



Millani

Your ESG integration  
Partner in capital markets

# ESG – Value Creation or Value Salvation?

April 25<sup>th</sup>, 2017

# Why do investors integrate ESG?

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**80%** cite better returns<sup>1</sup>

**65%** to manage risk<sup>2</sup>

**62%** to foster long-term investment mindset<sup>3</sup>

*\*Note: Respondents could select more than one option therefore percentages don't add to 100%*

*Source: <sup>1</sup> Equity Strategy Focus Point – ESG: good companies can make good stocks, Bank of America Merrill Lynch, December 2016; <sup>2</sup> CFA Institute ESG Survey, August 2015; <sup>3</sup> The Investing Enlightenment, Eccles and Kastrapeli, 2017*

# ESG is part of responsible investing

INVESTMENT STRATEGY	TRADITIONAL / MAINSTREAM	ESG INTEGRATION	THEMED	IMPACT FIRST	PHILANTROPY
INVESTOR FOCUS	<p>Limited or no focus on ESG factors of underlying investments</p>	<p>Explicit consideration of environmental, social and governance factors in the investment decision-making process</p>	<p>Strategy that addresses specific sustainability issues such as climate change, food, water, renewable energy/ clean technology, agriculture, etc.</p>	<p>Targeted investments, typically made in private markets, aimed at solving social or environmental problems. Includes community investing, where capital is specifically directed to traditionally under-served individuals or communities, or financing that is provided to businesses with a clear social or environmental purpose</p>	<p>Focus on one or a cluster of issues where social or environmental need requires 100% financial trade-off</p>

Source: Global Sustainable Investment Alliance and Kepler Cheuvreux

# ESG describes many different strategies

Strategy	Definition
Negative/ Exclusionary Screening	Exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria
Norms-based screening	Screening of investments against minimum standards of business practice based on international norms
ESG Integration	Systematic and explicit inclusion by investment managers of environmental, social and governance factors into traditional financial analysis
Engagement and shareholder action	Use of shareholder power to influence corporate behavior, including through direct corporate engagement (i.e., communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines
Positive/ Best-in-Class	Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers
Sustainability Themed investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology or sustainable agriculture)
Impact / Community Investing	Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose

Source: 2014 Global Sustainable Investment Review, GSIA, February 2015

# A global rising trend: investors are integrating ESG

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81%

of Canadian institutional investors **consider environmental and social issues** and 95% of them consider **governance issues when making investment decisions**

