

ESG and Personal Investment Advice

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Clarus Investment Solutions



Principals
Paul McCarville
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- Independent boutique investment consultancy – CBI regulated
 - Advice on strategic and tactical asset allocation
 - Research/due diligence on investment products
 - Portfolio design & selection of components
 - Due diligence and oversight on investment managers & product providers
 - Training & consultancy services for professional bodies and industry associations
 - Expert witness reports in investment mis-selling disputes

- Client base includes pension schemes, charities, corporates and retail intermediaries

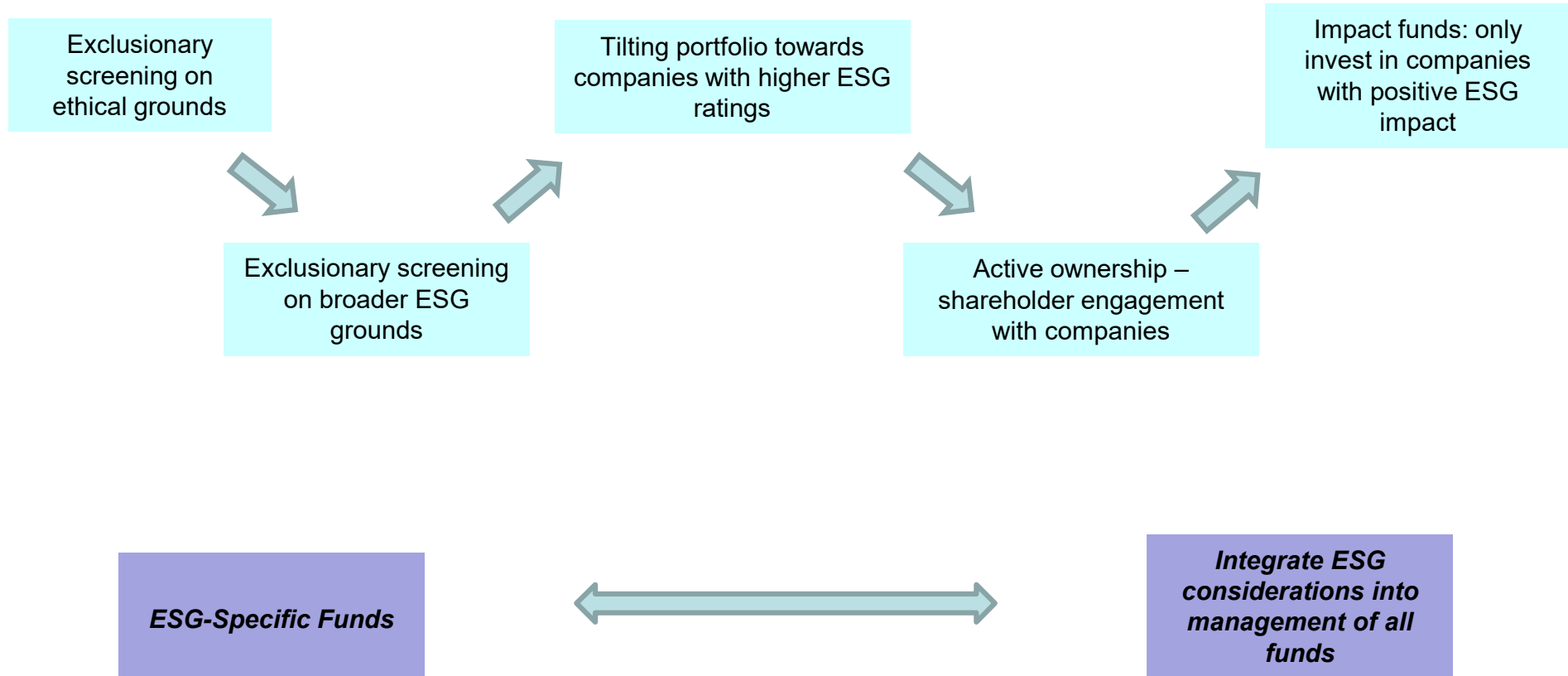
Topics

- Summary of regulatory developments
- The evolution of ESG investment approaches
- The key strands of client conversations
- Navigating the sustainable investment landscape
- Addressing the new suitability requirements
- Q & A

