99% CAGR in ETF AUM Tracking MSCI ESG Indexes since 2013



HERE'S WHY:

1. Investors have become less tolerant of corporate ESG incidents

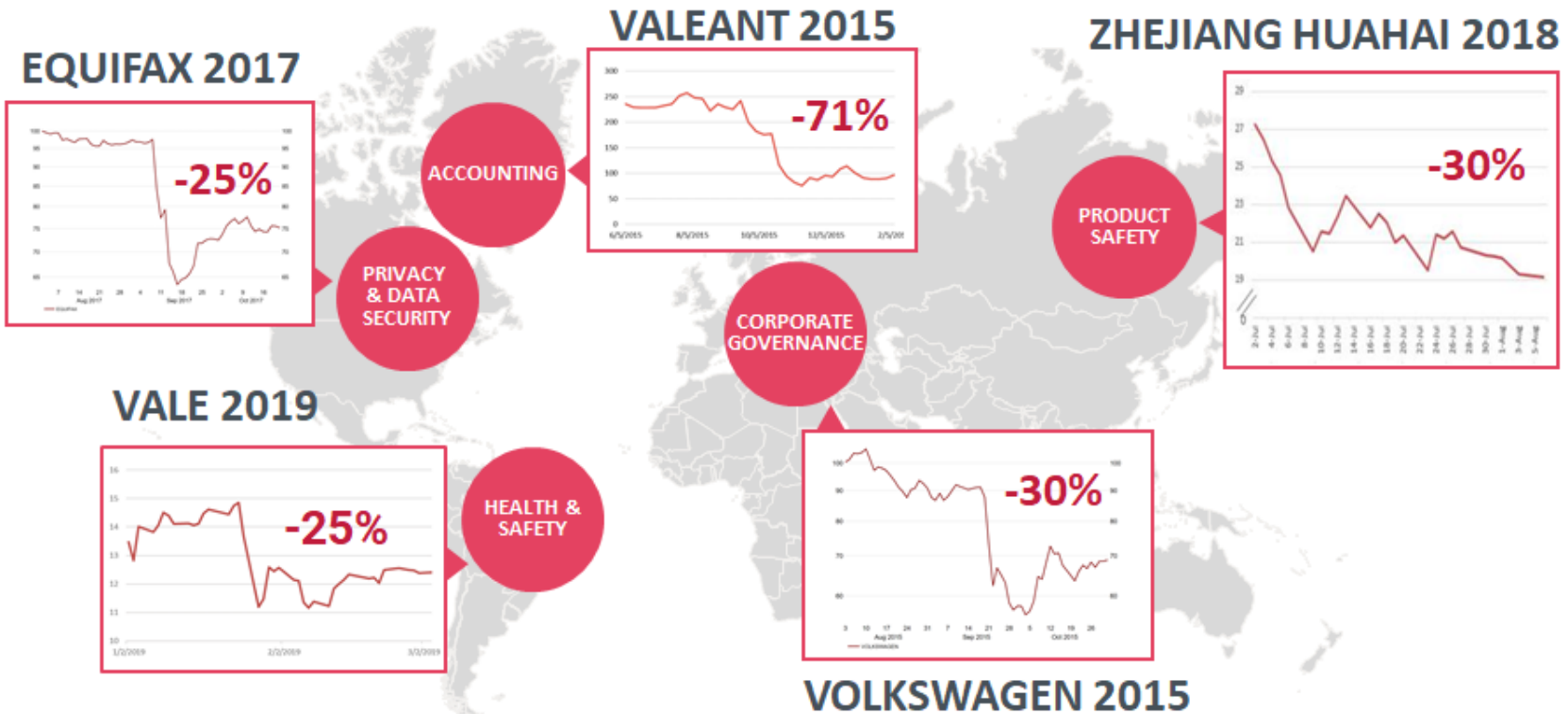
2. Investors demonstrating willingness to act

3. Greater understanding of potential financial benefit

4. Improved ESG ratings

1. Investors have become less tolerant of Corporate ESG incidents

30 years ago, Exxon's stock price barely moved when Exxon Valdez spilled 11mm gallons of oil on the Alaskan shore.* Today, with social media allowing for immediate, global communication of issues, investors are making companies accountable for their actions.

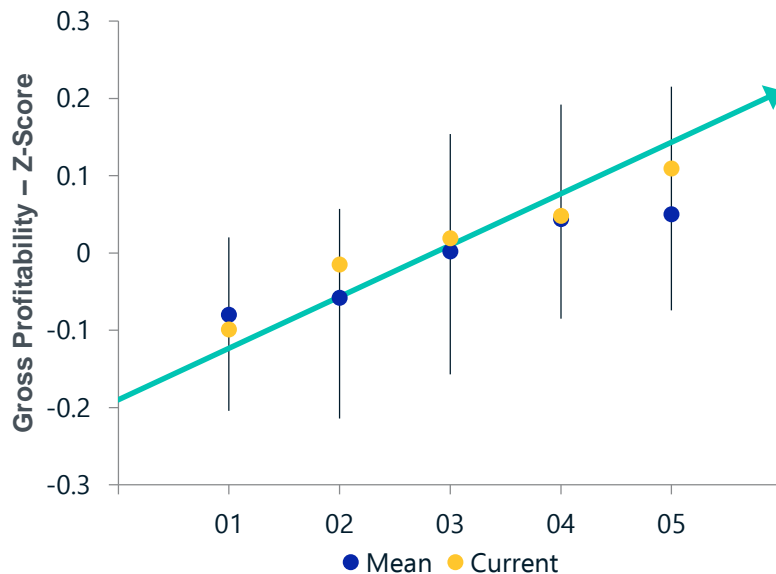


*Source: <https://www.fool.com/investing/general/2014/03/24/25-years-on-from-exxon-valdez-what-weve-learned-wh.aspx>
Examples only. Past performance is not indicative of future results, which may differ materially.

2. Greater understanding of potential financial benefit of ESG strategies, and longer track records

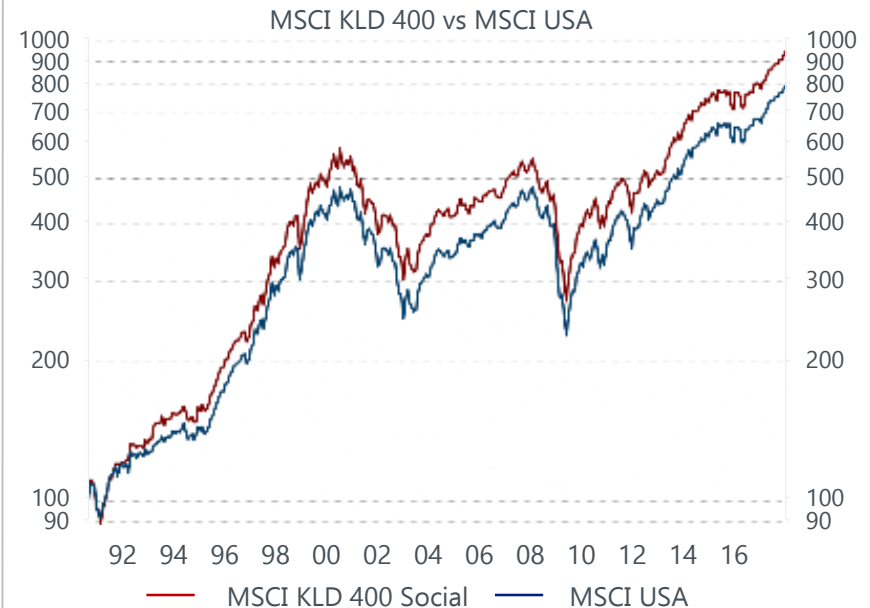
A MSCI ESG Research study¹ found that companies with high ESG Ratings had higher profitability, lower tail risk and lower systematic risk on average based on 10 years of data

