



BSR Conference 2009

Reset Economy. Reset World.

Environmental, Social, and Governance-Based Investment Trends

Breakout Session Summary

Thursday, October 22, 2009 | 9:45-10:45 a.m.

Speakers

- » **Chris McKnett**, Principal, ESG Investing, State Street Global Advisors
- » **Laura Commike Gitman**, Director, Advisory Services, BSR (moderator)

Highlights

- » A new generation of environmental, social, and governance (ESG) investors are increasingly focused on the opportunity for ESG factors to support higher returns, rather than on values-based investment criteria such as negative screens.
- » Environmental factors, in particular, are becoming much more material financial risks and opportunities for companies and investors.
- » Consolidation among independent ESG research providers will encourage greater standardization and relieve some pressure to respond to multiple surveys, but it may come at the expense of diversity in resources and opinions.

Memorable Quotes

“ESG is definitely going mainstream, but it is not fully mainstream yet.”—Laura Commike Gitman, BSR

“ESG investing has evolved from owners and values-driven to managers and financial-driven.”—Chris McKnett, State Street Global Advisors

“With the increase in data availability and client demand, I do think we’ll see more mainstream asset managers considering ESG in their valuation models.”—Chris McKnett, State Street Global Advisors

Overview

Gitman introduced the session by highlighting some of the key findings of BSR’s recent report [“ESG in the Mainstream: The Role for Companies and Investors in Environmental, Social, and Governance Integration.”](#) She pointed out that ESG factors are not mainstream investment criteria at this point, but they are becoming more so, and this trend is expected to continue. She also noted that company investor relations (IR) functions and investment analysts are each waiting for the other to begin discussing ESG factors.

She then introduced McKnett, who began the conversation by providing an overview of how ESG has evolved in both scope (moving into multiple asset classes such as private equity, venture capital, fixed income, and others) and sophistication (moving beyond negative screening, from client-based values drivers to a greater focus on returns). He noted how the application of ESG criteria is moving beyond developed markets and into emerging markets as well, which he finds very encouraging because emerging markets have key ESG-related risks. He also called out new entrants along the investment management value chain, from asset owners such as foundations and corporate plans, to asset managers, research providers, media, and others. Bloomberg, for



example, has started including ESG information on their terminals, so it is now readily accessible to tens of thousands of professional investors.

He continued by discussing a new generation of ESG involvement in asset management that focuses on using ESG to uncover opportunities for greater returns. When asked what is driving this new approach, McKnett stated that it is “an opportunity for investors and asset managers to refresh and reset their thinking.” He noted that over 60 percent of a company’s market value is typically based on intangibles rather than on the company’s book value, and ESG factors are a way to illuminate a part of this value. In addition, fiduciaries are increasingly considering ESG information in their financial decision making. This is particularly true in the case of climate change and its impact on company value.

Finally, McKnett noted that prior studies suggested that there are no performance sacrifices in traditional ESG investing, but the studies also showed that it doesn’t necessarily add value either.

Just five years ago, ESG was not on the radar of typical institutional investors, but external factors like climate change have been driving increased interest. This trend is not purely risk-based, as considering ESG criteria can also generate opportunities, for example, in mitigating climate change impacts and other environmental risks. ESG investment opportunities are also growing in areas such as derivative instruments linked to carbon.

McKnett next discussed how the lines between financial and ESG reporting are becoming increasingly blurred. The new administration and Securities and Exchange Commission (SEC) leadership are likely to push this issue even further. Petitions are even being sent to the SEC requesting that it require corporate climate change disclosure to be included in financial statements. Some markets outside of the United States have already required reporting on ESG issues. These types of formal disclosure rules will embolden shareholder activists, further driving already growing shareholder resolutions on climate and other issues.

McKnett next explained more about State Street Global Advisers (SSGA). He described SSGA as “the most mainstream of mainstream investors.” Until about five years ago, SSGA was client-driven in the ESG arena. They have since become more proactive, and in 2008, initiated a large study covering a variety of markets on the relationship between ESG issues and share price. The study found that there appears to be no excess returns from ESG factors in general, but the relationships between ESG factors and share price are strengthening over time and becoming more predictive.

For more information on this topic, read SSGA’s article “[A Comprehensive Analysis of the Relationship between ESG and Investment Returns.](#)”

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