

Investing in the ESG era

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Agenda

1. perspective on ESG factors

- Origins, evolution and definitions

2. who is behind the rise of ESG factors and why?

- Principles of responsible investment/finance
- Concept of stakeholders
- Concerns about climate change
- Regulatory trends

3. implementation of ESG factors

- ESG Indexes - constituent elements
- Comparisons - examples of leading companies

ESG Perspective

Origin, evolution and definitions

A controversial subject...!

Leaders | Sustainable investing
**ESG should be boiled down to one simple measure:
emissions**
Three letters that won't save the planet



ESG - A trend driven by investors

In 2018, I wrote to urge each company to articulate its purpose and how it contributes to all of its stakeholders, including shareholders, employees, customers, and the communities in which it operates. During 2020, we saw how determined companies with better environmental, social and governance (ESG) profiles outperformed their peers. In 2020, 81% of a selection of globally representative sustainable indices outperformed their benchmarks. This outperformance was even more pronounced during the first quarter downturn, another example of the resilience of sustainable funds that we have seen in previous downturns. And a broader range of sustainable investment options will continue to drive investor interest in these funds, as we saw in 2020.

From the 2020 Client Letter from Larry Fink, CEO, BlackRock Inc. <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

ESG: Definition

ESG (Environmental, Social and Governance): type of investment also known as *sustainable investment*. Generic name for investments that seek a positive return and a long-term impact on society, the environment and the organization's performance. Depending on the context, it may also be referred to as:

- Impact investing;
- Responsible investing;
- ESG;
- Investing based on values.

Another school of thought argues that ESG investing is dependent on responsible investing. Responsible investing includes ethical investing, ESG investing and impact investing.

The *Financial Times Lexicon* defines ESG as: "a generic term used in capital markets and used by investors to evaluate corporate behavior and to determine the future financial performance of companies."

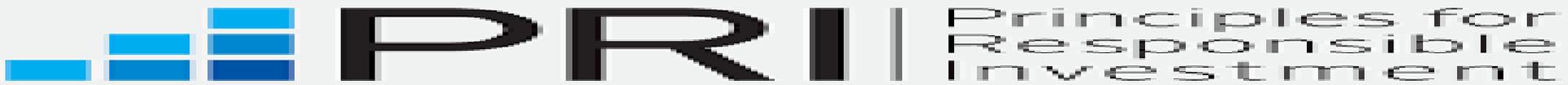
Underlying ESG Foundations

Environmental	Social	Governance
Energy used by an organization (energy efficiency)	Labour Relations/Working Conditions	Composition and diversity of the board
Waste management (air, water and soil protection)	Equity, diversity, inclusion	Structure of the Audit Committee
Resource depletion (deforestation, biodiversity, water shortage)	Human rights	Ethics (bribery, corruption, fraud)
Greenhouse gas emissions	Customer satisfaction	Management compensation
Climate change	Protection of personal information	Lobbying
	Employee engagement	Shareholder rights
<i><u>Consequences</u> for living beings of the organization's activities.</i>	<i><u>Relationships</u>, and the resulting reputation, with the people and institutions in the communities where the organization operates.</i>	<i><u>Internal practices, controls, and procedures</u> to govern the organization, make effective decisions, comply with laws and regulations, and meet the needs of stakeholders.</i>

Who is behind the rise of ESG factors factors and why?

Forces at work

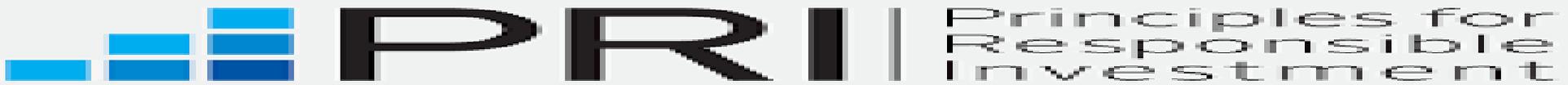
- Investors (mainly institutional)
- NGO (United Nations)
- Companies with capital needs



MISSION OF THE PRI

We believe that long-term value creation requires a sustainable and economically efficient global financial system. This system must reward responsible long-term investment and benefit the environment and society as a whole.

