NATIXIS EXCHANGE EVENT SERIES STREAMSHOW – 14 October 2020

A Partnership with Barron's Group

ESG: From Feel Good Filter to Essential Strategy

Increased interest in ESG

Jean Raby
Chief Executive Officer
Natixis Investment Managers

Environmental, Social and Governance (ESG) issues have moved from being a shallow buzz phrase to a critical consideration for investors and asset managers alike. However, the art of incorporating reliable and consistent metrics on all the elements of ESG into portfolios continues to be a major issue facing managers. Panelists on Natixis Investment Managers' "ESG: From feel good filter to essential strategy" webinar, held on 14 October in conjunction with Barron's, agreed that the financial industry remains very much on a journey toward standardization and effective quantitative and qualitative measurements.

ESG was once considered a niche that was confined to continental Europe. To some, it was even a contradiction that inevitably led to lower returns, remarked Jean Raby, Chief Executive Officer at Natixis Investment Managers, during the webinar. The tone, however, has significantly changed over the past few years, with the notion of ESG becoming increasingly prevalent around the world. Indeed, 94% of Asian fund selectors say they spend more time now reading about ESG than three years ago.[1]

In a nod to Natixis' multi-affiliate model, Jean made the point that there does not necessarily have to be a standardized approach to ESG, noting that it is a complex issue that requires an individualistic, long-term approach. There are important aspects of ESG, however, that can be agreed on. He stated that "responsible management is about diversity, not divergence; engagement, not exclusion; impact and outcomes, not products; and ultimately, it's about outperforming the market."

"55% of Asia distributors are in the process of integrating ESG across all their portfolios.[2]"

The need for consistent, comparable disclosure

The Covid-19 pandemic has provided an opportune time to focus on the topic of sustainability and nurturing a green recovery to current economic fallout. Christine Kung, Senior Director, Head of International Affairs and Sustainable Finance at the Hong Kong Securities and Futures Commission, made the point that climate change is here to stay and is the most urgent and existential threat to humanity.

It is clear that businesses and the financial industry have an important stake in combatting this challenge. On a basic level, Christine noted, this requires disclosure and integration of climate at the company, bank and insurer, asset manager and product levels. The success of this rests on two important issues: first, the new types of disclosure standards available, and second, the new sets of green finance taxonomies.

1, 2 ESG Clarity Asia survey of 46 fund selectors conducted between 12/8/2020 and 28/8/2020.

However, given the lack of consistent and comparable disclosure standards, Christine pointed to the significant challenges that regulators face when incorporating decision-useful disclosures into regulatory frameworks. While useful, the proliferation of standards and frameworks on ESG has led to confusion. The large number of standards has also led to a rise in so-called "greenwashing," where there has been a misuse of incompatible scores or labeling to inflate a company or asset's green credentials.

The good news is that regulators are working together on what is essentially a borderless issue, with Christine making the case that no one regulator can address the threat of climate change alone. She highlighted the International Organization of Securities Commissions (OSCO'S) work on the issue of disclosures and its plans to release a report by the COP26 summit in 2021.

The challenges are not putting Asian investors off increasing their ESG allocations, though. A poll of webinar participants found that 68.4% expect to do so, with allocations coming from various asset classes and new inflows.

"94% of Asia fund selectors say they spend more time reading ESG than 3 years ago.[3]"

From "values driven" to "value driven"

Anne-Laurence Roucher
Deputy CEO, Head of Development and Operations
Mirova

However, concerns do remain. Julie Koo, Managing Director, Head of Citi Investment Management Sales Asia Pacific at Citi Private Bank, commented that while interest is growing exponentially, there is great appetite among investors for a better understanding of ESG and sustainability – making the point that a lack of understanding is often a key problem.

Anne-Laurence Roucher, Deputy CEO, Head of Development & Operations at Mirova, agreed, adding that investors also want to understand the "idea generating" process and where ESG sits in the investment process. She highlighted that investors also like to know whether managers look at general impact in terms of ESG or specific issues, and the difference that asset managers make with their focus on ESG.

The case for ESG, however, is not simply about being "values driven," but taking actual value into account. Arnaud Bisschop, Senior Portfolio Manager at Thematics Asset Management, said that when externalities, such as the cost of environment degradation, are factored in, P&L can look considerably less attractive. Furthermore, the Covid-19 pandemic has shown that such risks from nature can materialize quickly. There is no 20% probability that climate change will happen, Arnaud quipped; climate change is happening right now.

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3 ESG Clarity Asia survey of 46 fund selectors conducted between 12/8/2020 and 28/8/2020.

ESG "food labels"

With market regulations maturing in the ESG space, the industry is at a crossroads in how it can combine impact with performance. Likening this to consumers knowing they need to consume more healthy organic food, Anne-Laurence made the point that investors know they need to invest in ESG products, which will help integrate ESG more deeply into business models and strategies. Echoing Christine's earlier point, she took the food analogy further to explain that good labels require reliable, standardized data – but that the industry is currently not at that stage. Metrics such as a portfolio's carbon footprint can be quantified, but a fund's impact on biodiversity is harder to discern. Thus, a combination of quantitative and qualitative analysis will be needed as part of standardization.

Julie weighed in on the analogy, saying that like how more detailed labels make a consumer think about how a food fits with their particular diet goals, more detailed standards will make investors consider products against their own investment goals. This is important for having conversations with clients about how ESG fits into the investment process and framework, and how it aligns with their goals.

Being consistent is key, even as all the metrics continue to be developed, Arnaud added. He said that an active approach that focuses on comparing what companies are doing against general industry practice will not be perfect, but showing consistently that the factors have been weighed up is better than tracking an index and is likely to mitigate the impact of ESG issues.

Is ESG crowding out?

Arnaud Bisschop
Senior Portfolio Manager
Thematics AM

Given the explosion of interest in ESG, there are important questions around possible asset bubbles in the space. For Arnaud, this boils down to a question of whether there are opportunities in the real economy. Green infrastructure spending, countries like China putting carbon on the agenda and Covid-19 vaccine investment would suggest so, noting that in the short term there may be an inflation in multiples but that these opportunities should be pursued long term.

Anne-Laurence agreed ESG investments are a long-term commitment. On a risk-adjusted returns basis, she pointed out that 50% of ESG funds have a Morningstar rating of 4 or 5 stars, while only 37% of non-ESG counterparts can claim the same.[4] She also agreed that bubbles or high multiples may occur, but it is an active manager's responsibility to manage these risks.

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