

INSIGHTS & IDEAS

A Conversation on Shareholder Engagement

HEALTH WEALTH CAREER

CHURCH PENSION GROUP

SOCIALLY RESPONSIBLE
INVESTING LANDSCAPE

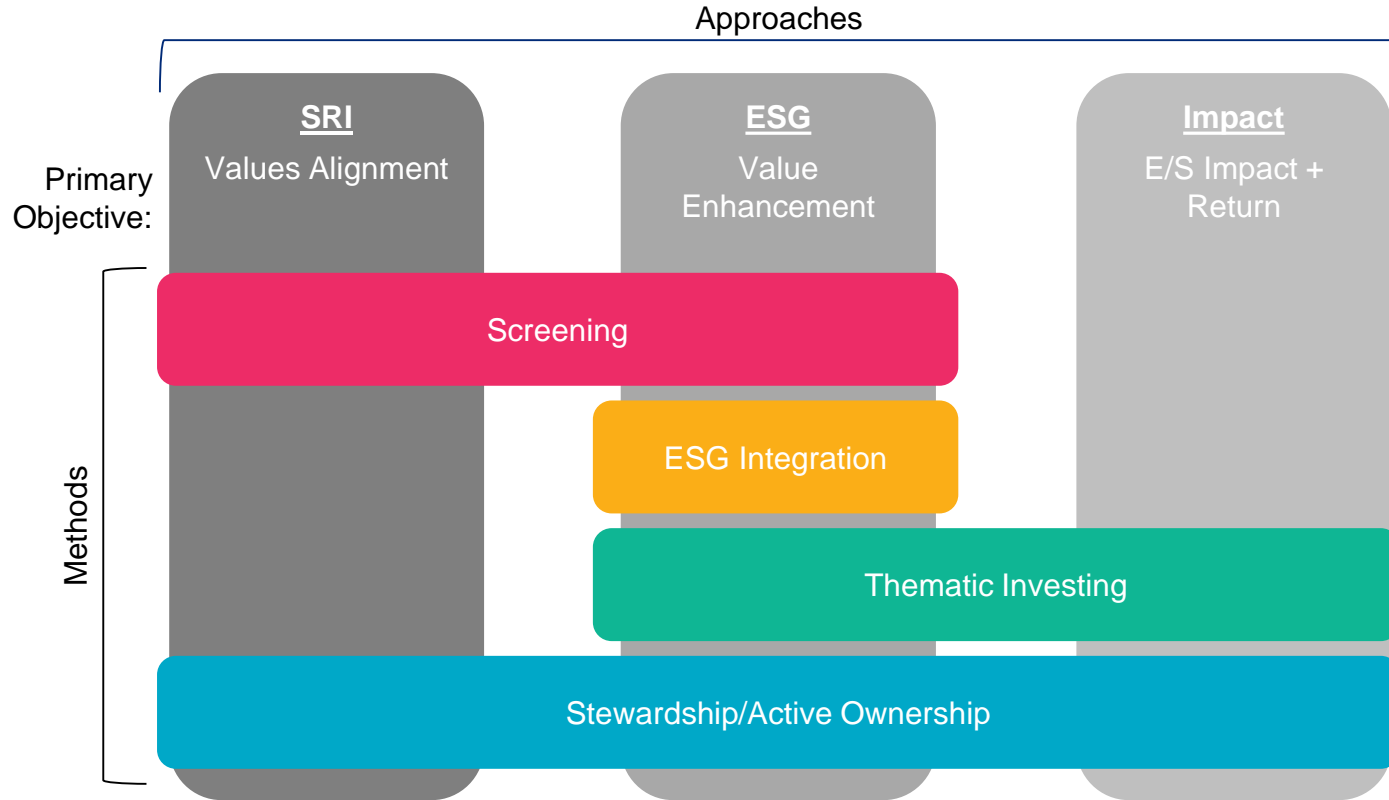
OCTOBER 29, 2019

CHRISTOPHER TAUBER

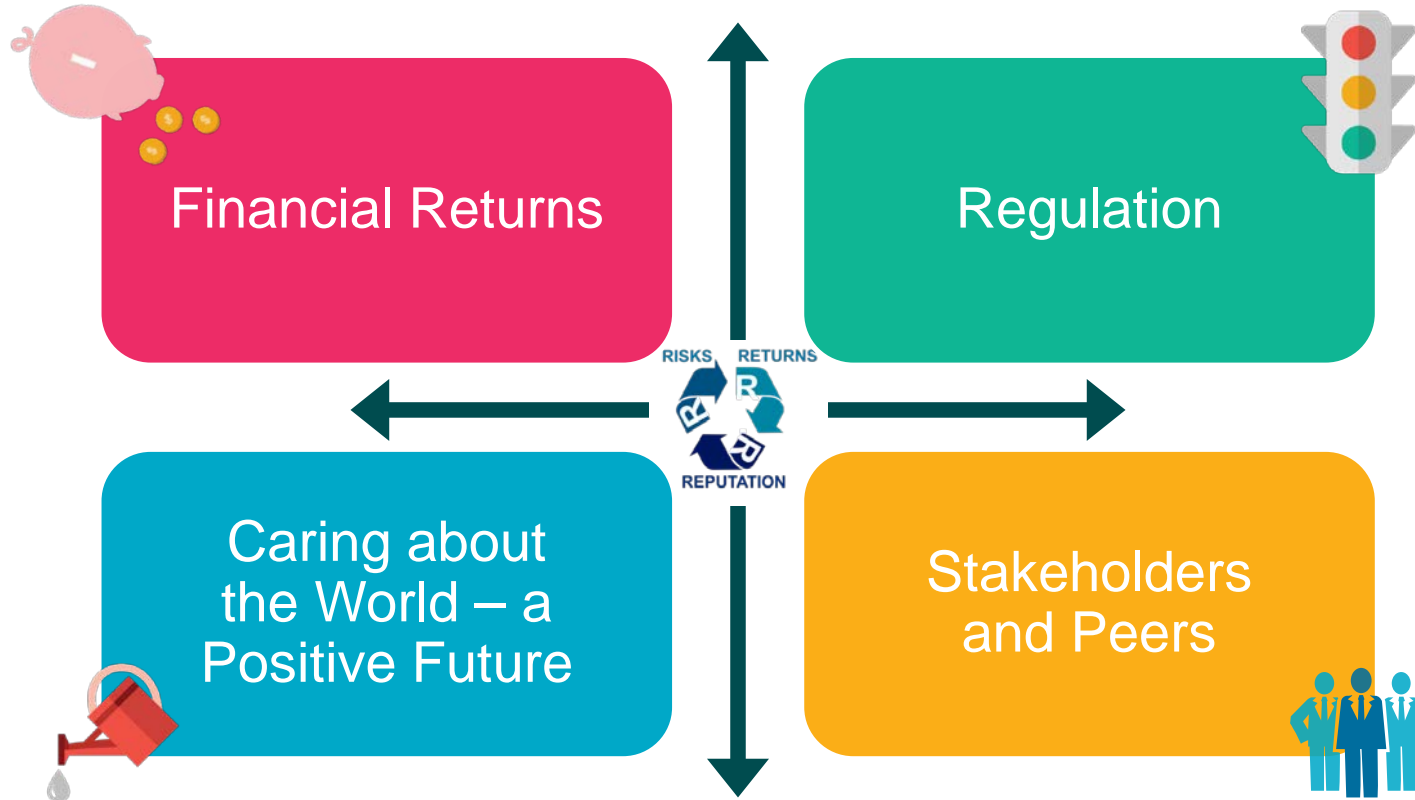
TRENDS



RESPONSIBLE INVESTMENT APPROACHES AND METHODS



INVESTOR MOTIVATIONS



WHAT IS IN FINANCIAL STATEMENTS?



A BROADER PERSPECTIVE ON RISK

DRIVERS OF SUSTAINABILITY THEMES



Sustainability themes are driven by secular shifts in...

Consumer preferences



Emerging technologies



Regulatory actions



Resource scarcity



...creating new investment opportunities which generate growth and positive social/environmental outcomes.