The PRI works to achieve this sustainable financial system by encouraging adoption of the Principles and collaboration on their implementation. The PRI promotes good governance, integrity and investor accountability, and works to address barriers to a sustainable financial system, whether they are in market practices, structures or regulations.



ACTION PLAN

RESPONSIBLE INVESTORS

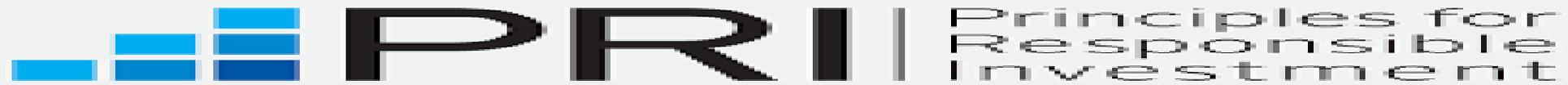
- Empowering investors
- Supporting investors in incorporating ESG issues
- Promote an active investor community (voting and engagement)
- Valuing leaders and increasing investor accountability
- Bringing together and educating responsible investors

SUSTAINABLE MARKETS

- Overcoming barriers to a sustainable financial system
- Promote the flow of relevant data in the markets

A BETTER WORLD FOR ALL

- Supporting the fight against climate change
- Promoting real-world results aligned with the SDGs

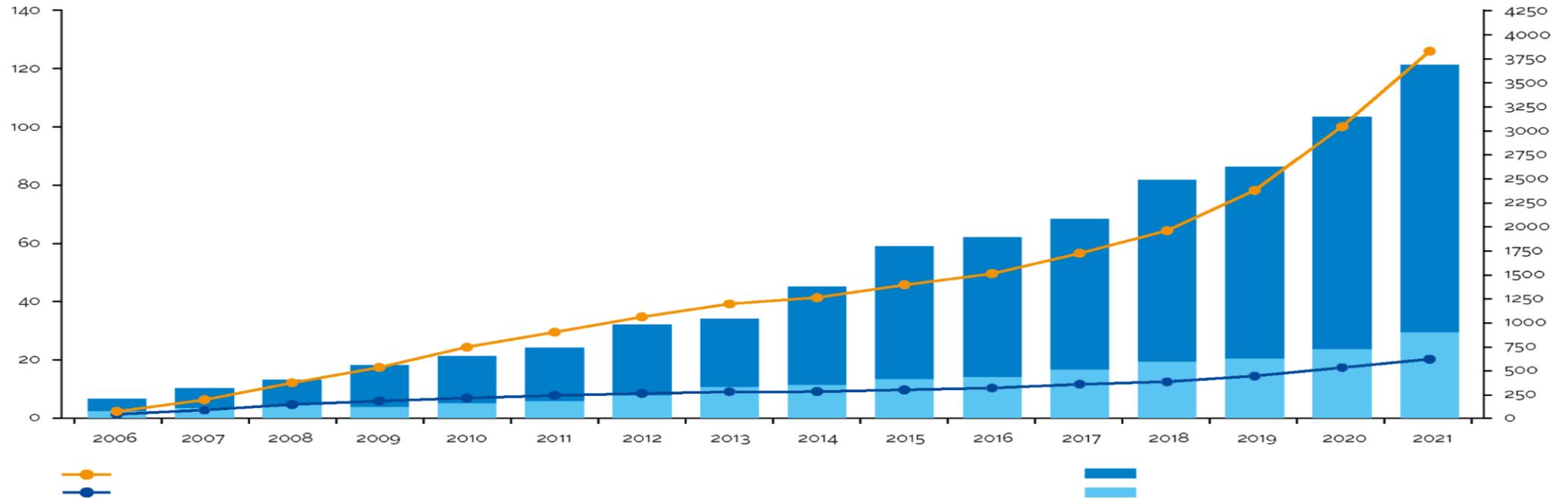


Principles

1. We will consider ESG issues in the analysis and investment decision processes.
2. We will be active investors and take ESG issues into account in our investor policies and practices.
3. We will require the entities in which we invest to disclose appropriate information on ESG issues.
4. We will promote the acceptance and application of the Principles among the asset management community.
5. We will work together to increase our effectiveness in implementing the Principles.
6. We will report individually on our activities and progress in implementing the Principles.

