Retirement Funds and ESG Investing

Prepared by: Bhina Botlhe-Tshukudu

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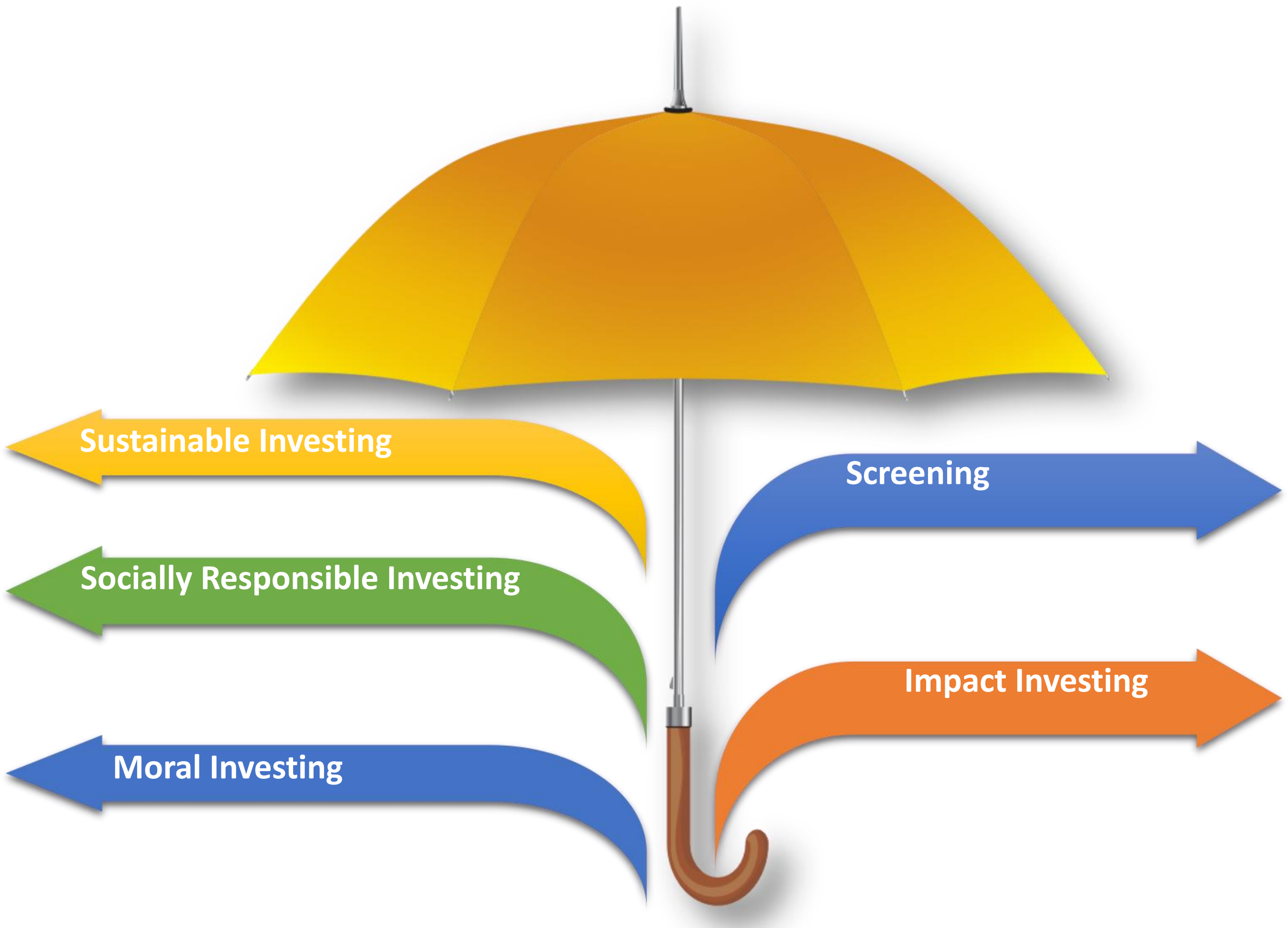
AGENDA

1. History of ESG Investing
2. Growth of ESG Awareness and Strategies
3. Organisations supporting ESG Investing
4. Financial Relevance of ESG Investing
5. Incorporation and cost of ESG into investment strategies


Sustainable Investing
Socially Responsible Investing
Moral Investing
Screening
Impact Investing

History of ESG Investing

History of ESG investing

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Unit Trusts

01

MSCI defines ESG investing as the consideration of environmental, social and governance factors alongside financial factors in the investment decision-making process