Companies with higher MSCI ESG scores had **higher profitability** and were more competitive



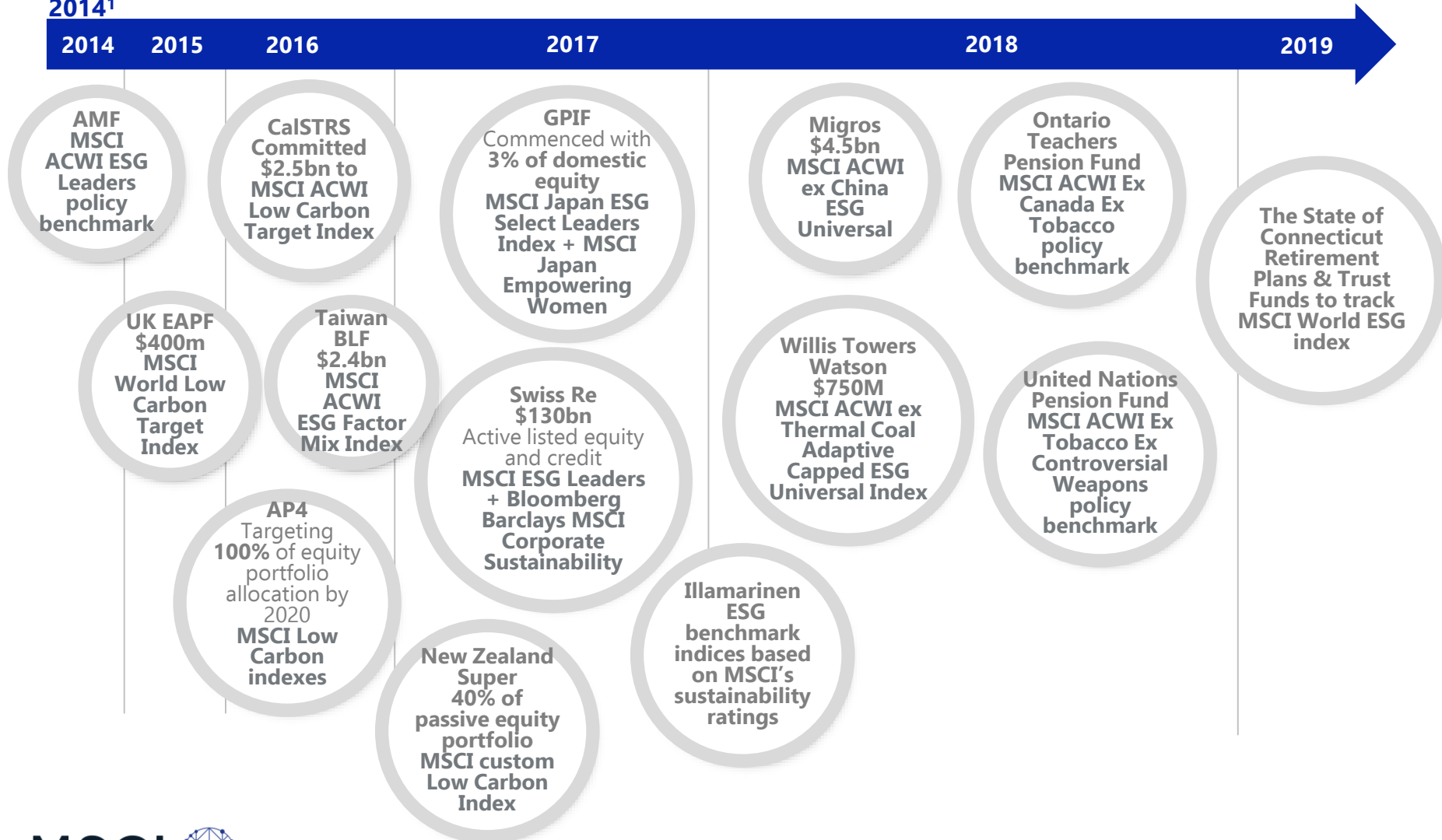
MSCI has a broad range of ESG Indexes with significant live history. More than 120 have five or more years of live history, with MSCI KLD 400 having the longest track record (28+ years).

MSCI KLD 400: **28+ years** of live history



3. Investors demonstrating willingness to act

More than \$250bn allocated to investments tracking / benchmarked to MSCI ESG equity & fixed income indexes since 2014¹



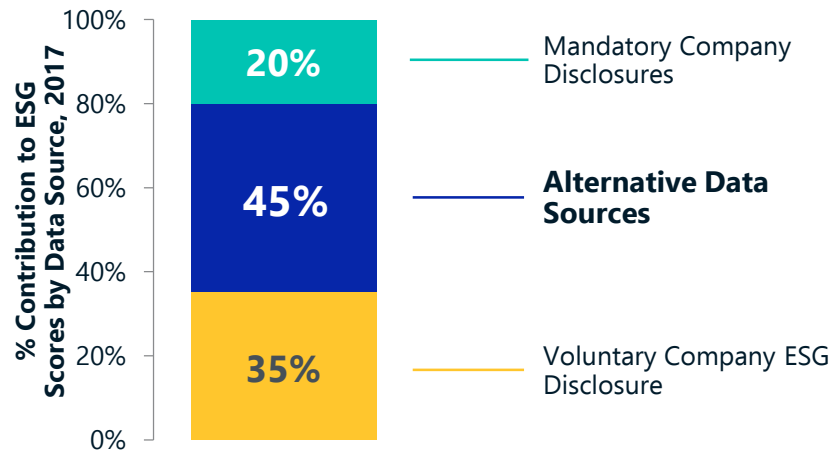
4. Improved ESG ratings now make it possible to measure what was once unmeasurable

Over the last eight years, MSCI has made significant investments in our ESG Ratings.