Growth in assets under management by PRI signatories

(US\$ thousands of billions and number of signatories;
total and institutional investors)





SUSTAINABLE DEVELOPMENT GOALS

1 NO POVERTY 	2 ZERO HUNGER
3 GOOD HEALTH AND WELL-BEING 	4 QUALITY EDUCATION
5 GENDER EQUALITY 	6 CLEAN WATER AND SANITATION
7 AFFORDABLE AND CLEAN ENERGY 	8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 	10 REDUCED INEQUALITIES
11 SUSTAINABLE CITIES AND COMMUNITIES 	12 RESPONSIBLE CONSUMPTION AND PRODUCTION
13 CLIMATE ACTION 	14 LIFE BELOW WATER
15 LIFE ON LAND 	16 PEACE, JUSTICE AND STRONG INSTITUTIONS
17 PARTNERSHIPS FOR THE GOALS 	



There is a trend for organizations to align their sustainability strategy with the UN goals, focusing on the most relevant goals and setting ambitions for one or a few.

<https://www.un.org/sustainabledevelopment/fr/objectifs-de-developpement-durable/>

Stakeholders:

A key foundation of the ESG approach

"any group or individual who can affect or is affected by the achievement of the organization's goals" (p. 46).

(Edward Freeman. 1984. Strategic Management: A Stakeholder Approach. Cambridge University Press)

Many of the institutional investors are pension funds or insurance companies with a very long investment horizon due to the nature of their financial obligations and the needs of their stakeholders (pensioners and active employees, largely from the public sector, insureds)

Climate Change Concerns and Regulatory Trends

In the United States, the *Securities and Exchange Commission* recently proposed that companies disclose information about:

- (1) Their climate change risk governance and relevant risk management processes;
- (2) How the climate-related risks identified by the company have or are likely to have a material impact on its ongoing business and financial statements, in the short, medium and long term;
- (3) How climate-related risks identified by the company affect or will affect its strategy, business model, and outlook;
- (4) The impact of climate-related events (e.g., natural disasters) and transition activities on the items reported in the financial statements and on the estimates and assumptions underlying the financial statements.

(Free translation; <https://www.sec.gov/news/press-release/2022-46>)

Implementation of ESG factors

Implementing ESG: Value or Values?

Value-based ESG	Values-based ESG
ESG issues are seen as economic risks and opportunities - a source of economic value.	ESG issues and challenges are not only seen as risks and opportunities but also as having a moral dimension (moral values).
Such an approach implies a focus on ESG issues and challenges of relative importance in terms of economic impact.	An example would be impact investing, which combines value and values.

ESG markup

ESG indices or rankings	ESG data providers
Dow Jones Sustainability	Bloomberg
MSCI	KLD (MSCI)
S&P TSX	Sustainalytics
Euronext	Trucost (S&P Global)
Corporate Knights	Asset4 (Refinitiv/Thomson)
	ISS Financial
	Morningstar
	Factset