Some Key Regulatory Developments

Regulation/Directive	When?	Content?
Non-Financial Reporting Directive	Aug-17	Mandated Annual Report disclosures by large PLCs on ESG matters
Shareholder Rights Directive II	Mar-20	Mandatory shareholder engagement policies for institutional investors
EU Taxonomy Regulation	Jul-20	Framework for classification of economic activities with reference to their sustainability characteristics
IORP II	Apr-21	Wide-ranging provisions on organisation and governance of pension schemes, including mandatory policies and disclosures on ESG matters
SFDR – <i>Phase 1</i>	Mar-21	Mandatory disclosures on sustainability issues by asset managers and investment advisors
Changes to Suitability Assessment	Aug-22	Client's sustainability preferences to be incorporated into suitability assessment by investment advisor
SFDR – <i>Phase 2</i>	Jan-23	More detailed disclosures required from fund providers on basis for Article 8 / Article 9 classifications

The Evolution of ESG Investment Approaches



The Key Strands of Client Conversations

What does the client want from choosing ESG?

- *Enhance return?*
- *Reduce risk?*
- *Do good?*
- *Values and priorities?*

Will sustainable investments outperform?

Will sustainable investments be less risky?

Will choosing sustainable investments do good for the world?

Sustainable Investment = Higher Returns?

What is the experience up to now?

Abundant claims for outperformance of ESG funds – especially in the recent past – most coming from industry providers

Where does the truth lie?

“Honey I Shrunk the ESG Alpha”: Risk-Adjusting ESG Portfolio Returns – Bruno, Esakia & Goltz – Scientific Beta – Apr-21 :

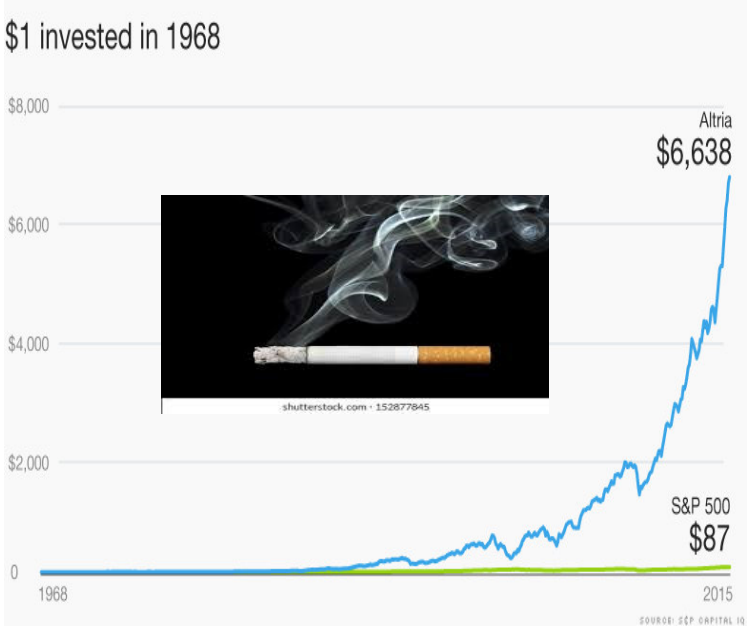
In this paper, we show that there is no solid evidence supporting recent claims that ESG strategies generate outperformance. We construct ESG strategies that have been shown to outperform in popular papers. We assess performance benefits to investors when accounting for sector and factor exposures, downside risk, and attention shifts.

=> Most of the apparent outperformance of ESG portfolios was a function of fortuitous coincidence with other favoured factors (growth, quality) and sectors (Technology, Healthcare etc), plus weight-of-money effects

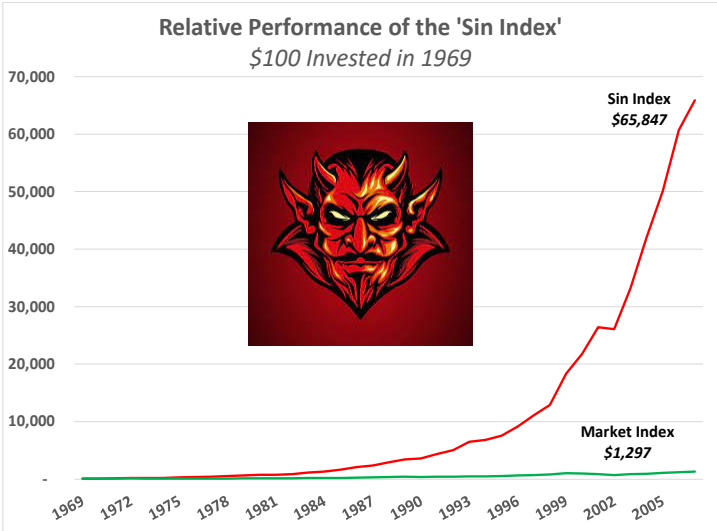
Sustainable Investment = Higher Returns?