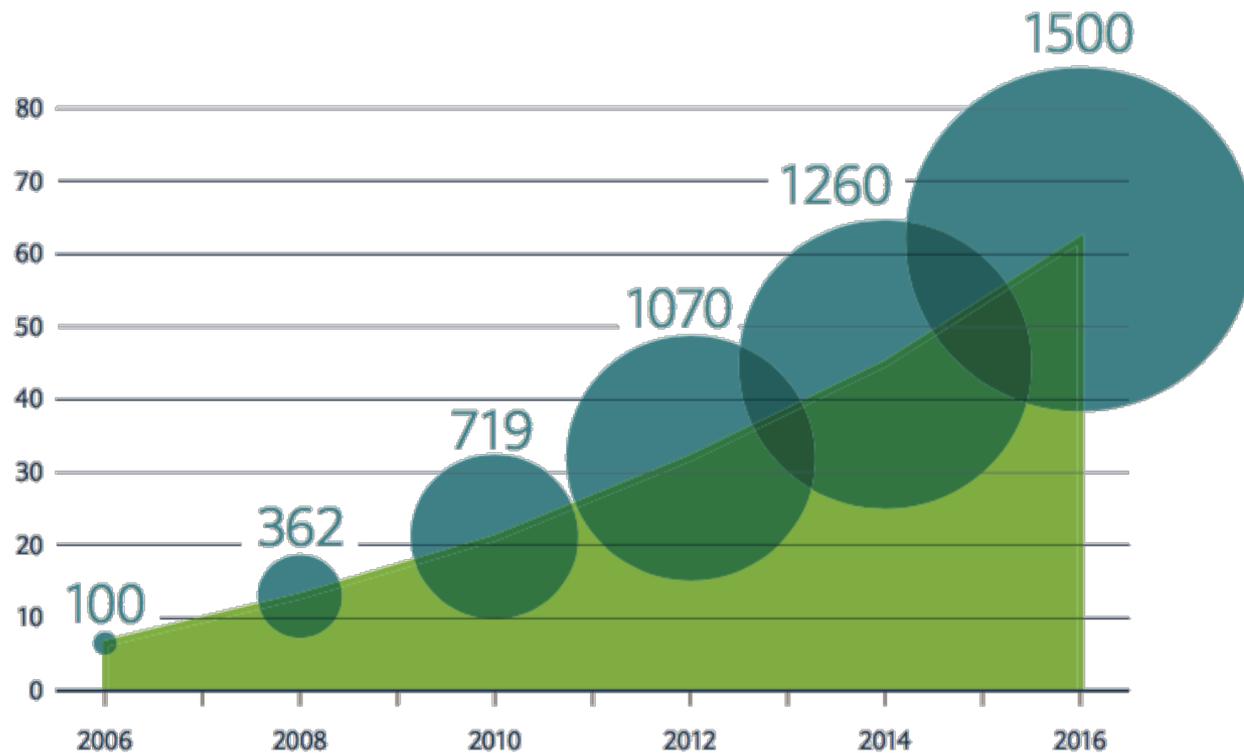
MORNINGSTAR®

Created an ESG ranking for **23,000** mutual funds in 2016

*Source: 2016 Canadian Investor Survey, RR Donnelley and Simple Logic, 2016*

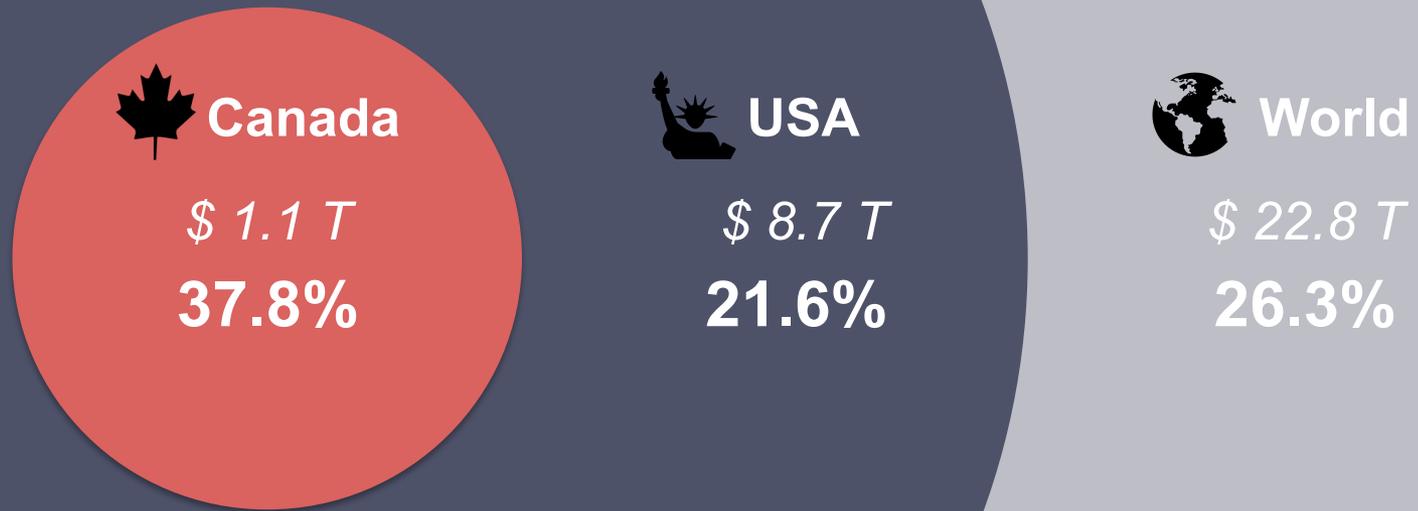
# UN-PRI signatories represent over \$60 trillion in AUM