Focusing on different reference standards for disclosure

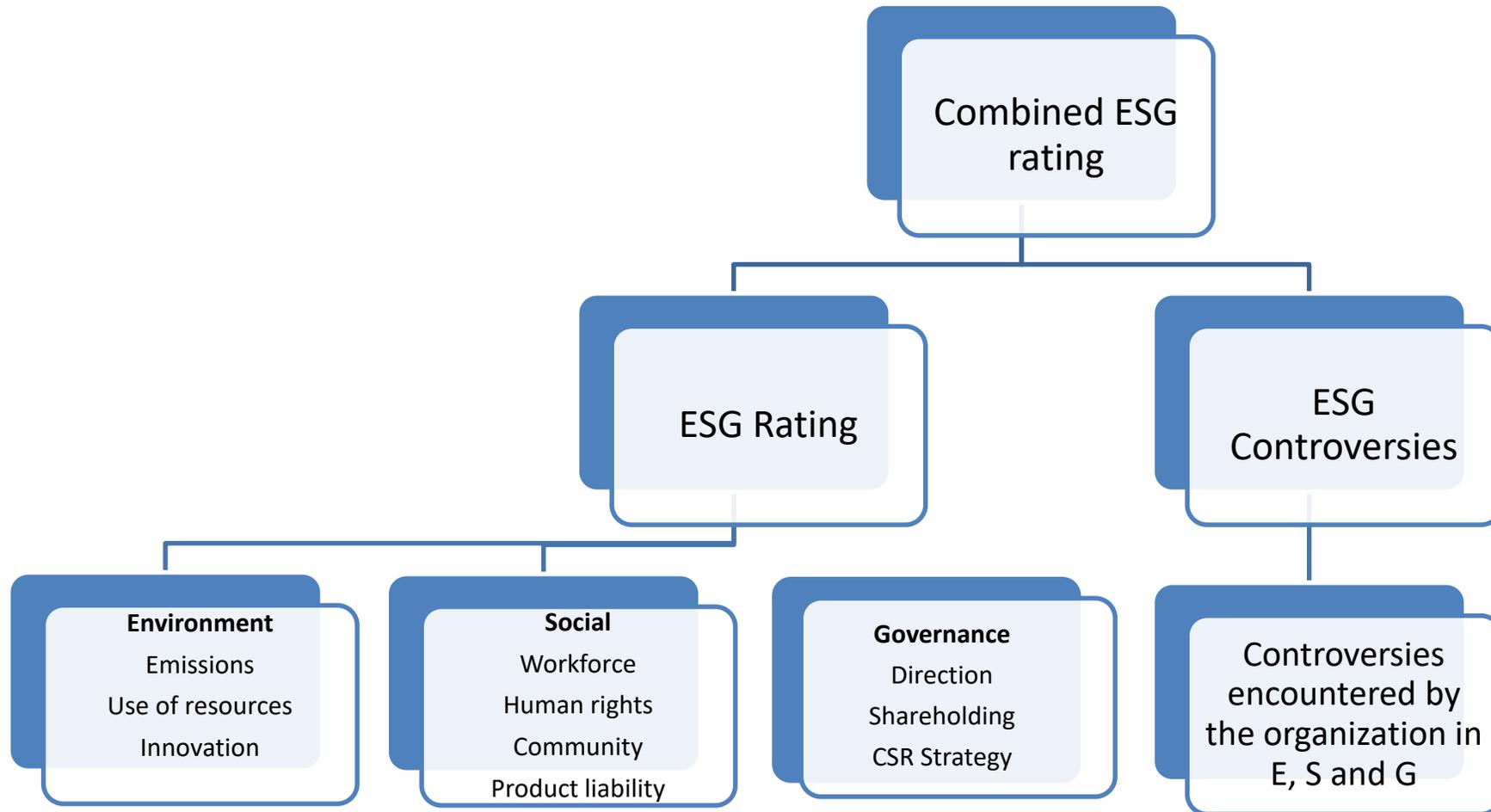
	Focus		
Terms of reference	Information contained in the financial statements	Subset of sustainability topics affecting value creation	Questions reflecting the organization's impact on the economy, the environment and the population
IASB / FASB	●		
IIRC	●	●	
SASB / CDSB		●	
GRI			●
CDP Worldwide			●
<i>International Sustainability Standards Board (IFRS)</i>			