NOTABLE RESEARCH FINDINGS



	INTEGRATION	STEWARDSHIP	THEMATIC	SCREENING																																							
Potential Implication in Practice	<p>Meta-analysis of over 2000 primary studies¹⁾:</p> <table border="1"> <caption>Figure 5: Environmental, social & governance categories and their relationship to CFP</caption> <thead> <tr> <th>Category</th> <th>Positive</th> <th>Negative</th> </tr> </thead> <tbody> <tr> <td>E</td> <td>58.7%</td> <td>4.2%</td> </tr> <tr> <td>S</td> <td>55.1%</td> <td>5.1%</td> </tr> <tr> <td>G</td> <td>62.3%</td> <td>9.2%</td> </tr> <tr> <td>E, S & G combinations</td> <td>35.2%</td> <td>7.1%</td> </tr> </tbody> </table> <p>Source: Friede, Busch, Bassen (December 2015)</p>	Category	Positive	Negative	E	58.7%	4.2%	S	55.1%	5.1%	G	62.3%	9.2%	E, S & G combinations	35.2%	7.1%	<p>Figure 5: CFI monthly returns over an 18-month event window. The 'Successful' line shows a clear upward trend, peaking at approximately 0.045 around month 12, while the 'Whole sample' and 'Unsuccessful' lines remain relatively flat and near zero.</p>	<p>Investing in sustainability themes may provide a return premium in specific future scenarios such as a 2 degree or “low-carbon transition” scenario where strong action is taken to limit greenhouse gas emissions globally⁴⁾:</p> <p>Figure 6: Returns for Transition and Ex-ESG scenarios. The chart shows that the 'Transition' scenario yields the highest returns, particularly for 'Ex Health Care' and 'Ex Consumer Staples'.</p>	<p>The impact of negative screens is mixed but typically small⁵⁾. Depends on a variety of factors:</p> <ul style="list-style-type: none"> • Size of screen • Performance measures used • Etc. <table border="1"> <caption>Figure 6: Return/Risk for various Ex categories</caption> <thead> <tr> <th>Category</th> <th>Return/Risk</th> </tr> </thead> <tbody> <tr> <td>Ex Health Care</td> <td>~0.75</td> </tr> <tr> <td>Ex Consumer Staples</td> <td>~0.65</td> </tr> <tr> <td>Ex Energy</td> <td>~0.60</td> </tr> <tr> <td>Ex Utilities</td> <td>~0.55</td> </tr> <tr> <td>S&P 500</td> <td>~0.50</td> </tr> <tr> <td>Ex Industrials</td> <td>~0.45</td> </tr> <tr> <td>Ex Telecom</td> <td>~0.40</td> </tr> <tr> <td>Ex Consumer Discretionary</td> <td>~0.35</td> </tr> <tr> <td>Ex Materials</td> <td>~0.30</td> </tr> <tr> <td>Ex IT</td> <td>~0.25</td> </tr> <tr> <td>Ex Financials</td> <td>~0.20</td> </tr> </tbody> </table>	Category	Return/Risk	Ex Health Care	~0.75	Ex Consumer Staples	~0.65	Ex Energy	~0.60	Ex Utilities	~0.55	S&P 500	~0.50	Ex Industrials	~0.45	Ex Telecom	~0.40	Ex Consumer Discretionary	~0.35	Ex Materials	~0.30	Ex IT	~0.25	Ex Financials	~0.20
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	<p>Materiality matters²⁾:</p> <table border="1"> <caption>Figure 7: Stock Returns (in annualized alpha) by type of Sustainability Performance</caption> <thead> <tr> <th>Materiality on Materiality Factors</th> <th>High</th> <th>Low</th> </tr> </thead> <tbody> <tr> <td>High</td> <td>6.01%</td> <td>1.95%</td> </tr> <tr> <td>Low</td> <td>-2.90%</td> <td>0.60%</td> </tr> </tbody> </table>	Materiality on Materiality Factors	High	Low	High	6.01%	1.95%	Low	-2.90%	0.60%	<p>Analyzing a database of CSR engagements with US public cos. over 1999–2009 researchers found cumulative abnormal returns of +1.8%. After successful engagements, companies experienced improvements in operating performance profitability, efficiency, and governance³⁾.</p>																																
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Sources: 1) Deutsche Asset Management/University of Hamburg; [ESG & Corporate Financial Performance: Mapping the Global Landscape](#) (2015) 2) Kahn, Serafeim and Yoon; [Corporate Sustainability: First Evidence of Materiality](#) (2016) 3) Dimson, Karakas & Li; [Active Ownership](#) (2013) 4) Mercer, [Preparing Portfolios for Transformation](#) (2017) 5) Jeremy Grantham, [The Myth of Divesting from Fossil Fuels](#) (2018)

ZEITGEIST SHIFT

THE EVOLUTION OF SUSTAINABLE BUSINESS

“There is one and only one social responsibility of business...to increase its profits.”