02

History dating back to 1960s as exclusionary screening

03

It was originally a separate process that was used as an overlay

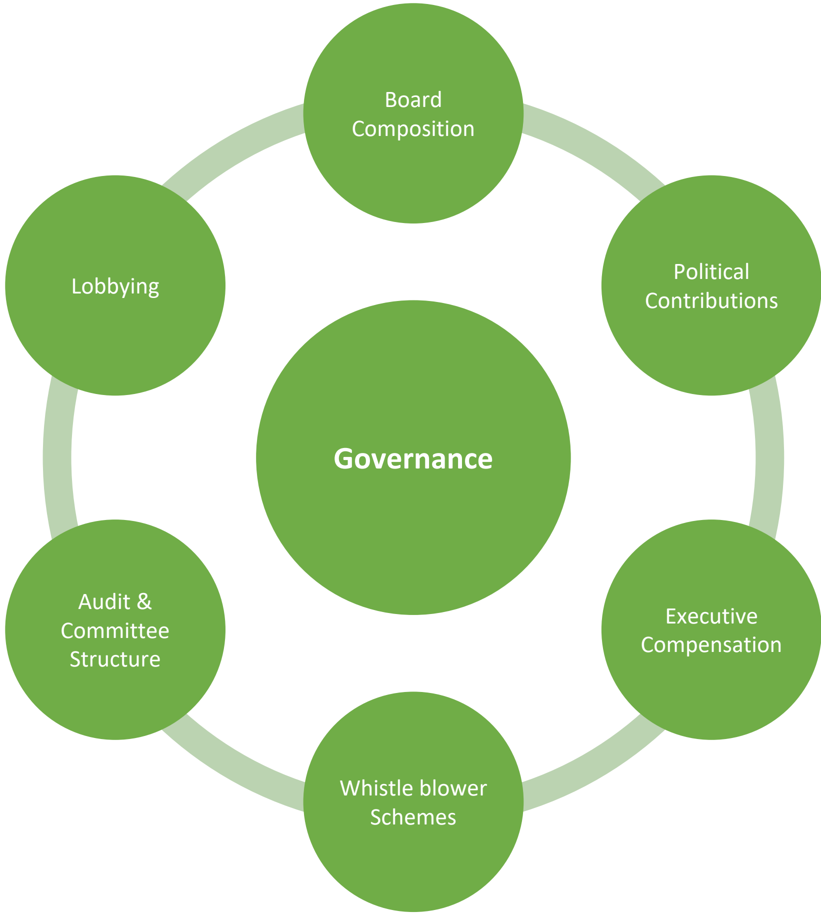
04

The evolution has now resulted in an integration of ESG into the investment process

The term **ESG** was only coined in **2005** in an exercise that culminated in the United Nations backed Principles for Responsible Investing (UNPRI), an organization that works to;

- understand the investment implications of environmental, social and governance (ESG) factors; and
- to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions.

Examples of ESG Factors



Awareness of ESG and Growth of Strategies

Awareness of responsible investing

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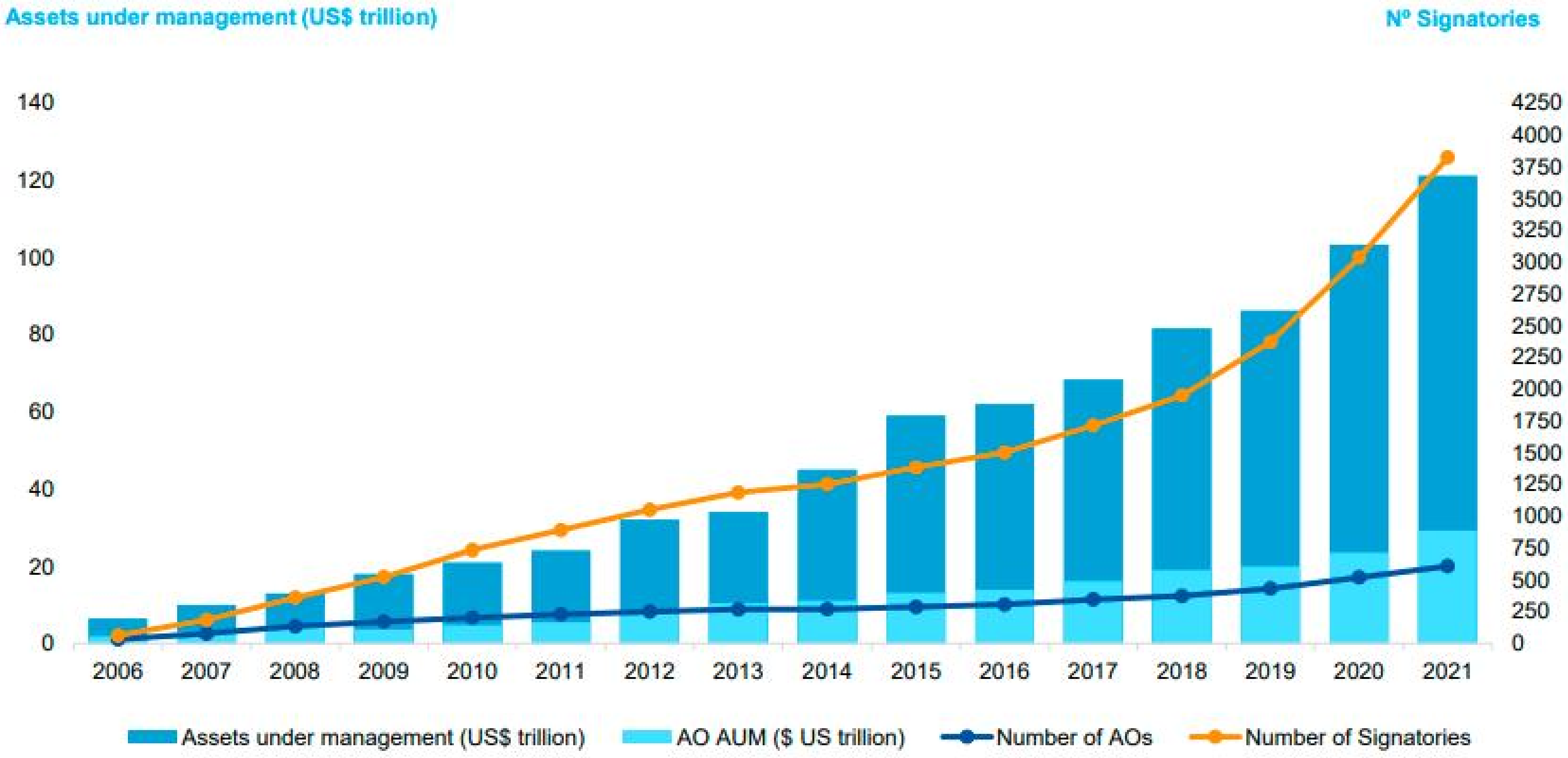
AUM, total number of signatories and number of asset owner signatories all increase