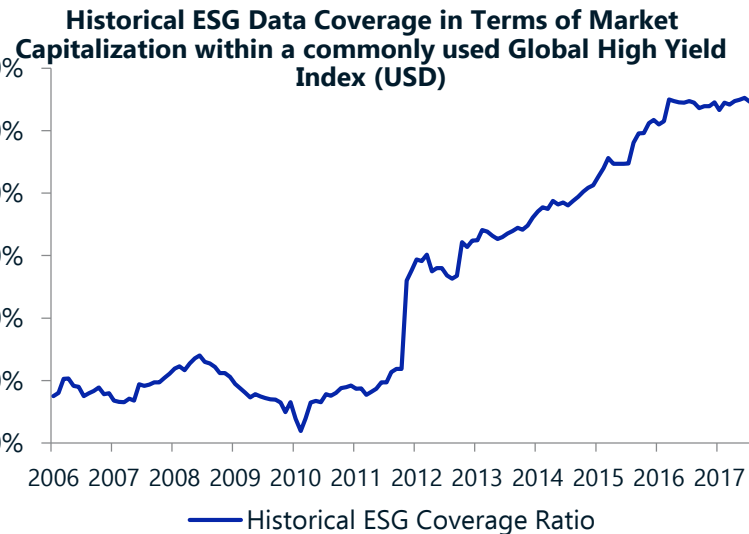
Our approach focuses on (1) identifying most relevant risks by sector; (2) recording forward-looking management data; and (3) incorporating unique alternative data sources beyond company disclosed (or reported) data

More alternative data beyond company self-reported data (~45% in our model)



2,434 constituents of the MSCI ACWI Index as of November 30, 2017
Source: MSCI ESG Research

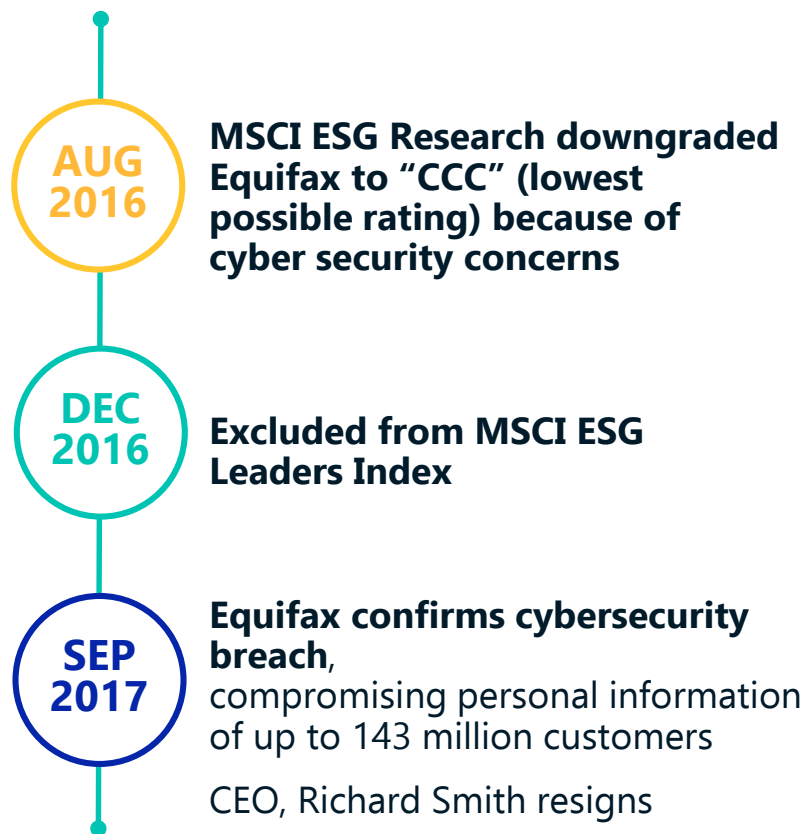
More asset classes and securities covered



Source: JP Morgan. Blog: Systematic investing in ESG themes within the USD high yield corporate bond market. August 23, 2018 [Link](#)

5. The Equifax example illustrates how a proper ESG approach helped identify a material risk

ESG Ratings for Equifax highlighted key data breach risks more than one year before the breach.



HERE IS WHAT LED TO EQUIFAX'S DOWNGRADE IN AUGUST 2016:

- 1 High weight on Data Privacy and Security key issue. The methodology-driven issue selection triggers **deeper analysis on what matters**
- 2 Systematic review of **forward-looking** information (strategy, policies and targets) across sector. EFX was weakest by far
- 3 Special focus on performance analysis. EFX was already subject to major hack and did not adapt. **Use of alternative data sources** (in this case, databases of hacks) allows for more effective assessment compared to company reported data

From why to how

ESG leaders have demonstrated increased sophistication across their organizations

ASSET OWNERS

PENSION FUNDS <ul style="list-style-type: none"> ESG Mandates Manager Selection & Monitoring Policy/benchmark Engagement 	CONSULTANTS <ul style="list-style-type: none"> RFP Fund selection OCIO solutions
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INSURANCE <ul style="list-style-type: none"> Manager Selection Policy benchmark Low carbon Tobacco 	ENDOWMENTS & FOUNDATIONS <ul style="list-style-type: none"> Fund Selection Fossil divestment Impact investing
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WEALTH MANAGEMENT

CIO OFFICE <ul style="list-style-type: none"> Model portfolios ESG themes Fund Profile Philanthropy 	FUND SELECTION <ul style="list-style-type: none"> Due Diligence Fund Selection / Peer Analysis Screening
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FINANCIAL ADVISORS <ul style="list-style-type: none"> Portfolio Analysis & Reporting Stock and Fund Research 	RETAIL <ul style="list-style-type: none"> Robo Stock and Fund Research
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ASSET MANAGEMENT

FUNDAMENTAL EQUITY <ul style="list-style-type: none"> ESG Integration Engagement Low carbon Compliance 	FUNDAMENTAL FIXED INCOME <ul style="list-style-type: none"> Corp. Credit EMD credit Green bonds 	QUANT <ul style="list-style-type: none"> ESG Integration ESG solutions ESG + Factors Low carbon
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ESG SPECIALIST <ul style="list-style-type: none"> ESG Themes Engagement 	STEWARDSHIP & GOVERNANCE <ul style="list-style-type: none"> Active Ownership Engagement ESG Themes
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RISK MANAGEMENT

RISK MANAGEMENT <ul style="list-style-type: none"> Risk monitoring Risk Reporting TCFD stress test 	COMPLIANCE <ul style="list-style-type: none"> Mandates Global Sanctions
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OTHER / PRODUCT

EMERGING <ul style="list-style-type: none"> Custodian Hedge Fund Capital Markets 	ACTIVE FUND <ul style="list-style-type: none"> Core EQ / FI ESG + Factor Thematic 	PASSIVE FUND & ETP <ul style="list-style-type: none"> Core EQ / FI ESG + Factor Thematic
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Asset Managers are moving beyond fundamental equity and **integrating ESG into fixed income and quantitative** strategies with growing sophistication

Largest consultants are incorporating ESG dimensions into manager selection in reaction to Asset Owner requests

Engagement is becoming an important tool for improving company performance and returns

