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An In Depth Look at the Nuanced Practices of ESG Investing

Nicsa presents a Rosetta Stone for Learning to Speak ESG.

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"Like Learning a New Language..." Nicsa Presents a Rosetta Stone for Learning to Speak ESG

The number of institutions and individuals considering ESG factors when making investment decisions is on the rise. Nicsa recently held a series of events focused on ESG Essentials for Asset Managers & Advisors focused on the sustainable, responsible and impact-investing landscape and the tools asset managers and advisors are using to approach this rapidly evolving investment theme.

Nicsa's NYC-based event was led by moderator Hannah Glover, Managing Editor with **Ignites**, and featured:

- John Farley, Vice President – Responsible Investment Strategy, **Calvert Research & Management;**
- Mark Hays, Vice President – Sustainable Investing, **J.P. Morgan Asset Management;**
- Mark McDivitt, Managing Director, Global Head of ESG, **State Street**;
- Todd Scorzafava, Partner in Charge of Wealth Management, **Eagle Rock**

The following summaries seek to provide Nicsa members an understanding of the nuanced practices of ESG investing.

Learning to Speak ESG

According to Mark McDivitt, "Understanding ESG is like learning a new language; a narrative derived from the evolution of disclosure seeking greater transparency into the health of a company by quantifying non-traditional financial factors. It's a discipline that has gained material traction globally over the past 18 months and is rapidly becoming an essential tool being incorporated into standard risk management practices."

"Approximately 80% of balance sheets today are comprised of intangible assets such as Intellectual Property," he added. "ESG factors are used to help better measure these 21st Century assets where investors are increasingly looking beyond standard P&L statements and digging deeper into a corporation's governance practices, employee and client engagement as well as approaches towards environmental sustainability. To be clear, these are factors utilized to quantify the Value of a company, NOT to be misconstrued as an effort to highlight the Values of a company."

The panelists also all agreed that we are now well past the days of ESG being a niche approach, but pointed to ongoing needs for consistency in scoring and data, since one provider's ESG "winner" can score poorly based on another's metrics. Those inconsistencies point to an even larger issue when it comes to how many in finance and investing think about ESG.

"Socially responsible investing (SRI) often gets conflated with ESG, and SRI is closely associated with the idea of negative screening, i.e. an approach that takes out what the investor doesn't like or doesn't agree with," said John Farley of Calvert. "But in ESG, it's not about negative screening; it's about finding the factors that will impact companies and their performance and thinking of ways to act on that information, which can include engaging with management to help spur important changes that won't just make a company more ESG-friendly but which can have a tangible, positive impact on performance."

The panel agreed that there is no "perfect company" from an ESG perspective, so the question then becomes do investors divest from companies that score low or do you engage with those companies and try to help them improve?

According to the panelists, engagement would seem to offer the better approach to building long-term opportunity.

The Institutional View of ESG

Rosetta Stone secured, the audience was then treated to discussion on where the ESG space is headed, particularly with regard to the institutional community.

When it comes to ESG: "Investors want consistency in scoring and data," said Todd Scorzafava, Partner in Charge of Wealth Management, Eagle Rock. "The marketplace understands that ESG is not a niche and that this is a conversation they should all be having, but that lack of consistency comes up as an issue again and again."

Mark Hays, Vice President – Sustainable Investing with J.P. Morgan Asset Management, agreed, and added, "Institutional investors are focused first and foremost on hitting their financial goals. They're clearly thinking about ESG, but they're thinking about it through the lens of how it can help them meet the needs of their constituents and achieve their long-term financial objectives."

But beyond merely thinking about ESG, how are institutions actually implementing ESG-focused approaches?

According to Hays, when it comes to implementation, at least in the institutional community, the preferred method is often bespoke rather than "off the shelf." "There is still a lot of skepticism around ESG 'products' in the institutional community," he added.

Hays continued, "One size fits all doesn't always work for this universe of investors – you need to be able as an Asset Manager to design solutions that are tailored to specific needs.

John Farley, Vice President – Responsible Investment Strategy, Calvert Research & Management, added, "There is a tremendous need for education right now. You have some of the endowments and foundations who are really far along in their ESG journey; you have others who might be starting to carve out some allocations, perhaps as an experiment. For institutional investors, adopting ESG is a very complicated issue. You have to define what your goals are, you have to define the performance metrics, you have to make sure all the stakeholders are on the same page, work on internal communications."

That internal communications focus was one that other panelists echoed.

"You have to move away from just talking with an audience that's already involved in ESG efforts," said Hays.

The Intersection of ESG, Big Data, and Artifical Intelligence

Another main topic of conversation among the panelists: the role that big data and artificial intelligence (AI) are playing in the ESG investing process and the role they may play in the future.

To begin with, the panel pointed to the fact that the rise in required disclosures has meant there is now more data available than ever to investors as they consider the landscape. But raw data alone is not useful. One must have the right tools for parsing and best understanding of just what all of this data means, and that's where new technologies are already starting to have a significant impact when it comes to ESG-focused investing.

"Technology and disclosures are making ESG data sources much easier to find," said Mark Hays, Vice President – Sustainable Investing, J.P. Morgan Asset Management. "And artificial intelligence can scrape all that data better than humans ever could on their own."

Mark McDivitt, Managing Director, Global Head of ESG with State Street agreed and pointed back to his earlier comments about how approximately 80% of current balance sheets are non-traditional intangible assets. "As disclosure and reporting has evolved, doing a deeper dive is essential, and that is where emerging technology can play a major role," he added.

The panel also discussed the ways in which AI can allow investors to look beyond traditional data and information sources. Numerous AI approaches can mine data from sources as disparate as cargo ship emissions, power consumption, and consumer sentiment towards a company's governance via the scraping and analysis of news headlines and social media discussions.

"It's important to consider nontraditional or other untrafficked data sources," added Hays. "AI allows investors to open entirely new doors to better understanding their investments and potential investments.

Investment research in general is going through a technology-driven sea change, and that may be all the more true in the ESG arena, as AI-driven approaches allow investors to understand not just what has been said or written about a particular company, but why, how, when, where and with far greater depth of understanding and corresponding data than has ever been available before. How all of this will continue to impact the ESG space in years to come remains to be seen, but the panel agreed that the pace of technological advancement will only accelerate.