- Assets under management (US \$ trillion)
- Number of signatories



Source: Sustainable Investing and Bond Returns, Barclays, 2016

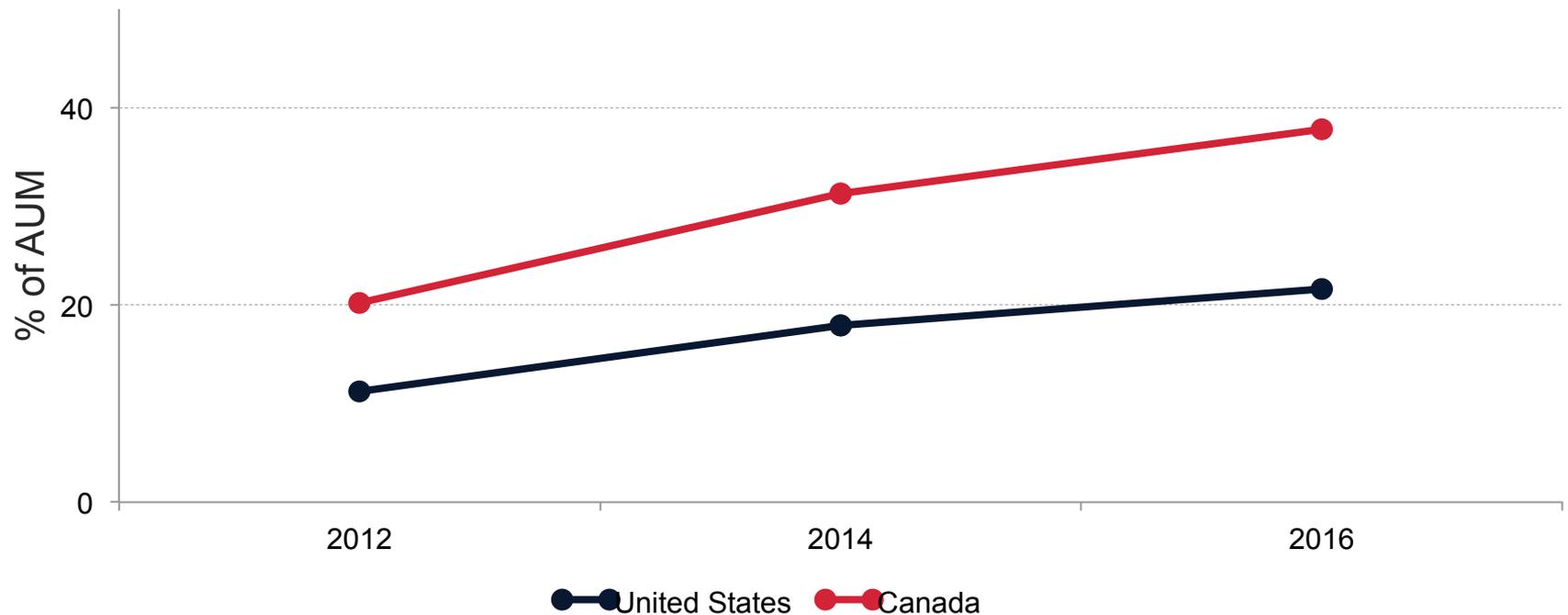
# In Canada, almost 40% of AUM are being invested responsibly



*Notes: All assets are converted to US dollars based on exchanges rates at year-end 2015. Percentages represent portion of total AUM  
Source: 2016 Global Sustainable Investment Review, GSIA, March 2017*