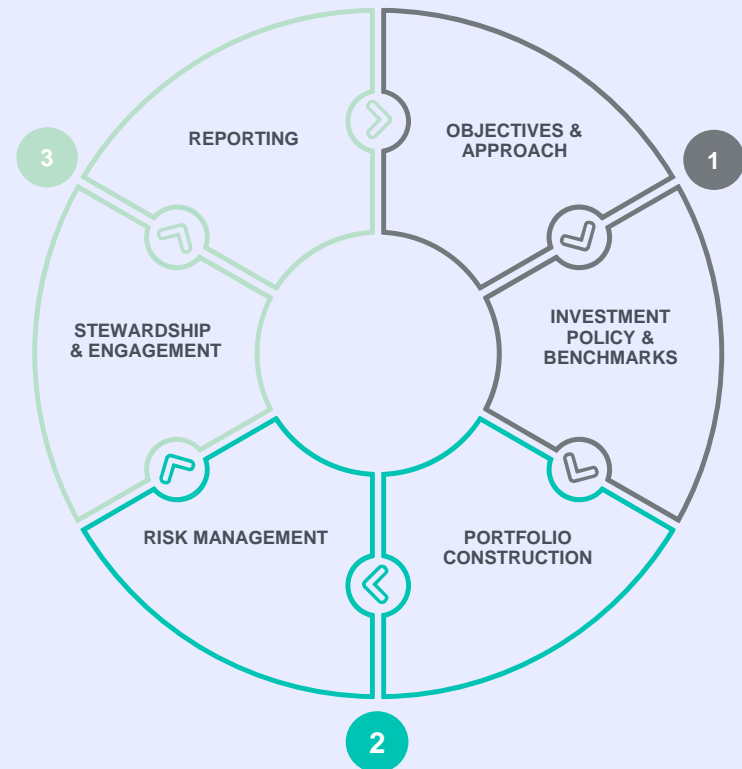
Risk teams are increasingly **systematically reporting** on ESG risk

Demand for active and passive **ESG Funds across asset classes** for total portfolio exposures

Integrating ESG across your entire investment process

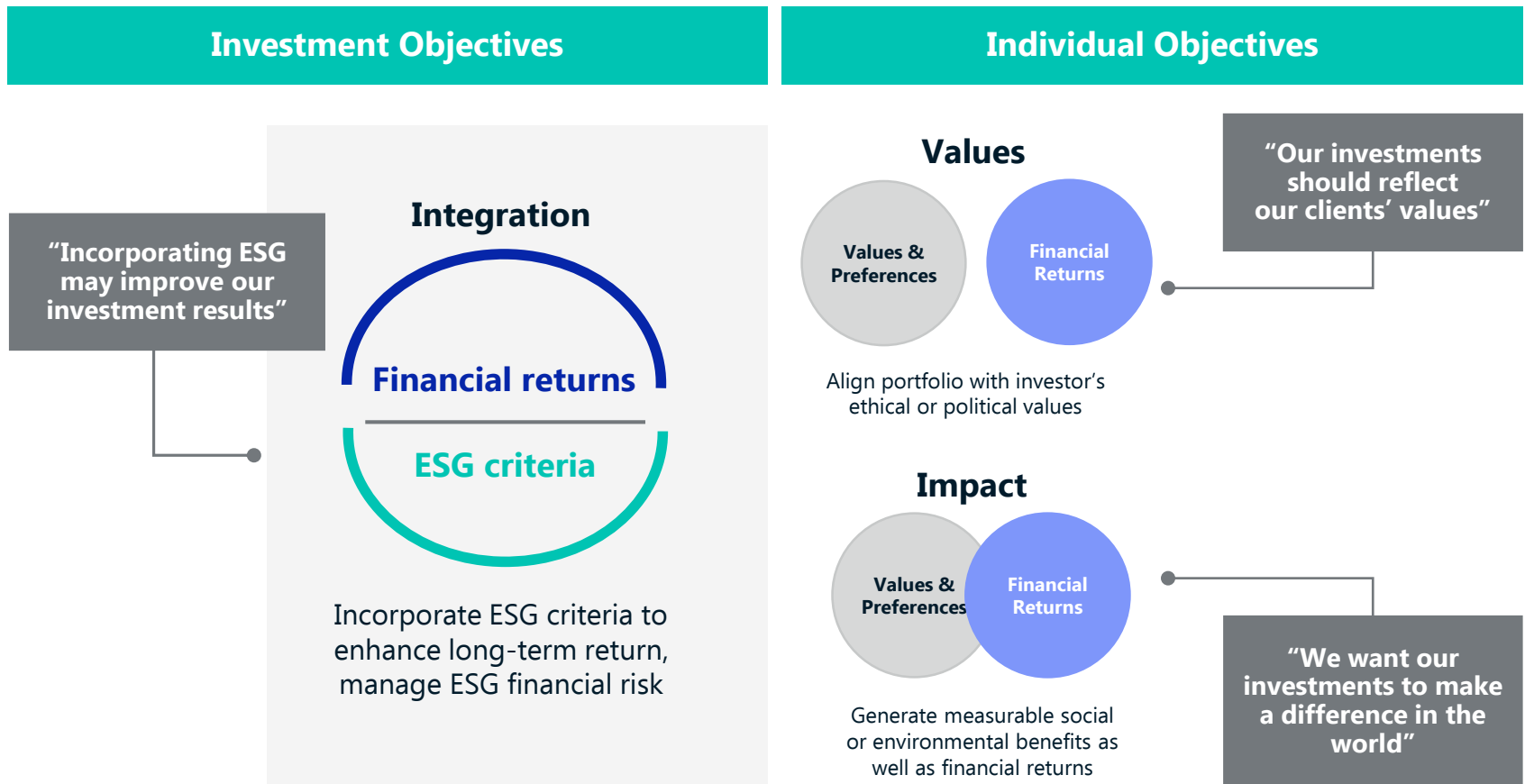
MSCI can help you:

- 1 Define objectives & policy**
 - Define investment and ESG objectives
 - Set targets and strategies to enhance ESG profile
 - Develop investment policy
 - Select benchmarks
- 2 Integrate into investment process**
 - ESG in portfolio construction
 - Active and index-linked ESG products
 - Scalable risk management reporting
 - Stress testing
- 3 Engage stakeholders & report**
 - Engage companies and external stakeholders
 - Provide transparency through client reporting



Define: align investor objectives with investment design

Incorporating ESG into investment strategy or creating products typically starts with understanding client objectives, which may combine elements of managing long-term risk, reflecting values and positive impact.