Milton Friedman, NYT Magazine, 1970

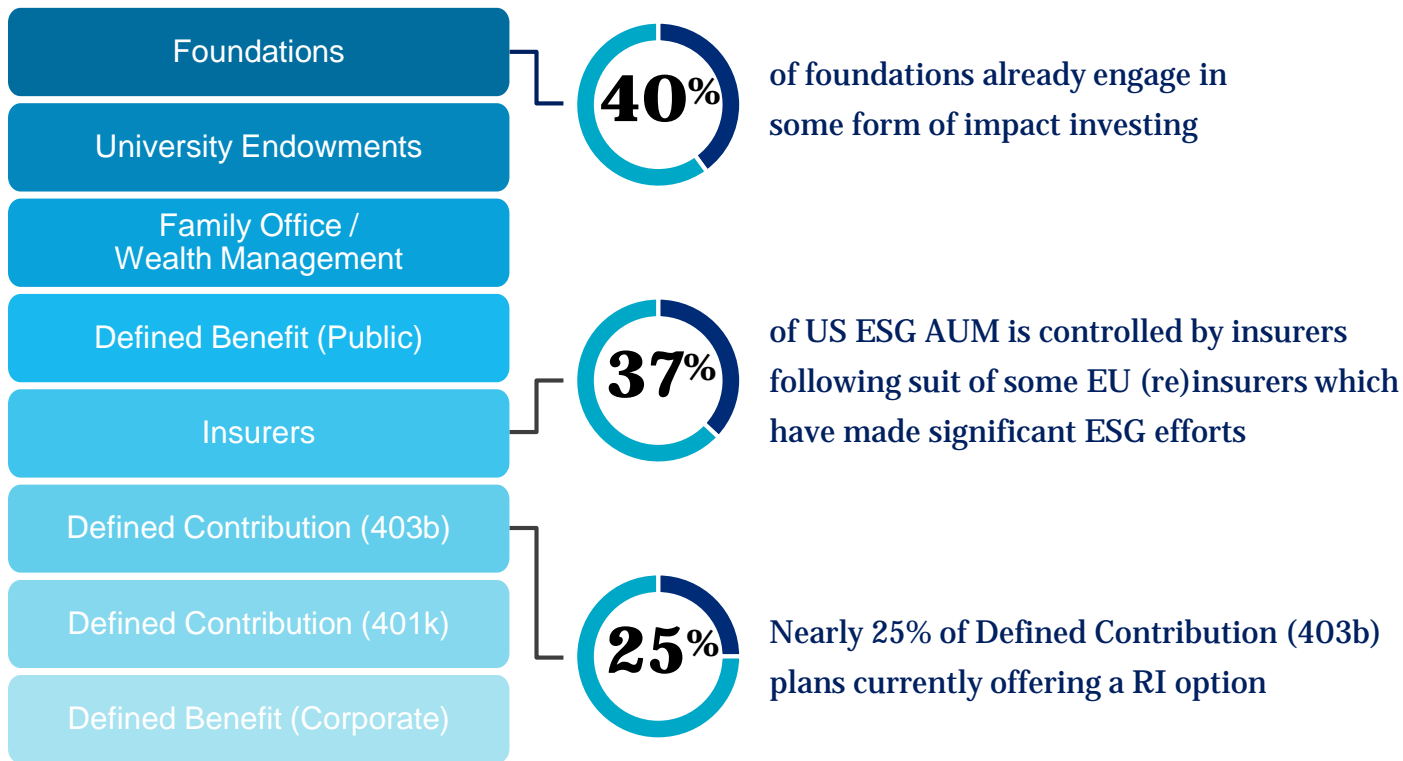


“Society is demanding that companies, both public and private, serve a social purpose...without a sense of purpose, no company...can achieve its full potential.”