Source: UNPRI Signatory Update Oct – Dec 2021

Growth of Sustainable Investing Strategies

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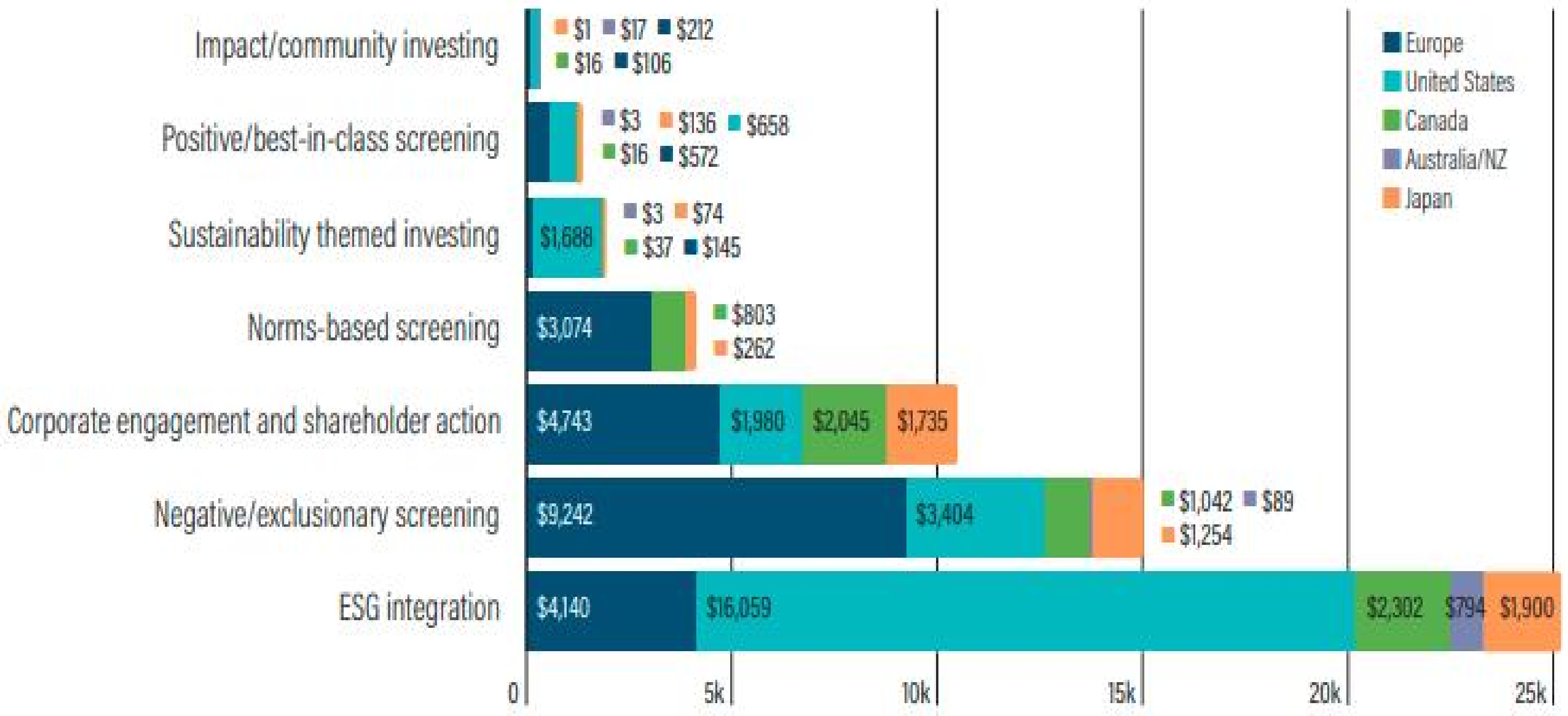
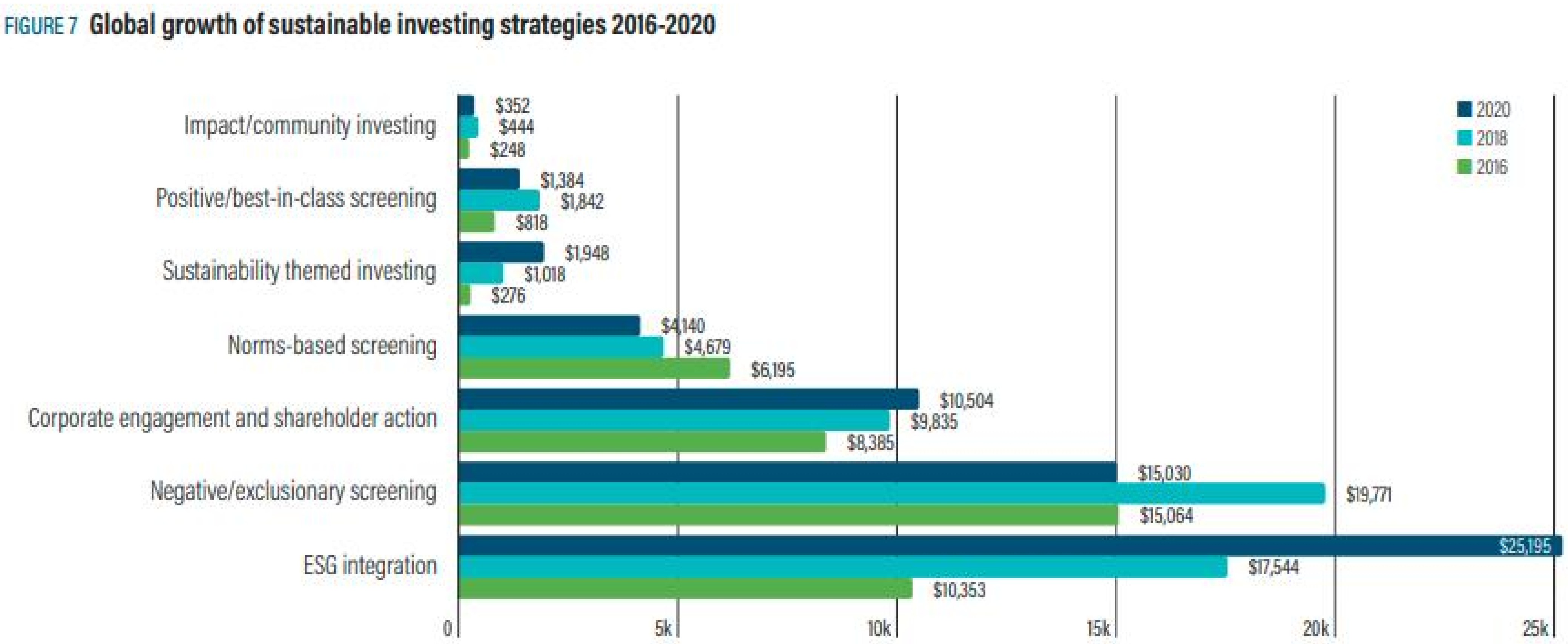
FIGURE 6 **Sustainable investing assets by strategy & region 2020**



Source: Global Sustainable Investment Alliance (GSIA)

Growth of Sustainable Investing Strategies



Source: Global Sustainable Investment Alliance (GSIA)

Organisations supporting ESG Investing

Organisations that support ESG Investing

ESG RATING AGENCIES

- S&P Global ESG Scores
- Moody's ESG Solutions Group
- Sustainalytics (a subsidiary of Morningstar)
- MSCI ESG Ratings
- Bloomberg ESG Disclosures Score
- FTSE Russell's ESG Ratings