Define: evaluate & develop approach

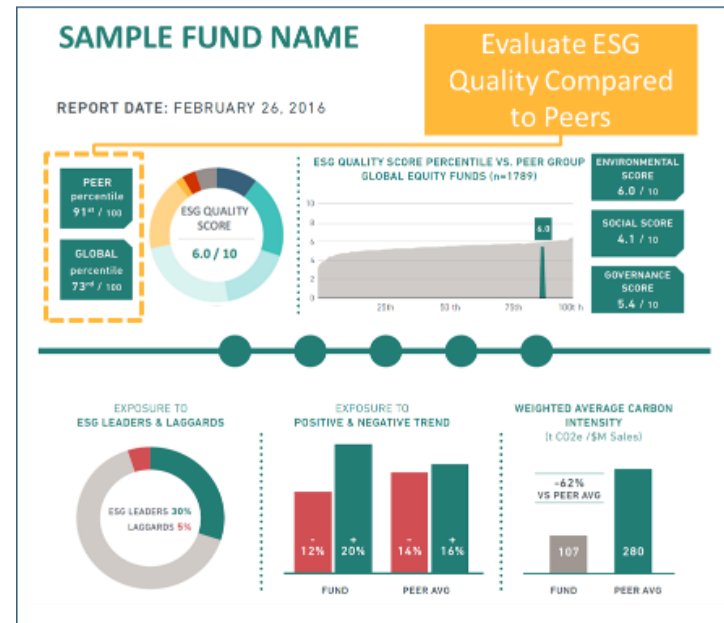


A critical step in the process of ESG integration brings clarity on the objectives, the policies that would apply throughout the organization as well as expected outcome. MSCI's research and tools can assist in developing policy, selecting the right benchmark, measuring expected outcomes and determining strategic positioning.

MSCI ESG Research Provide Guidance on Trends and Best Practices



ESG Fund Metrics Provide an Understanding of Positioning vs Peers



Integrate ESG into your investment strategy

1 2 3

There are numerous approaches for integrating ESG into portfolio construction—whether active or passive strategies—in equities or fixed income. Here are some common approaches.

1

Improve ESG Quality /
Reduce Risk

ESG



MSCI's ESG Ratings can be used for security selection or within systematic strategies to help improve ESG quality and reduce risk. *Foundations of ESG Investing* illustrate various investment approaches.¹

2

Reduce Carbon Footprint

CO₂



The MSCI Low Carbon Target Index targets an 80% reduction in carbon emissions while maintaining similar characteristics as the parent Index, including a 0.5% tracking error.²

3

Exclude Business
Activities

VALUES



Asset owners increasingly require screens on their funds. MSCI offers a full range of screens and thresholds to help managers meet client needs.

Integrate ESG into your risk management

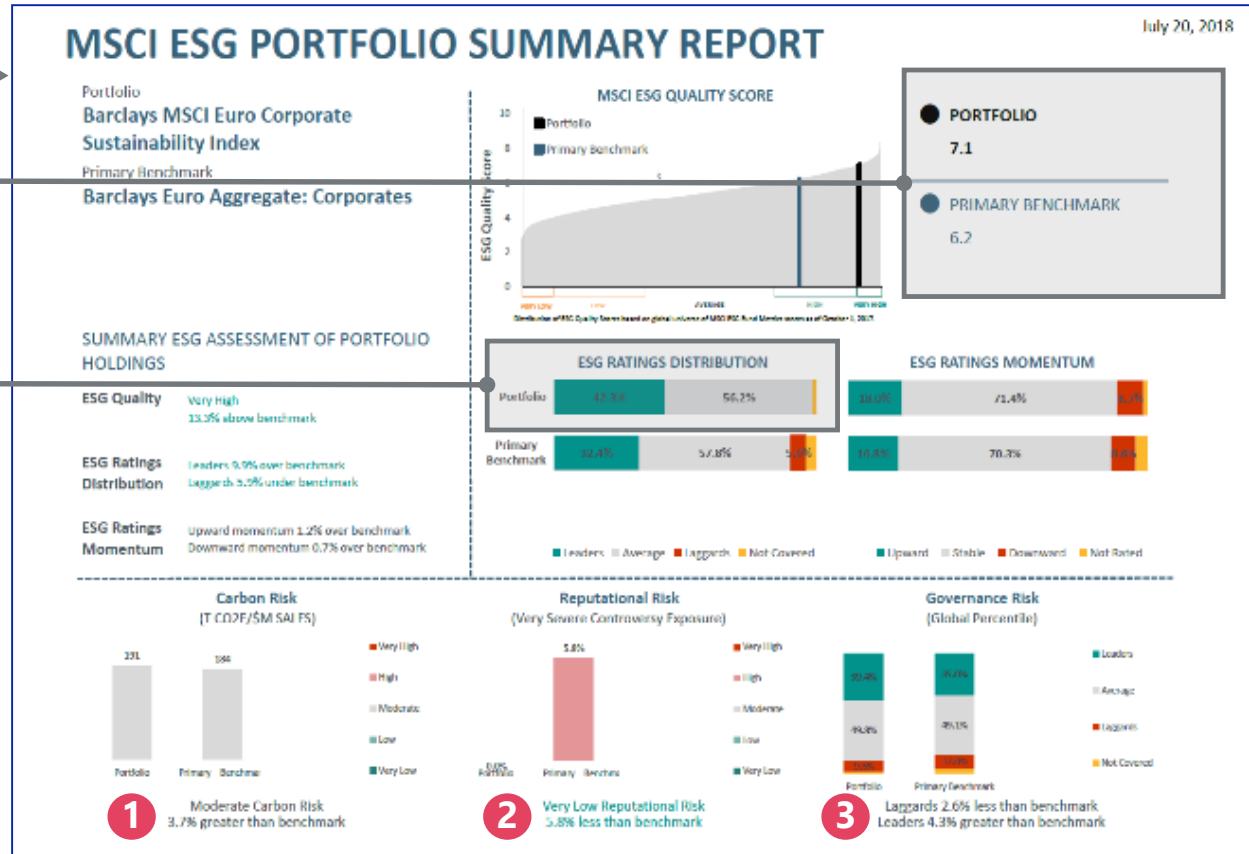
We increasingly see clients incorporating ESG into risk reporting and conversations with portfolio managers.

Sample report used by large fund manager for quarterly risk reporting

Portfolio has a **higher ESG Quality score** than the benchmark

High ESG Quality score coming from **higher exposure to ESG leaders** and lower exposure to laggards

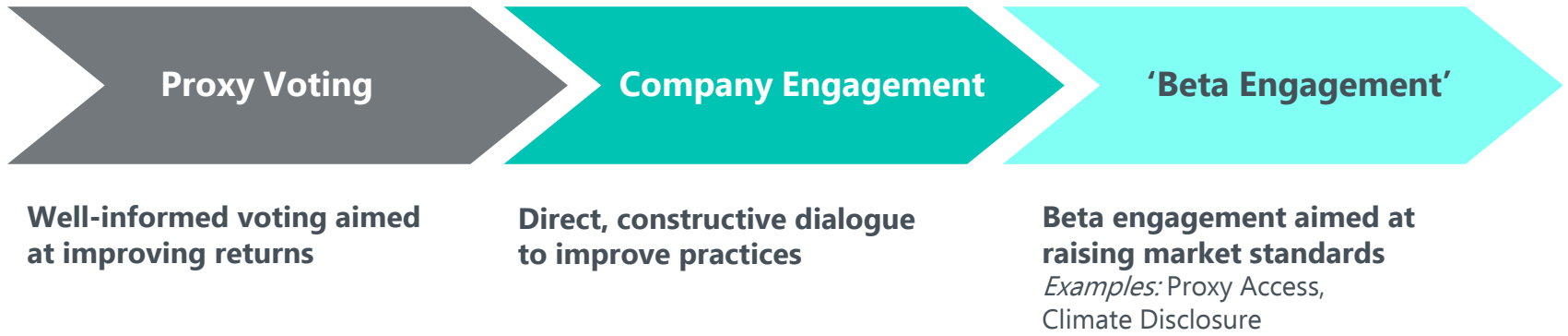
Portfolio has **moderate Carbon Risk (1)** and **Very low Reputational Risk (2)**, as well as **4.3% more exposure to Governance Leaders (3)** than the benchmark