ESG and economic value: the MSCI model

MSCI ESG Rating Quintiles	Analysis of fundamental factors	Financial performance
Q5	Transmission channel: A more profitable business	Higher business profitability, less volatility and more cash flow generation
Q4		
Q3	Transmission channel: Improved risk and compliance management	Lower specific (idiosyncratic) risk, resulting in fewer incidents, less residual volatility and falls
Q2	Transmission channel: Control of other factors	Lower systematic risk resulting in a lower cost of capital
Q1		

Asset4 ESG Rating (Refinitiv)

calculated from 450 measurements



A case in point:

Corporate Knights' Canadian ranking

1. Hydro-Québec

....

4. ECB

....

10. Société de transport de Montréal

....

36. Desjardins Group

ESG indicators according to Corporate Knights

Environmental	Social	Governance
Sales \$/net energy use	Injuries per 200,000 hours	Management compensation linked to the achievement of ESG or sustainability objectives
Sales \$/GHG emissions	Deaths vs. Number of employees	% of non-male members of the management team (Rank vs. Universe)
Sales \$/water useage	Staff turnover	% of non-males on the Board (Rank vs. Universe)
Sales \$/mass of waste generated	Paid sick days	% of diversity in the management team (Rank vs. Universe)
Sales \$/emissions	CEO compensation/Average compensation	% of diversity in CA (Rank vs. Universe)
Sales \$/Sulfur dioxide emissions		Sustainability index of the main supplier
Sales \$/Nitrogen oxide emissions	Taxes paid	
Sales \$/particulate emissions	Quality of pension plans	
% of 'clean' income	Sanctions and penalties	
% of 'own' investments		

Issues related to these rankings

- Perimeters/Spans (scopes) 1, 2 or 3
- Weighting of the (ESG) components and the indicators making up these components
- Assessment based on disclosed information (with subsequent validation)
- Reliability and validity of data

Focus on perimeters

Scopes 1, 2 and 3 to categorize emissions:

- **direct emissions** produced by the company (1)
- **indirect emissions** related to **energy** consumption (2)
- other **indirect emissions** that concern the **entire value chain** (3)

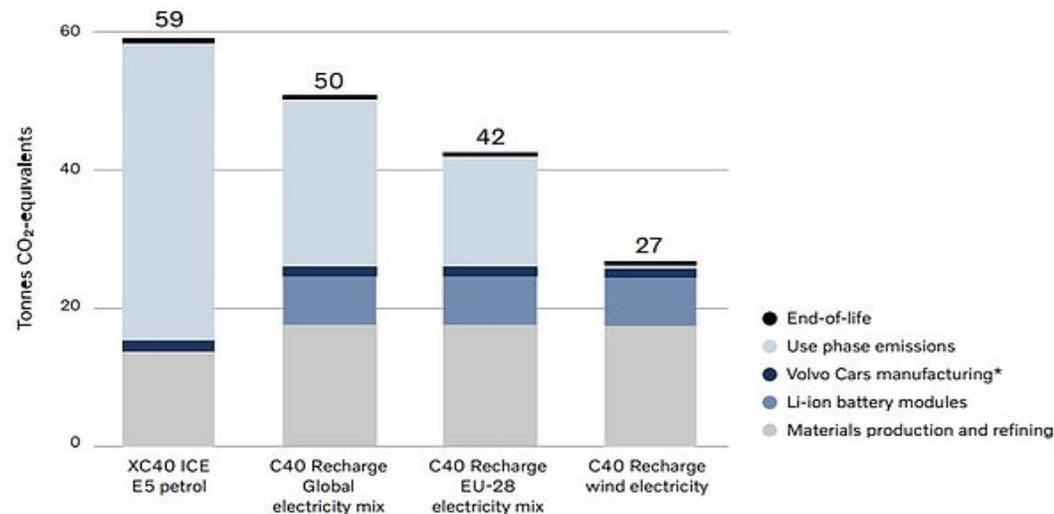
Several calculation methods:

- the **Bilan Carbone© (carbon footprint)**
- the **ISO 14064 standard**
- Institutional Investors Group on Climate Change (IIGCC)
- the Carbon Disclosure Project (CDP) methodology at the international level

Measurement and time perspective issues

Volvo claims that emissions from the manufacture of electric vehicles can be up to 70% higher than those from the manufacture of gasoline-powered cars - up to 9 years of use may be required to reach equilibrium.