# Responsible investment in Canada is growing

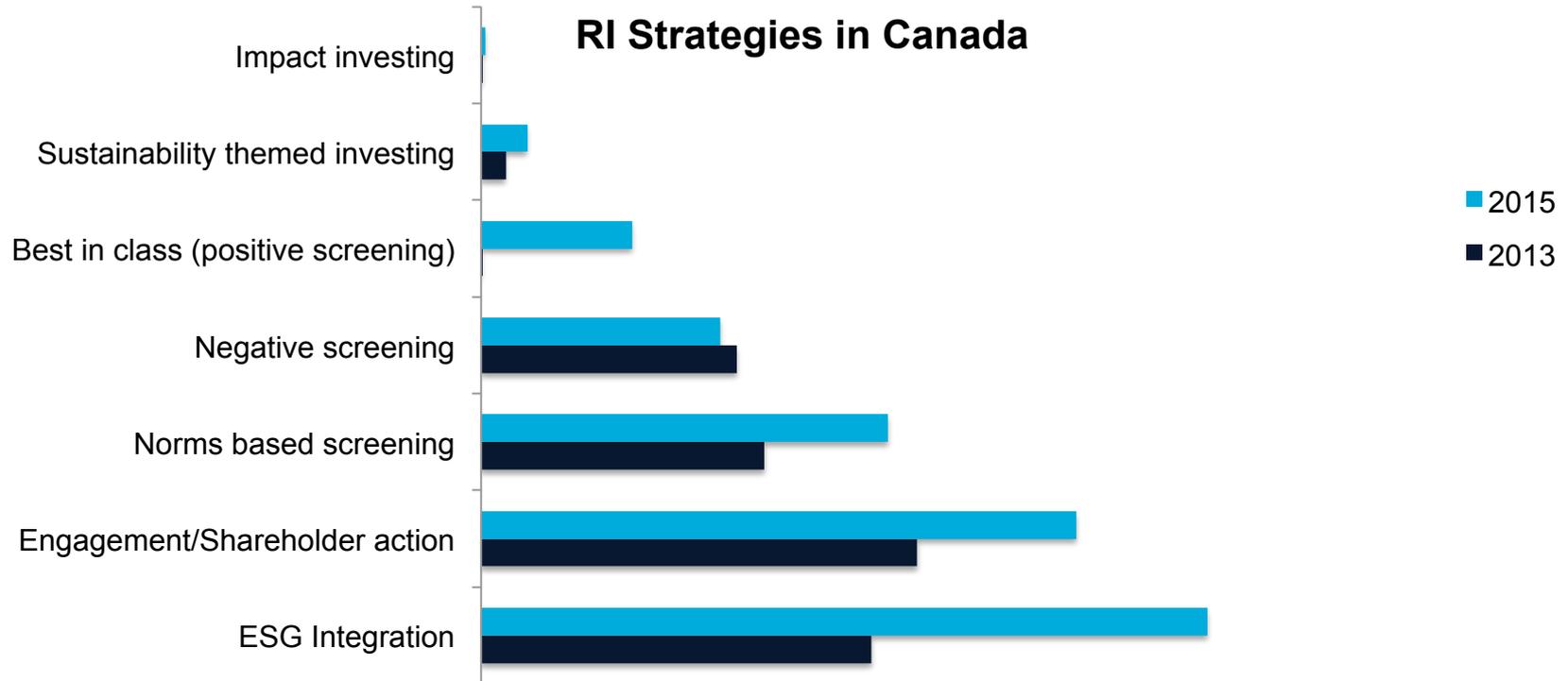
Growth of RI as a proportion of AUM in Canada vs. the United States