Available in MSCI RiskManager, MSCI BarraOne and MSCI Barra Portfolio Manager

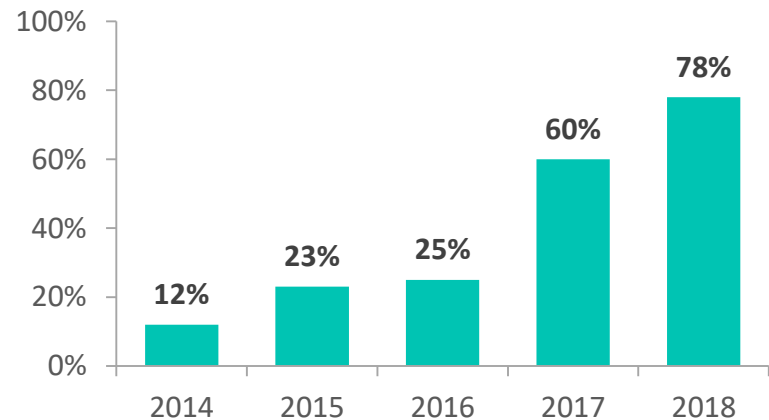
Engage with stakeholders and communicate 1 2 **3**

Many asset owners expect managers to be active stewards of capital and to exert oversight and influence on companies they own. Leaders in field use engagement to improve company performance.



Corporate Inquiries/Feedback from Japanese Companies

As part of Japan's Government Pension Fund (GPIF) allocation to MSCI ESG Leaders Index mandates, MSCI initiated engagements with Japanese corporates in 2017 to raise awareness of ESG best practices. As a result, we have seen a dramatic increase in interest, measured by an increase in response rates from Japanese companies.



MSCI ESG Ratings

Measuring material ESG risks

ESG RATING METHODOLOGY



EVALUATE CORPORATE GOVERNANCE

Analysis begins with a **deep governance assessment**

Ownership, Board, Pay, Accounting, Corporate Behavior



IDENTIFY KEY ISSUES BY INDUSTRY

Focus on **most material** ESG factors by industry

Quantitative Approach + Annual Consultation



SCORE KEY ISSUES (0-10)

Focus on **risk exposure** not just disclosure

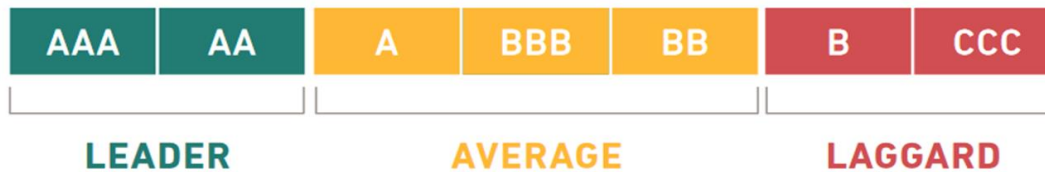
Scoring Models Assess Risk Exposure + Risk Management



FINAL ESG RATINGS (AAA-CCC)

Identify **leaders and laggards** within each industry

Industry-Relative ESG Ratings (AAA-CCC)



MSCI ESG RATINGS KEY ISSUES

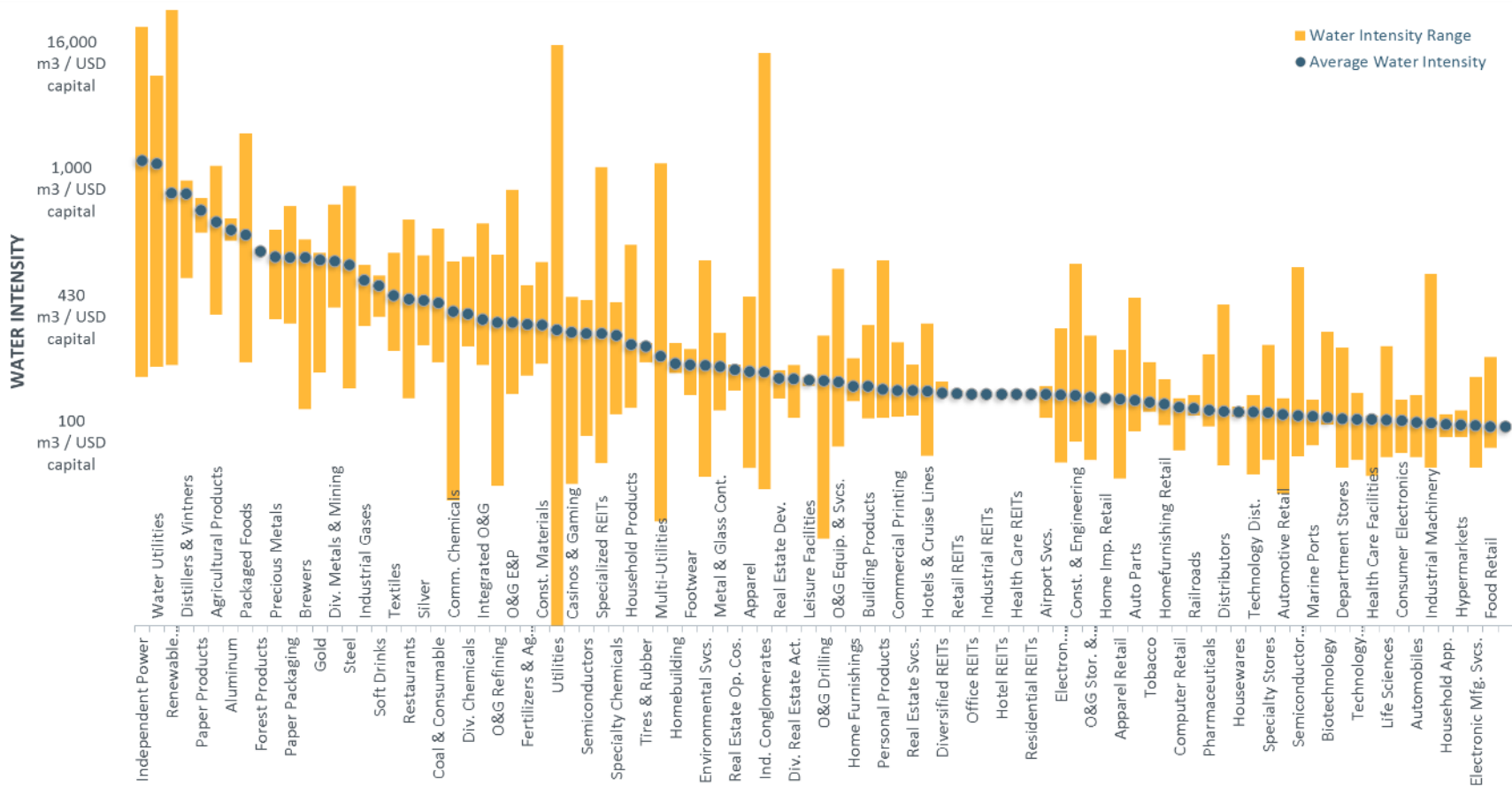
ENVIRONMENT PILLAR				SOCIAL PILLAR				GOVERNANCE PILLAR	
Climate Change	Natural Capital	Pollution & Waste	Env. Opportunities	Human Capital	Product Liability	Stakeholder Opposition	Social Opportunities	Corporate Governance	Corporate Behavior
Carbon Emissions	Water Stress	Toxic Emissions & Waste	Clean Tech	Labor Management	Product Safety & Quality	Controversial Sourcing	Access to Communication	Board	Business Ethics
Product Carbon Footprint	Biodiversity & Land Use	Packaging Material & Waste	Green Building	Health & Safety	Chemical Safety		Access to Finance	Pay	Anti-Competitive Practices
Financing Environmental Impact	Raw Material Sourcing	Electronic Waste	Renewable Energy	Human Capital Development	Financial Product Safety		Access to Health Care	Ownership	Corruption & Instability
Climate Change Vulnerability				Supply Chain Labor Standards	Privacy & Data Security		Opportunities in Nutrition & Health	Accounting	Financial System Instability
					Responsible Investment				Tax Transparency
					Insuring Health & Demographic Risk				