<https://www.thisismoney.co.uk/money/cars/article-10161697/Volvo-says-electric-car-making-emissions-70-HIGHER-netrol.html>



* Volvo Cars manufacturing includes both factories as well as inbound and outbound logistics.

Figure ii. Carbon footprint for C40 Recharge and XC40 ICE, with different electricity mixes. Results are shown in tonnes CO₂-equivalents per functional unit (200,000km total distance, rounded values).

Are electric cars green? Yes, but it's complicated.

<https://www.cnbc.com/2021/07/26/lifetime-emissions-of-evs-are-lower-than-gasoline-cars-experts-say.html>

The production of electric vehicles causes much more GHG emissions than gasoline-powered cars...mainly due to the production of batteries.

This is not the magic potion for managing climate change. Ideally, we will also have to significantly reduce the number of cars and invest in means such as public transportation.

Florian Knobloch

CAMBRIDGE CENTER FOR ENVIRONMENT,
ENERGY AND NATURAL RESOURCE
GOVERNANCE

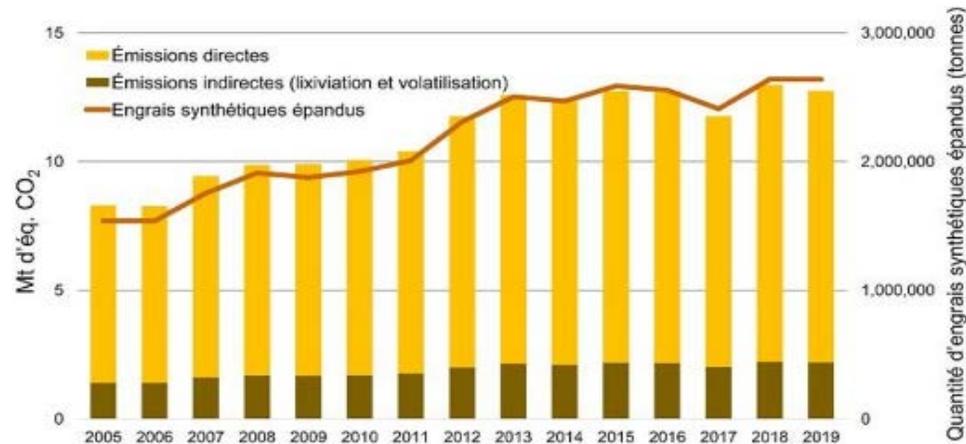
Measurement and time perspective issues

Reducing GHG emissions from fertilizer a huge challenge for western farmers

<https://ici.radio-canada.ca/nouvelle/1908308/engrais-emissions-ges-fermier-ouest-azote-changements-climatiques>

New report says Canada can reduce greenhouse gas emissions from fertilizer use without putting food production at risk

<https://fertilizercanada.ca/fr/news-events/news/selon-un-nouveau-rapport-le-canada-peut-reduire-les-emissions-de-gaz-a-effet-de-serre-liees-a-lutilisation-des-engrais-sans-mettre-a-risque-la-production-alimentaire/>



[Agrandir l'image](#)

Émissions directes et indirectes découlant de l'application d'engrais synthétiques, de 2005 à 2019.

PHOTO : AGRICULTURE ET AGROALIMENTAIRE CANADA

Measurement and time perspective issues

- Reality is multi-dimensional and difficult to grasp
- The measurement and calibration of measurements is evolving
- The time horizon used can make a difference
- Science is converging but still has many grey areas or uncertainties
- Many assumptions are required
- Inter-organizational comparisons should therefore be viewed with caution