The longer-term historical experience

Little evidence that the returns from 'dirty' sectors are hurt by investor unpopularity



Source: money.CNN.com



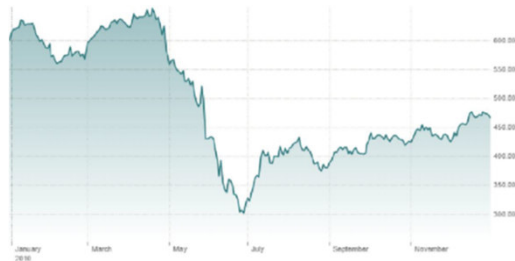
"Sin Stock Returns" – Fabozzi & Oliphant – Journal of Portfolio Management – Fall 2008

Sustainable Investment = Lower Risk?

Much evidence to suggest that sustainable investment reduces portfolio tail risk.....

Example 1

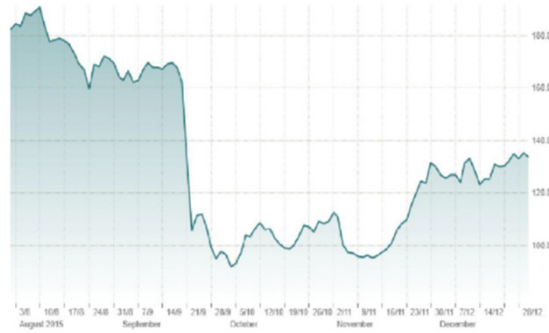
BP / Deepwater Horizon 2010



11 people killed
Share price down 54%
Total cost to BP \$65bn

Example 2

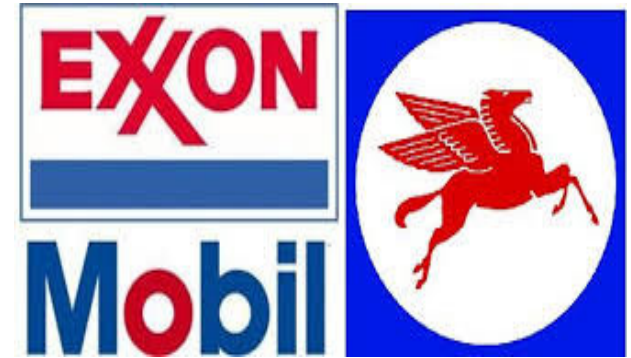
Volkswagen / Dieselgate 2015



Share price down 52%
Total cost to VW \$34bn

Example 3

Exxon Mobil / Stranded Assets



	\$bn	%
Oil & Gas Reserves & Related Equipment	182	55
Other Assets	151	45
Total Assets	333	100
Price/Book Value	1.95x	

Sustainable Investment = Lower Risk?

....But be aware of concentration risk and valuation risk in some ESG products

Example iShares Clean Energy ETF (INRG)



Source: iShares.co.uk

Doing Good with Sustainable Investment?

A tale of two companies

		Microsoft	ArcelorMittal
CO2 Emissions - Current	<i>tonnes x m</i>	12	179
CO2 Emissions - 2030 Target	<i>tonnes x m</i>	0	134
		-----	-----
Implied CO2 Reduction	<i>tonnes x m</i>	12	45
Weight in MCSI World		3.57%	0.04%
Weight in MCSI World ESG Enhanced		4.00%	0.01%
=> Relative Weight in ESG Index		1.12x	0.26x

Which company will make the greater contribution to decarbonising the world?

Is that reflected in the ESG Enhanced index?

Navigating the Landscape of ESG Fund Choices

- Active or passive approach?
- For an active fund, how much visibility on its process?
- Exclusion vs. engagement
- What sectors are subject to outright exclusion?
- What is the materiality threshold for exclusion?
- What rating system is applied?
- What is the degree of 'ESG skew' applied to the portfolio, and what does it imply for valuation and diversification metrics?

Understanding Rating Systems

Assessment of many factors across three domains => Complexity!