POLICY AND BEST PRACTICE ORGANISATIONS

- United Nations
- Organisation for Economic Corporation and Development (OECD)
- Institute of Directors Southern Africa
- Regulatory Bodies

ORGANISATIONAL SUPPORT

- Global Sustainable Investment Alliance (GSIA)
- United Nations Principles of Responsible Investing (UNPRI)

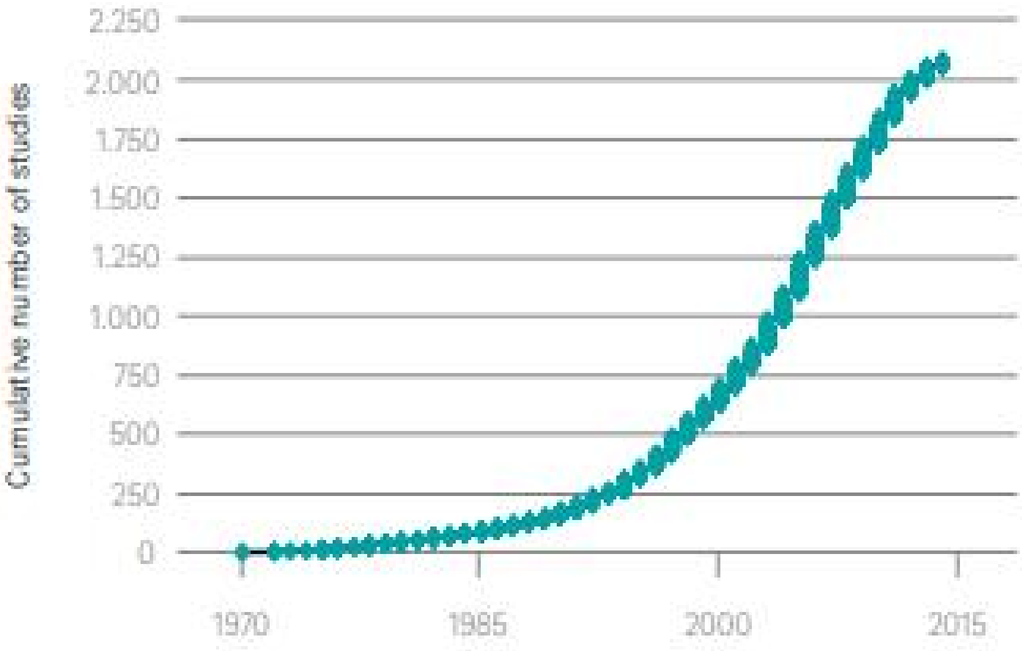
EDUCATIONAL SUPPORT

- CFA INSTITUTE
- Corporate Finance Institute
- Leading Universities

Financial Relevance of ESG Investing

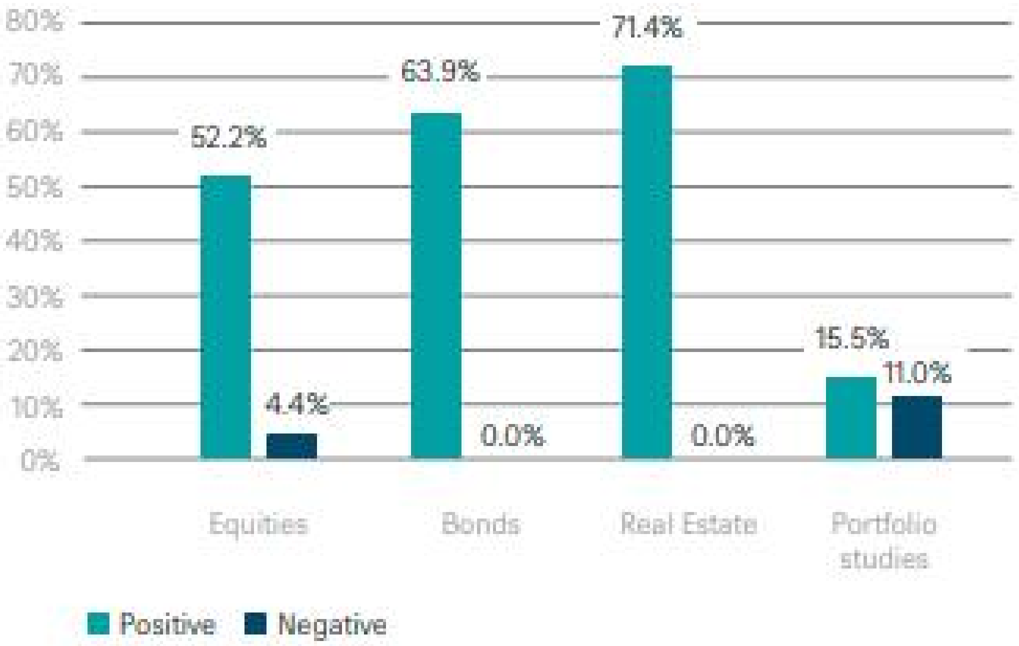
Financial relevance of ESG investing

FIGURE 1: THE NUMBER OF EMPIRICAL STUDIES TRACKING THE LINK BETWEEN ESG AND CFP OVER TIME (cumulative number of studies)