Larry Fink, Annual Letter to CEOs, 2017



SUSTAINABLE INVESTMENT PROGRESS BY INSTITUTIONAL INVESTOR SEGMENT (U.S.)

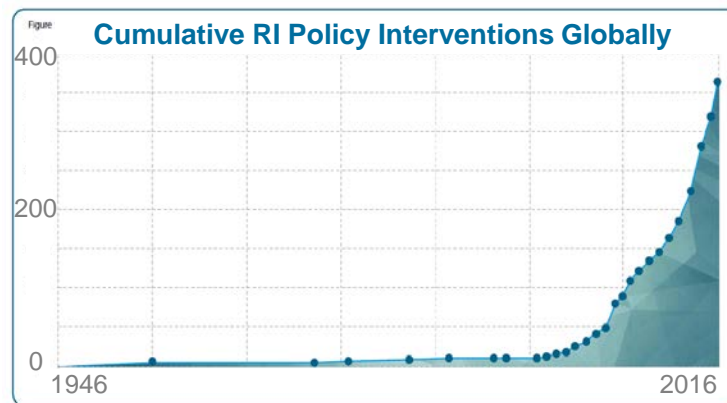


IMPLEMENTATION



INDUSTRY AND POLICY DEVELOPMENTS FROM VOLUNTARY STANDARDS TO REGULATION

Voluntary Disclosure Initiatives

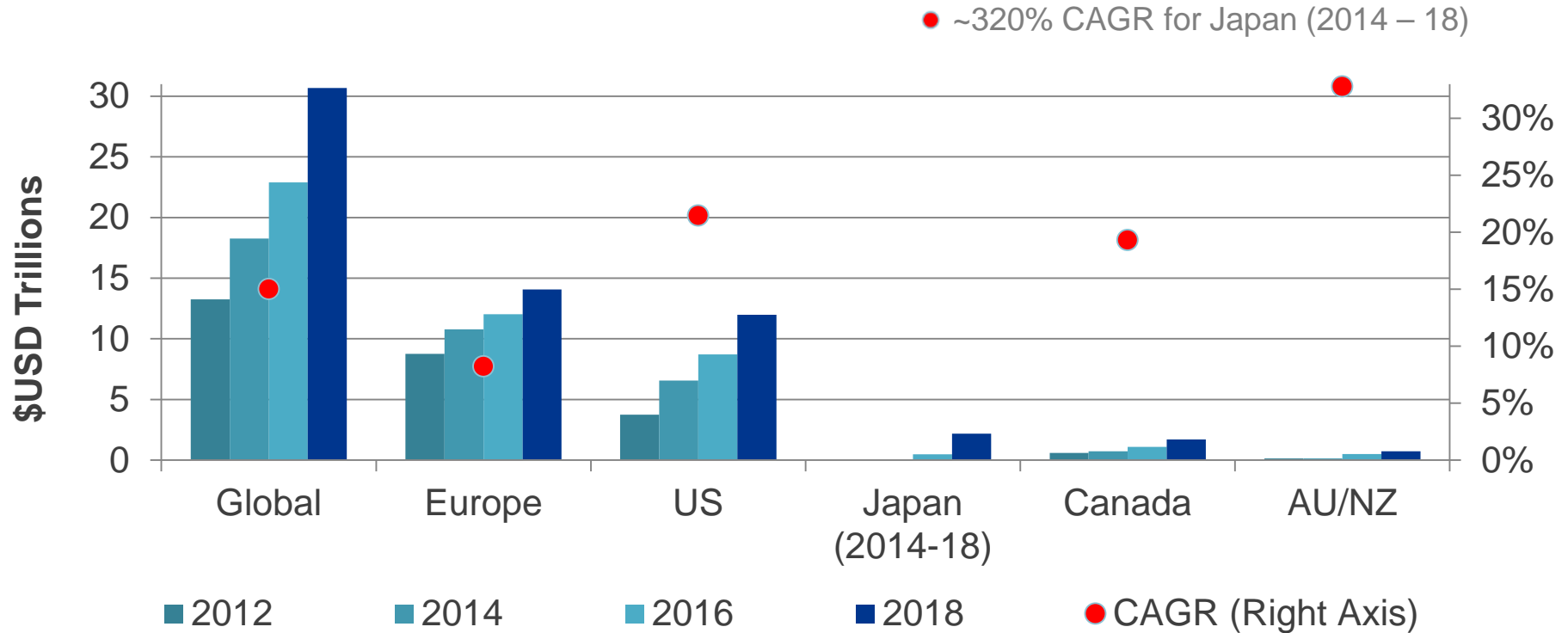


“In the largest 50 economies in the world...almost 300 policy instruments support investors to consider long-term value drivers, including ESG factors. Over half...were created between 2013 and 2016.”