MSCI ESG Score									
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	Community Relations	Access to Finance	Pay	Tax Transparency
Financing Environmental Impact	Raw Material Sourcing	Electronic Waste	Renewable Energy	Human Capital Development	Consumer Financial Protection		Access to Health Care	Ownership	
Climate Change Vulnerability				Supply Chain Labor Standards	Privacy & Data Security		Opportunities in Nutrition & Health	Accounting	

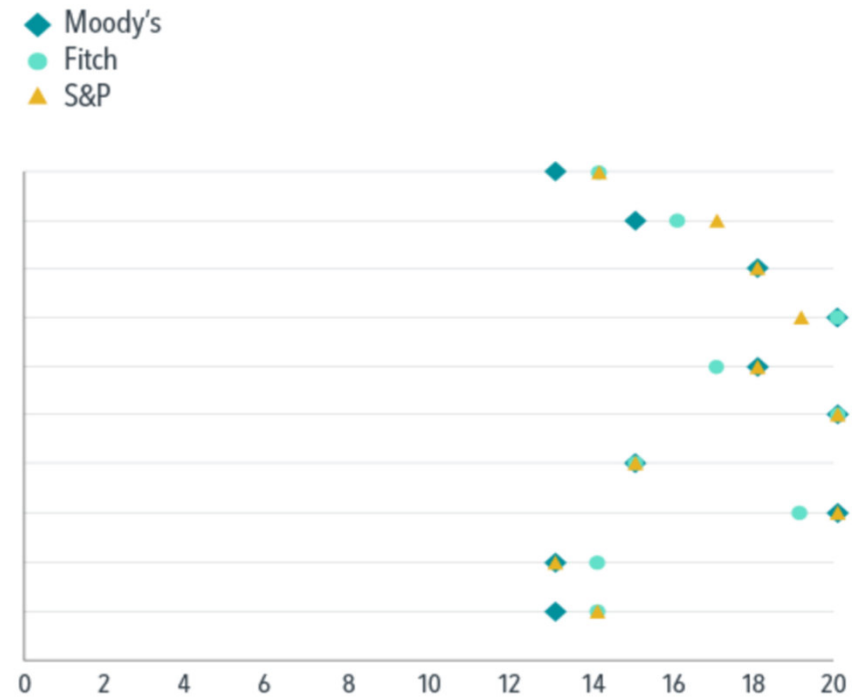
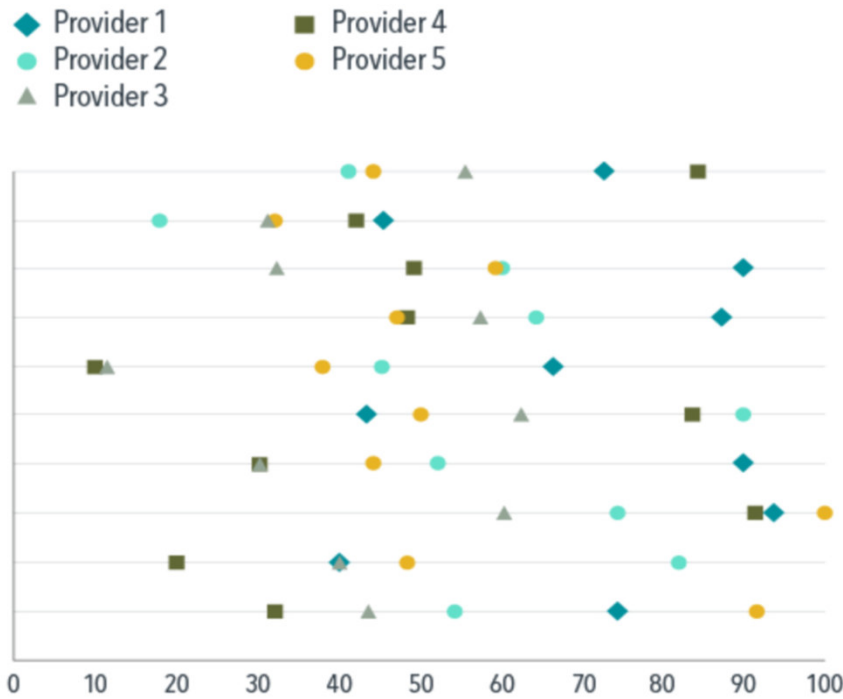
Source: MSCI.com

Understanding Rating Systems

Complexity + Subjectivity + Measurement Challenges = Inconsistency

ESG Rating

Issuer Credit Rating



Source: Dimensional Fund Advisors

Development of Unit-Linked ESG Offerings

- No. of unit-linked funds with Article 8 / Article 9 status is growing rapidly – currently 11% of the universe
- Reasonable choice across spectrum of risk levels
- Quality of easily accessed back-up information: very good to non-existent

	Lifeco #1	Lifeco #2	Lifeco #3	Lifeco #4	Lifeco #5	Total	
						Number	%
Number of Funds	72	84	161	50	52	419	100%
<i>of which:</i>							
Article 8	8	17	10	2	3	40	10%
Article 9	0	2	0	2	0	4	1%
<i>Breakdown of Sustainable Funds:</i>							
Equity	4	5	9	2	1	21	48%
Fixed Income	1	0	0	1	2	4	9%
Multi-Asset	3	14	1	1	0	19	43%

Incorporation of Sustainability Preferences to Suitability Assessment

D-Day: 2nd August 2022

What does “sustainability preferences” mean?