Source: Friede, Busch and Bassen (December 2015)

FIGURE 4: TRACKING THE LINK BETWEEN ESG & CFP ACROSS MAJOR ASSET CLASSES (vote-count sample)



Source: Friede, Busch, Bassen (December 2015)

Financial relevance of ESG investing

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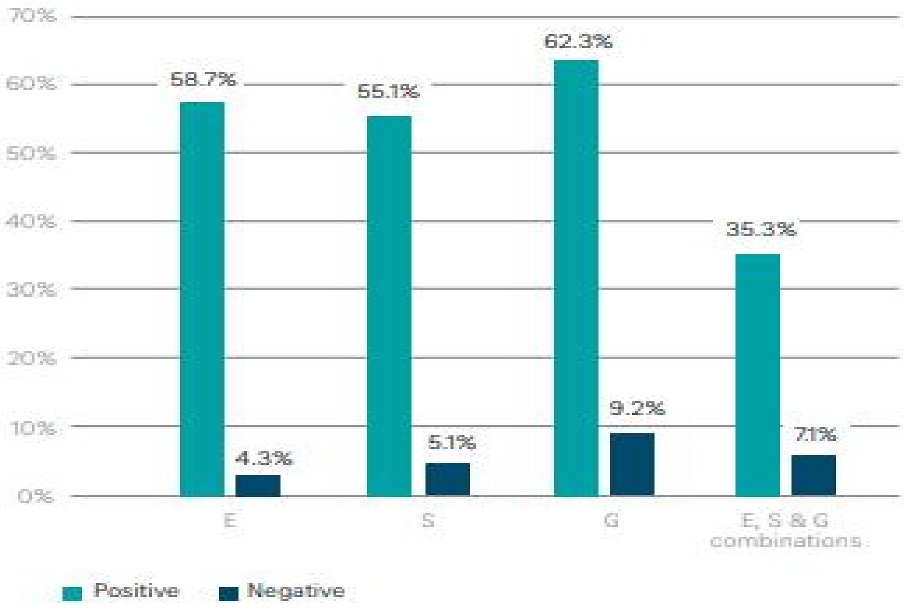
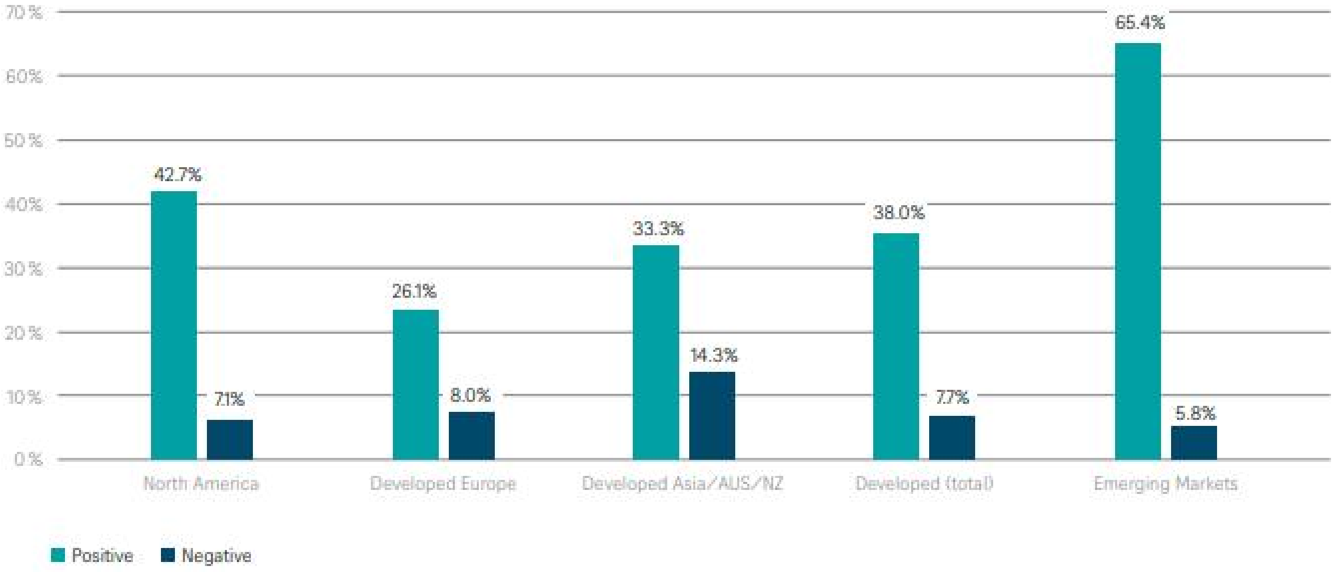
FIGURE 5: ENVIRONMENTAL, SOCIAL & GOVERNANCE CATEGORIES AND THEIR RELATIONSHIP TO CFP