Note: Eurosif used a narrower definition of SRI in 2016 than in 2014

Source: 2016 Global Sustainable Investment Review, GSIA, March 2017

# ESG integration is emerging as the main strategy

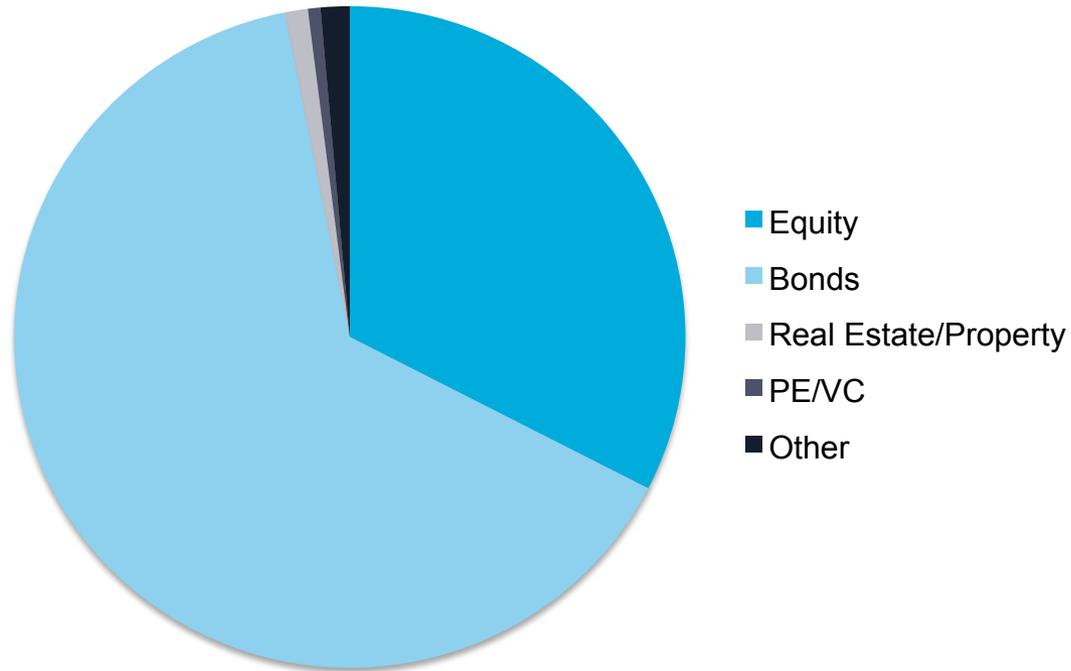


Source: 2016 Canadian Responsible Investment Trends Report, RIA, 2016

# ESG integration is moving beyond equities

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Asset allocation in Canada and Europe

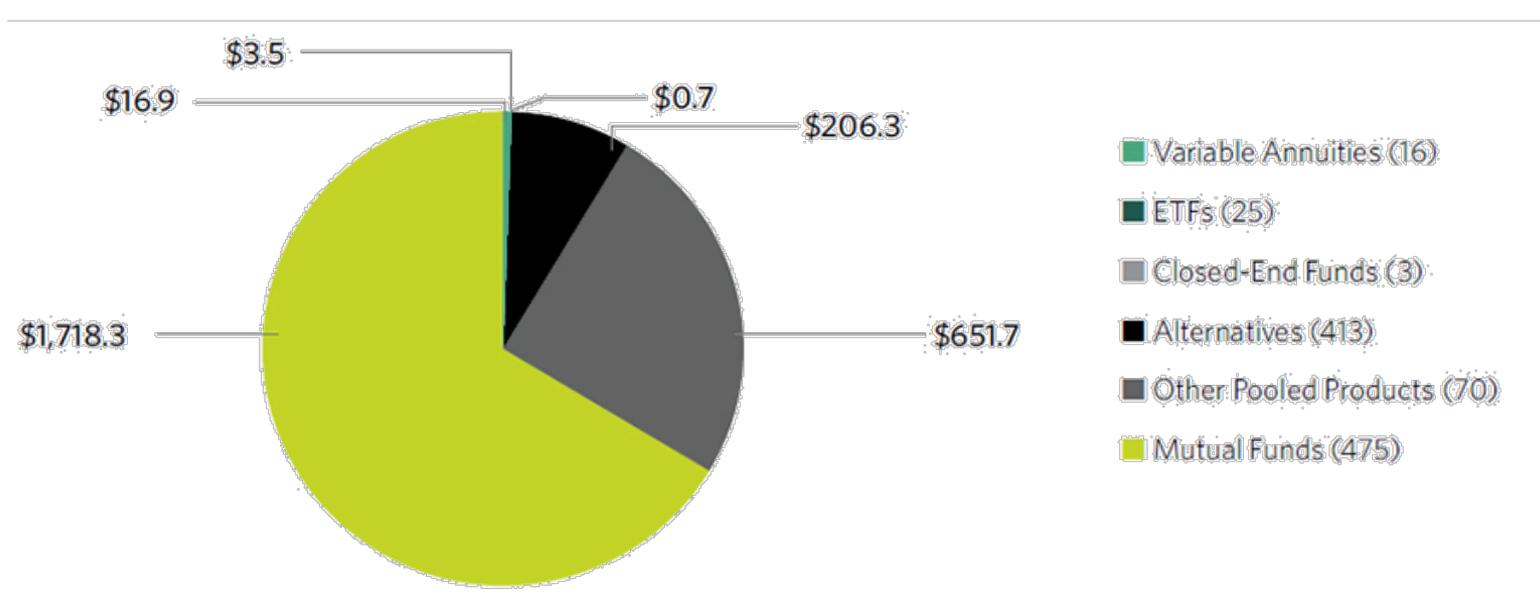


*Note: Other includes alternative hedge funds, monetary/deposits, commodities and infrastructure*

*Source: 2016 Global Sustainable Investment Review, GSIA, March 2017*

# ESG ETFs represent 12% of the US market

Total number of ESG assets by fund type  
(ESG assets in investment vehicles, in billions USD)



Source: US SIF Foundation, November 2016

# Regulation is a key driver

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Changes in the regulatory landscape are accelerating the uptake of responsible investing in the mainstream market



**ERISA**



**Ontario**

*Ontario's Pension Benefit Act*



**Canadian Securities Administrators**

**Autorités canadiennes en valeurs mobilières**

# The information disconnect

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Investors increasingly  
need information about ESG...