How much does the client wish to invest in instruments which:

- Have a minimum proportion invested in environmentally sustainable investments as defined under the EU Taxonomy

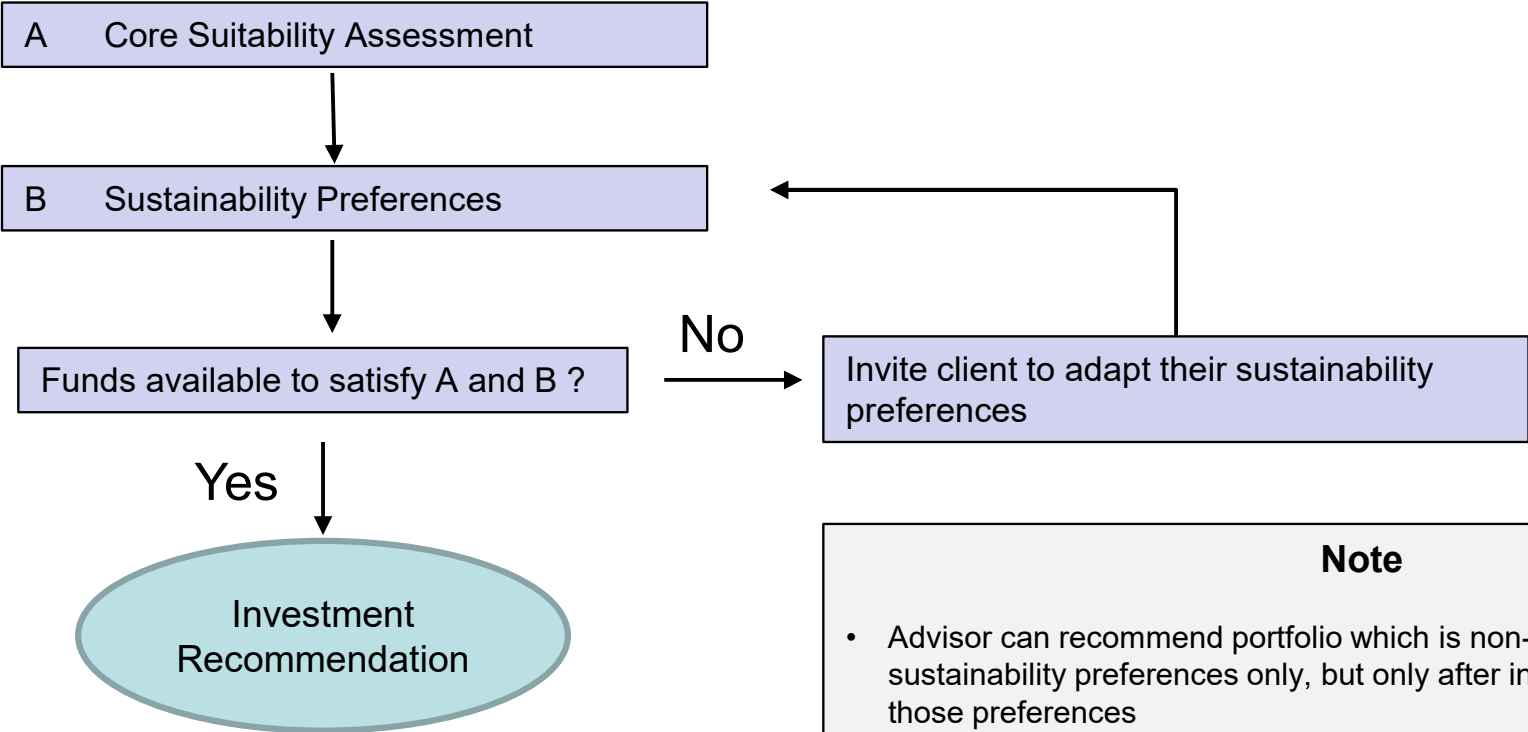
and/or

- Have a minimum proportion invested in sustainable investments as defined under SFDR (i.e. Article 8 / Article 9 products)

and/or

- Consider principal adverse impacts in sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client