Three-Step Process

- 1) Identify Key Issues By Industry
- 2) Measure Risk Exposure for each Key Issue
- 3) Measure Risk Management for each Key Issue

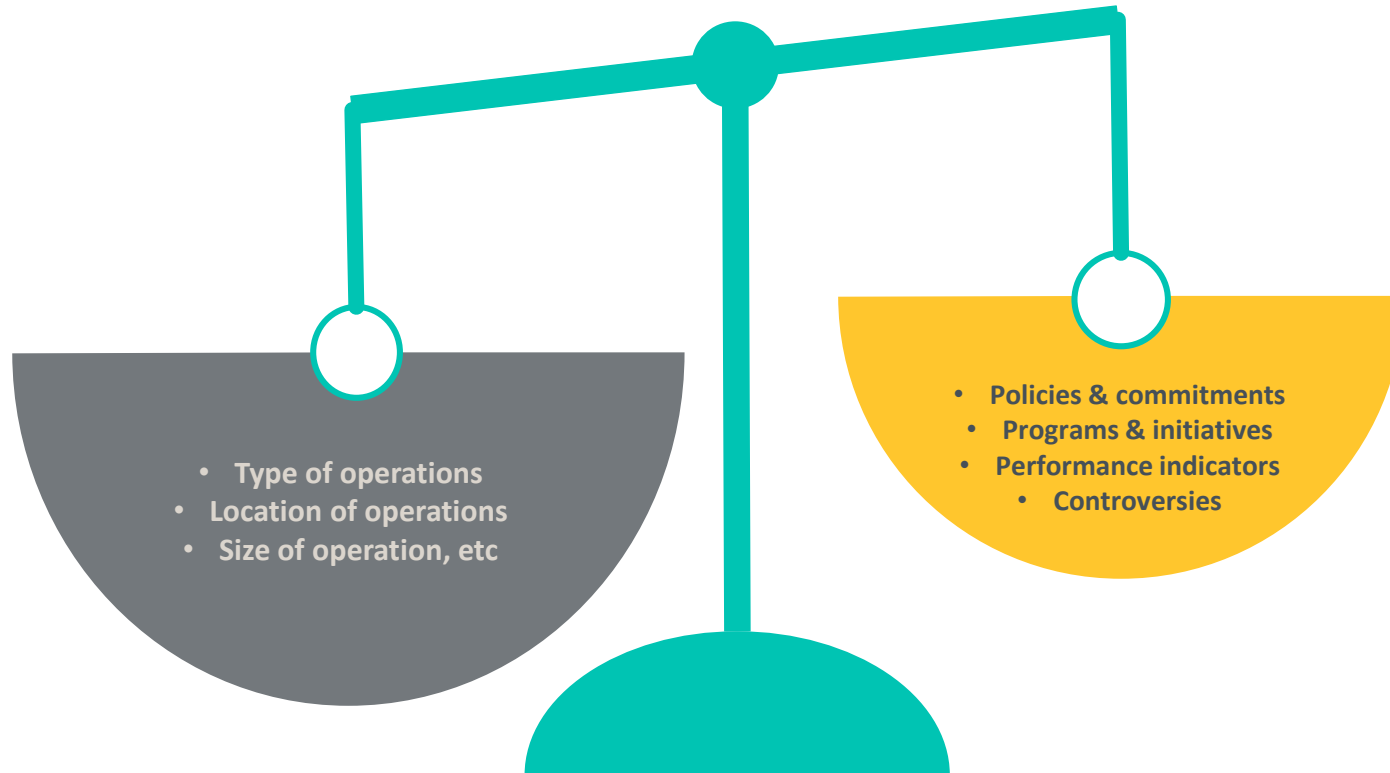
DETERMINING KEY ISSUES:

E.g. Water Risk by Sub-Industry



Water Intensity Data Sources: Company data from MSCI ESG Research, IERS Comprehensive Environmental Data Archive, Canadian Industrial Water Survey

MEASURING ESG RISK EXPOSURE



ASSESSING RISK EXPOSURE

Business Activity Data



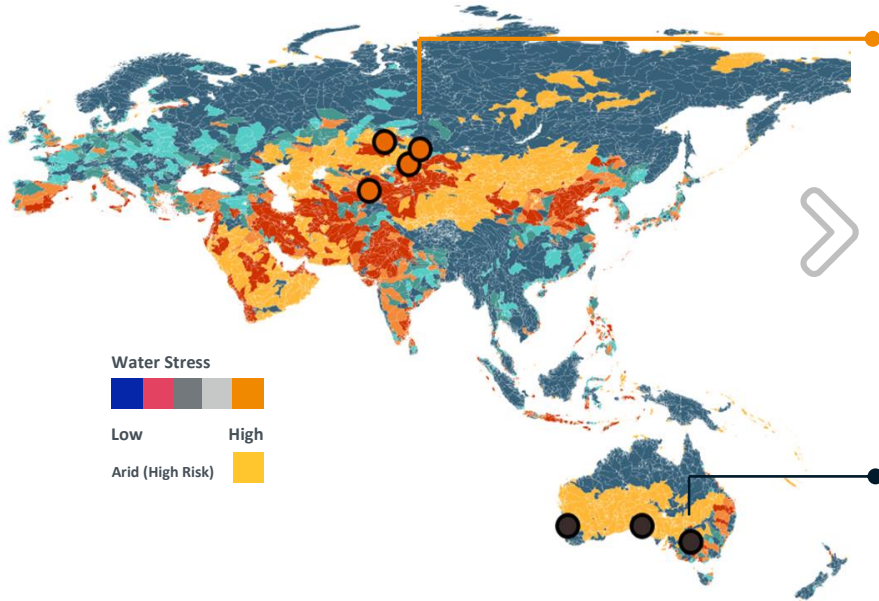
Geographic Data

mapped to

Company Segment Data



Risk Exposure



Example:

Kaz Minerals

MINE NAME:		Aktogay	Bozshakol	Bozymchak	East Region Operations
% of Operations		29%	11%	2%	57%
GEOGRAPHIC	WATER BASIN	Kazakhstan Balkhash	Kazakhstan Pavlodar	Kazakhstan Aral	Kazakhstan Ob
	WATER STRESS	SEVERE	MEDIUM	SEVERE	LOW
BUSINESS	BUSINESS ACTIVITY	Copper	Copper	Gold	Copper/Zinc
	WATER INTENSITY	HIGH 5.99	HIGH 5.99	HIGH 6.03	HIGH 6.07

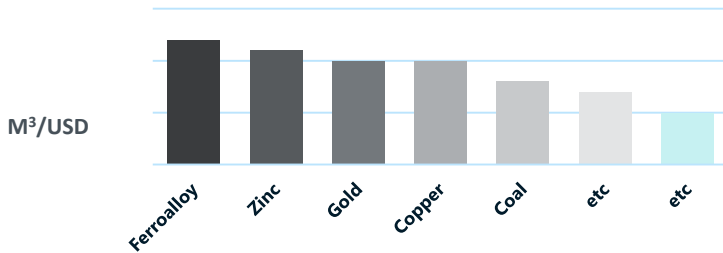
5.9

Risk Exposure Score

7.7

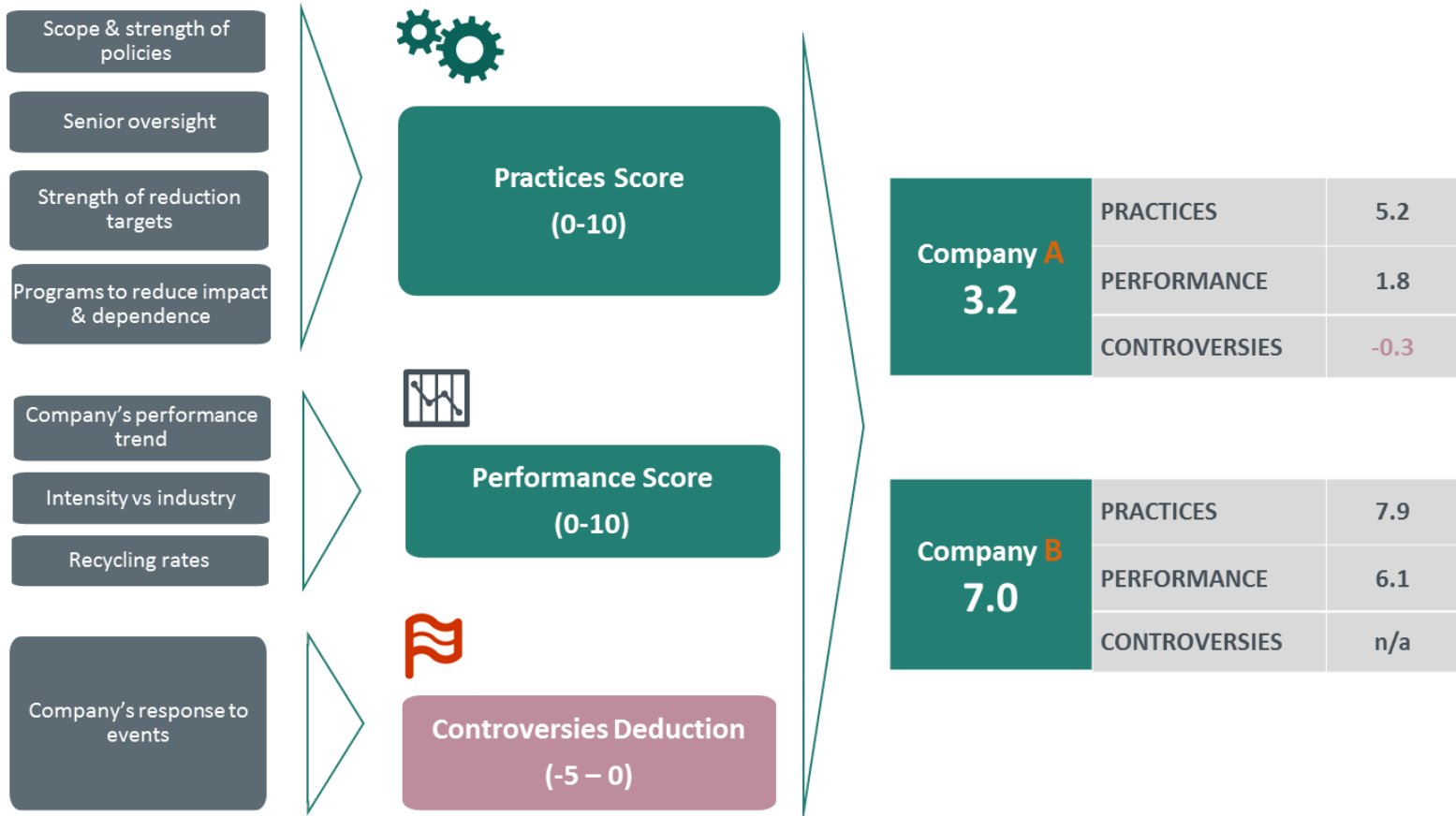
Iluka Resources

MINE NAME:		Eucla	Murray	Perth
% of Operations		34%	20%	44%
GEOGRAPHIC	WATER BASIN	Australia Eucla	Australia Murray	Australia Perth
	WATER STRESS	SEVERE	SEVERE	MEDIUM
BUSINESS	BUSINESS ACTIVITY	Heavy Minerals	Heavy Minerals	Heavy Minerals
	WATER INTENSITY	HIGH 6.44	HIGH 6.44	HIGH 6.44



ASSESSING RISK MANAGEMENT

The focus is not only on policies and practices but also on evidence of actions



Powering better investment decisions

MSCI can help you integrate ESG into your investment process and communicate with your stakeholders using the common language of ESG Ratings:

1 Leading ESG Ratings & Research

Broad coverage with more than 13,000 entities, >90% of equity and FI MV



2 Innovative equity & fixed income indexes for various ESG approaches

More than 900 indexes covering integration, values and impact



MSCI Emerging Markets ESG Leaders Index

3 Market-leading risk analytics platform & ESG reporting

Sophisticated ESG Analytics and scalable reporting across 700,000 multi-asset class securities



4 ESG expertise & network

350+ ESG experts and over 600 individuals working with investors around the world



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