**Growing Emphasis on ESG
Transparency and Disclosure**

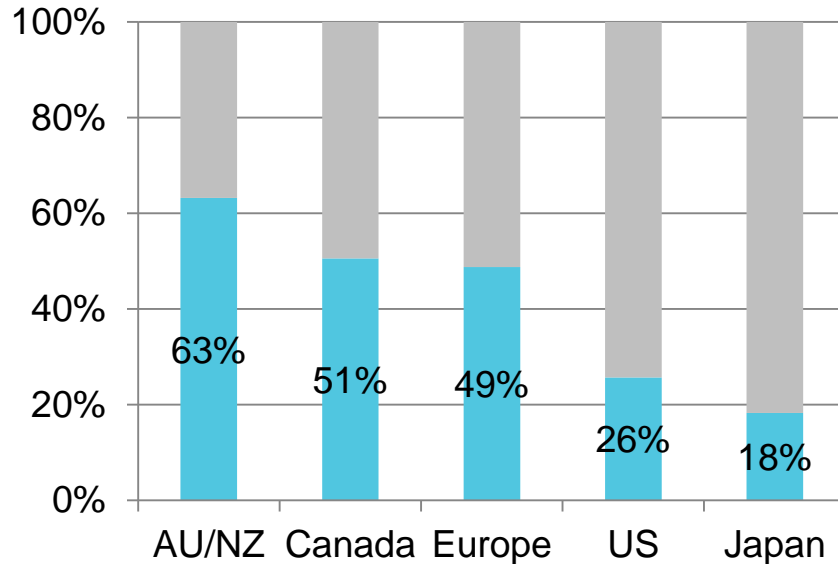
Increasing Regulatory Focus

GLOBAL SUSTAINABLE INVESTMENTS GROWTH BY REGION 2012-2018



GLOBAL SUSTAINABLE INVESTMENTS PERCENTAGE OF TOTAL BY REGION

Sustainable and Responsible Investments
as a % of Total Managed Assets (2018)



Source: GSIA – 2018 Review

“As chief investment officer of Japan’s Government Pension Investment Fund, **Mizuno requires his asset managers to integrate ESG into their investment analysis**—among many changes he has brought to the pension fund since taking the helm in late 2014.

But while Mizuno told *Barron’s* there is growing consensus that using ESG criteria can lower risk, he routinely gets pushback. Despite the recent hype around ESG and impact investing, **he says most on Wall Street and in asset management aren’t actually doing it.**”¹

WHAT TO DO NEXT? INVESTOR PERSPECTIVE



<https://www.mercer.com/our-thinking/wealth/pathway-to-responsible-investing.html>

ACTIVE OWNERSHIP VOTING AND ENGAGEMENT

- Investment stewardship (a.k.a. active ownership) involves voting shares responsibly on an informed basis, monitoring companies' governance and performance and engaging with company management towards a shared goal of sustainable long-term value creation¹).
- Relatively speaking, stewardship can be a more important consideration for broad passive mandates than for concentrated active mandates²:
 - Passive managers cannot express their views through stock selection but can influence company management on environmental, social and governance (ESG) issues.
 - Passive managers have a long-term horizon which lends itself well to ongoing conversations with management teams on key issues.
 - As the share of the total market devoted to passive ownership grows, the importance of this class of investor to encouraging adoption of best management practices on ESG issues will increase.