Source: Friede, Busch, Bassen (December 2015)

FIGURE 7: TRACKING THE LINK BETWEEN ESG & CFP ACROSS VARIOUS REGIONS (vote-count sample)



Source: Friede, Busch, Bassen (December 2015)

Financial relevance of ESG investing

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- Historically it was thought that companies that had better ESG scores would perform poorly based on risk and return trends
- Better management of ESG factors can minimize costs, mitigate risks, or create revenue generating opportunities
- Examples of these include better work environments that result in higher productivity
- Companies with little to negligible ESG risks have been shown to outperform those with high or medium ESG risk
- Including ESG in investment process is in line with fiduciary duties.

Financial relevance of ESG investing

Incorporation and cost of ESG into investment strategies

Effective Incorporation of ESG factors into Investment Strategy

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BOTTOM UP

- **SWOT Analysis**
  - ✓ Subjective
  - ✓ No direct relation to valuation
- **Rating Scales**
  - ✓ Relatively more objectively applied to valuation
  - ✓ Over time improvements or deterioration can be observed
  - ✓ Enables a portfolio rating based on holdings
- **Portfolio weighting**
  - ✓ Strong ESG ratings can be reflected in higher weighting

ACTIVE OWNERSHIP

- **Policies**
  - ✓ Policies that support active ownership, Proxy voting policies
- **Management Engagement**
  - ✓ Management meetings focused on ESG matters
- **Exercising ownership rights**
  - ✓ to effect change
  - ✓ Proxy voting
  - ✓ Slow change due to ownership structure and little buy-in by managers

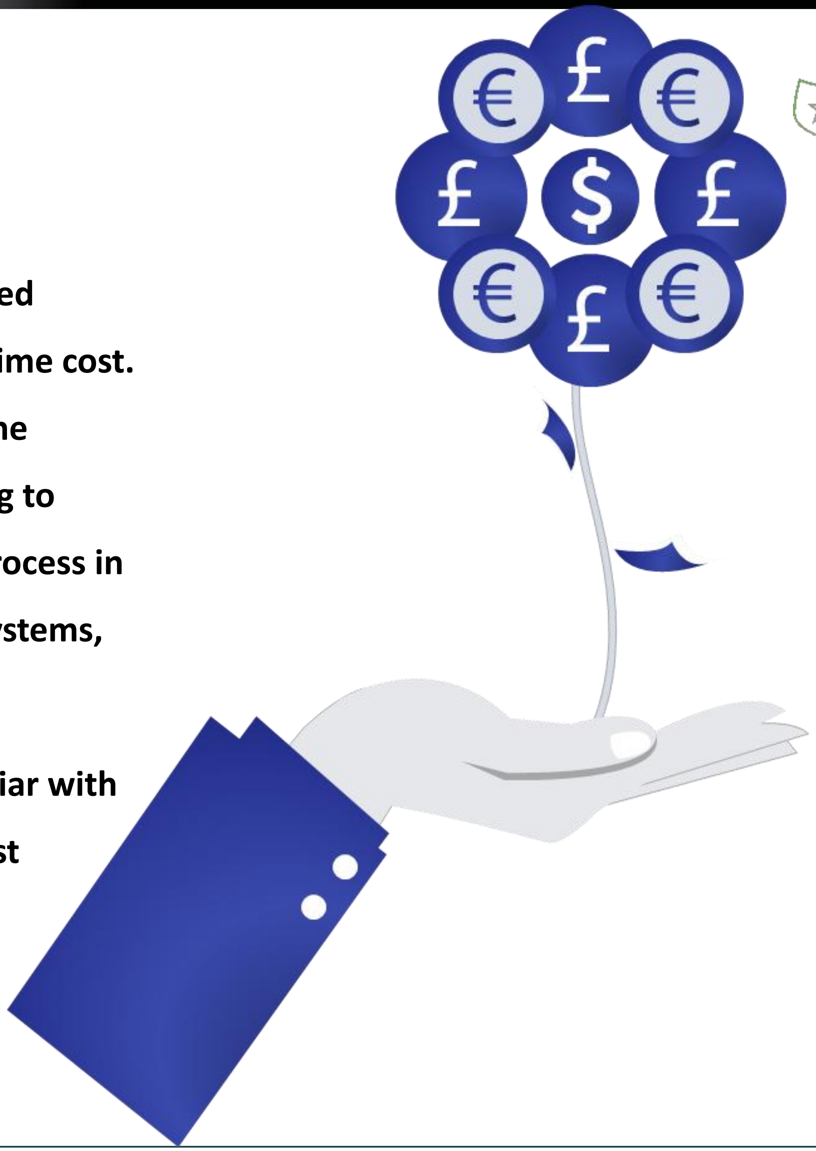
MONITORING

- **ESG Reporting**
  - ✓ Policies that support ESG investing
  - ✓ Proxy voting
  - ✓ Company engagements
  - ✓ Incorporation of ESG into investment decisions