The Suitability Assessment Process



Note

- Advisor can recommend portfolio which is non-suitable with respect to sustainability preferences only, but only after inviting client to adapt those preferences
- Adaptation of preferences must be documented by the advisor
- Any such adaptation is valid only for the current transaction

Putting it into Practice

- ESMA Guidelines being drafted – due for release Q3 2022
- Consultation with industry bodies and other regulators under way

Some General Thoughts

- Have a clear and simple explanation of ‘sustainable investment’ ready for the client
- Avoid ‘framing’ the client’s choice
- Discourage false expectations!
- Align questions to the client with the menu available
- Be familiar with the fund choices

General Disclosures

- *Clarus Investment Solutions is authorised by the Central Bank of Ireland under the Investment Intermediaries Act, 1995*
- *The value of your investment may go down as well as up*

SUPPLEMENTARY MATERIAL

EU Taxonomy

- A classification system which defines six overarching environmental objectives and sets out a detailed list of economic activities which can contribute to at least one of the objectives, without doing significant harm to any of the others.
- For each activity, it sets performance hurdles for defining what constitutes a positive contribution.



Sustainable Finance Disclosure Regulations

Article 6 – All Funds

All managed products

Article 8 – General ESG

Funds that promote environmental or social characteristics

Article 9 – Sustainable

Funds that have a sustainable investment objective

Level of detail in disclosure



Source: Morningstar Direct, Morningstar Research. Data as of December 2020.

IORP II - Provisions on ESG Issues

- All pension schemes to conduct a Risk Assessment of their activities
- Trustees encouraged but not obliged to take account of ESG factors in the risk assessment and in formulating investment policy
- Trustees must disclose whether and how ESG factors are taken into account
- Information on the above to be made available to all prospective members before they join

Risk Management – Why ‘S’ and ‘G’ Matter

Sports Direct's Mike Ashley apologises for poor Covid-19 actions

Mark Sweney and Simon Goodley

Fri 27 Mar 2020 08.23 GMT

Sports Direct workers say they're being forced to work despite being on furlough



Sports Direct Shares Plunge – Here Is Everything You Need To Know

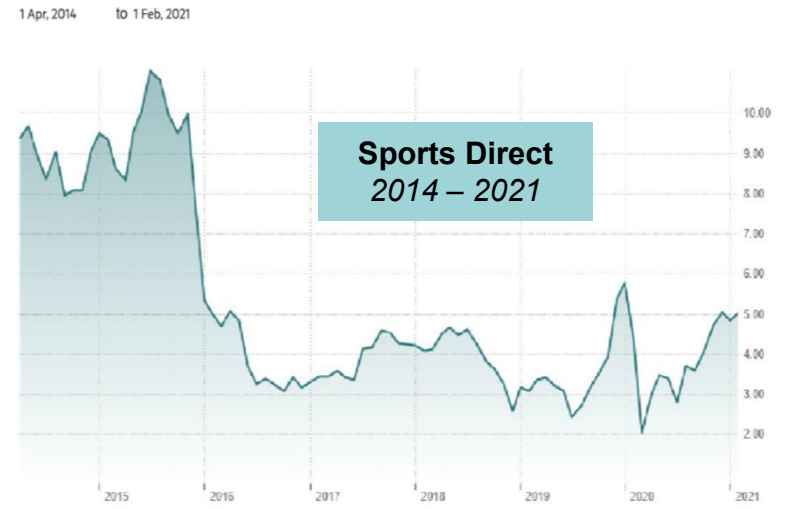
The embattled company was called “an embarrassment to UK corporate governance” after the chaotic way it announced its results on Friday.

Mike Ashley admits Sports Direct staff effectively paid below minimum wage

Question raised over Mike Ashley's brother's company used for Sports Direct deliveries
 Posted 10th June
 By Ben Stevens – August 23, 2016

Sports Direct staff 'not treated as humans', says MPs' report

© 22 July 2016



UN Framework

UNSDG UN Sustainable Development Goals



UNPRI UN Principles for Responsible Investment

- 1 We will incorporate ESG issues into investment analysis and decision-making processes.
- 2 We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4 We will promote acceptance and implementation of the Principles within the investment industry.
- 5 We will work together to enhance our effectiveness in implementing the Principles.
- 6 We will each report on our activities and progress towards implementing the Principles.