1). Paraphrased from: <https://corpgov.law.harvard.edu/2017/04/17/a-synthesized-paradigm-for-corporate-governance-investor-stewardship-and-engagement/>

2). Mercer; The Active Side of Passive Management; 2017. See summary article: <https://www.top1000funds.com/opinion/2017/05/01/passive-managers-active-ownership/>

STEWARDSHIP PROGRAM DEVELOPMENT SAMPLE PROCESS

Review Current Voting and Engagement Practices

Conduct quantitative proxy voting review of commingled public equity funds

Conduct qualitative voting and engagement policy/process review of public equity managers

Review results of quant/qual analyses against current beliefs, policies and procedures



Update Policy Documents

Develop stewardship guidelines which reflect beliefs on E, S and G management issues

Develop work plan to support implementation of guidelines

Communicate program expectations to third-party partners



Implement Stewardship Program

Ensure adequate resourcing

Monitor progress

MANAGER COMPLIANCE WITH US STEWARDSHIP PRINCIPLES – EXAMPLE

US Stewardship Code Principles	MANAGER NAMES REDACTED									
	ESG2	ESG2	ESGp2	ESG3	ESG4 ¹	ESG3	ESG1	ESGp2	ESG4	ESG3 ²
Mercer ESG Rating Has Adopted US (or UK) Code?	Yes	Yes	Yes	Yes	No ³	No	No	Yes	No	Yes
Overall Compliance										
A. Institutional investors are accountable to those whose money they invest.										
B. Institutional investors should demonstrate how they evaluate corporate governance factors with respect to the companies in which they invest.										
C: Institutional investors should disclose, in general terms, how they manage potential conflicts of interest that may arise in their proxy voting and engagement activities.										
D. Institutional investors are responsible for proxy voting decisions and should monitor the relevant activities and policies of third parties that advise them on those decisions.										
E: Institutional investors should address and attempt to resolve differences with companies in a constructive and pragmatic manner.										
F: Institutional investors should work together, where appropriate, to encourage the adoption and implementation of the Corporate Governance and Stewardship Principles										

Note: This review could be conducted against any set of articulated principles

MERCER ESG RATINGS



MERCER'S ESG RATING SCALE

ESG ratings are undertaken by Mercer's global manager research team. They are on a scale from 1 (highest) to 4 (lowest) and assess how well managers integrate ESG factors into investment processes.

ACTIVE

ESG 1

Leader in the integration of ESG factors and active ownership into core processes.

ESG 2

Less advanced than ESG1 investors but with moderate integration of ESG factors and active ownership.

ESG 3

Limited progress with respect to ESG integration and active ownership, albeit with signs of potential improvement.

ESG 4

Little or no integration of ESG factors or active ownership into core processes and no indication of future change.

Ratings for passive equity strategies differentiate how well firms undertake their stewardship activities such as voting, engagement, industry collaboration and reporting.

PASSIVE

ESG p 1

Leaders in Voting & Engagement across ESG topics, with active ownership activities and ESG initiatives undertaken consistently at a global level

ESG p 2

Strong approach to Voting & Engagement across ESG topics, and initiatives at a regional level, with progress made at a global level

ESG p 3

Focus tends to be on Voting & Engagement on governance topics only, more regionally focused with less evidence of other internal ESG initiatives

ESG p 4

Little or no initiatives taken on developing a Voting & Engagement capability, with little progress made on other ESG initiatives

MERCER'S ESG RATING CRITERIA

ACTIVE (all asset classes)

IDEA GENERATION

- ESG factors integrated into active fund positions as a source of value added.
- Identification of material ESG factors - skill of team members, data sourcing

PORTFOLIO CONSTRUCTION

- Efforts to integrate ESG driven views into the portfolio's construction.

IMPLEMENTATION

- Engagement and proxy voting activities (if applicable).
- Investment horizon align with ability to effectively implement ESG views?

BUSINESS MANAGEMENT

- Firm-level support for ESG integration, engagement activities and transparency.



PASSIVE (equities)

VOTING & ENGAGEMENT

- Policy, process and prioritisation.
- Quality of engagements.

RESOURCES & IMPLEMENTATION

- Skill set of resources.
- Effectiveness of engagement outcomes.

ESG INTEGRATION

- Data analysis to enhance active ownership.

FIRMWIDE COMMITMENT

- Collaborative initiatives and engagement with regulators and policymakers.

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MAKE



**TOMORROW,
TODAY**

INSIGHTS & IDEAS

A Conversation on Shareholder Engagement