Cons and Costs of ESG

With any process that requires enhanced reporting and engagement, there is a time cost. This can be particularly noticeable in the beginning when a manager is beginning to incorporate ESG into the investment process in a more objective way through rating systems, etc.

Over time, as one becomes more familiar with the issues in the company, the time cost reduces.



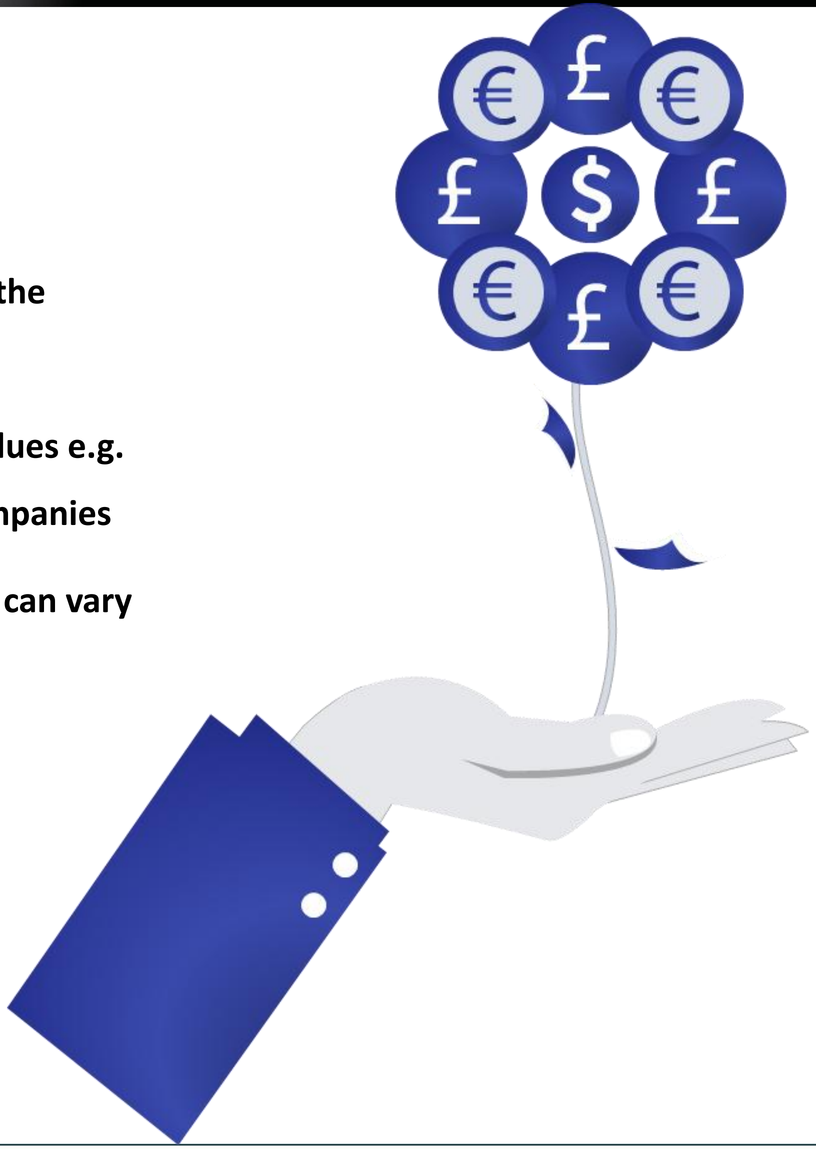
Indirect Costs

- There are indirect costs, relating to how stringent the manager is on applying ESG factors.
  - Depending on the investor universe, this could result in a concentrated, less diversified portfolio.

Cons and Costs of ESG

No Standardised approach because of the different schools of thought

- ESG fund may be misaligned with values e.g. an ESG fund may have fossil fuel companies
- Rating scores for the same company can vary across rating agencies
- A lot of details to consider



Financial cost

- subscribing to organisations that support the integration of ESG factors into the investment process. UNPRI is one such organization
- cost of systems that help track ESG matters and assist with reporting, e.g., Accuvio. The sort of system an organization should meet it specific needs.
- Because of demand, Companies with high ESG ratings can trade at higher multiples than peers.
- ESG funds often charge higher management fees.

Thank You

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