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92%

of investors **want companies to identify and report on the material ESG issues** they believe affect financial performance<sup>1</sup>

...but they are not  
getting it from companies

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70%

of Canadian institutional investors find the **ESG information companies provide is not good enough** to help them assess materiality to the company's business<sup>2</sup>

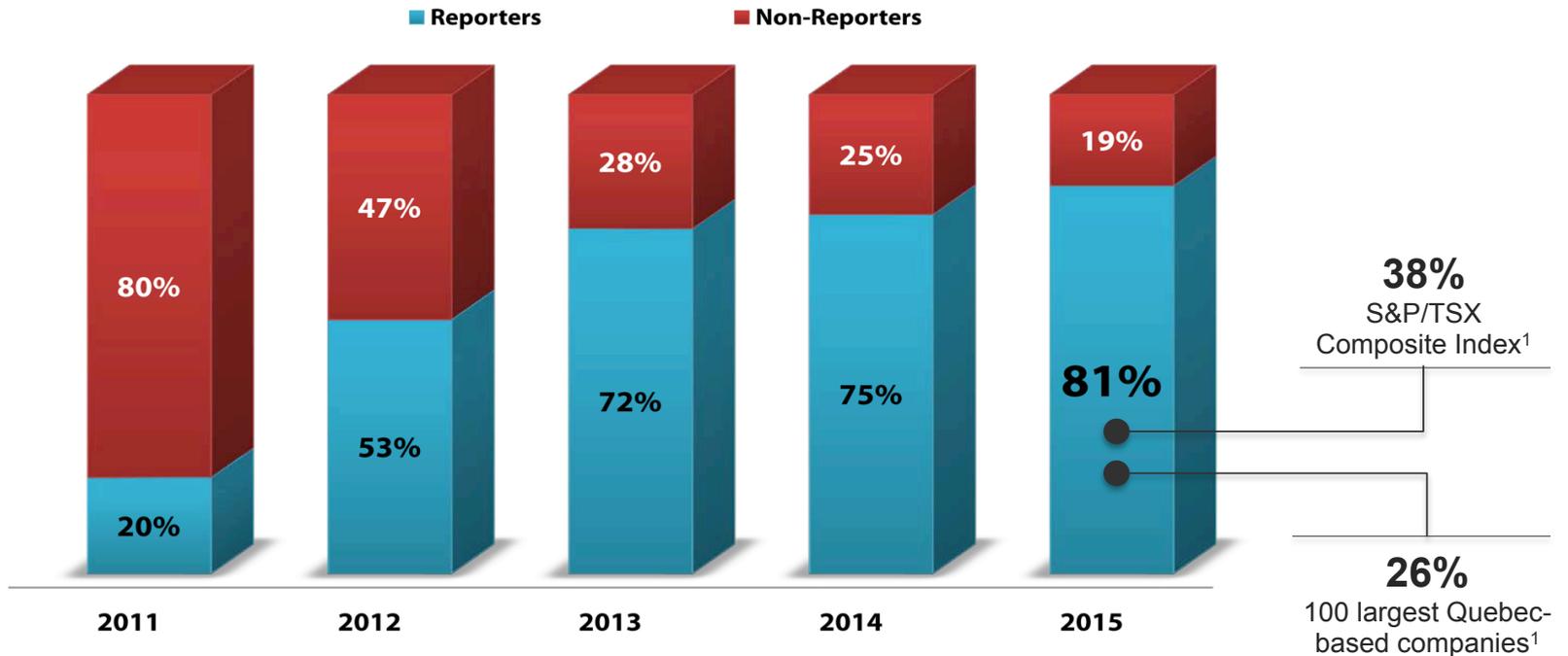
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Source: <sup>1</sup>The Investing Enlightenment, Eccles and Kastropeli, 2017; <sup>2</sup>2016 Canadian Investor Survey, RR Donnelley and Simple Logic, 2016

# Corporate sustainability reporting is on the rise

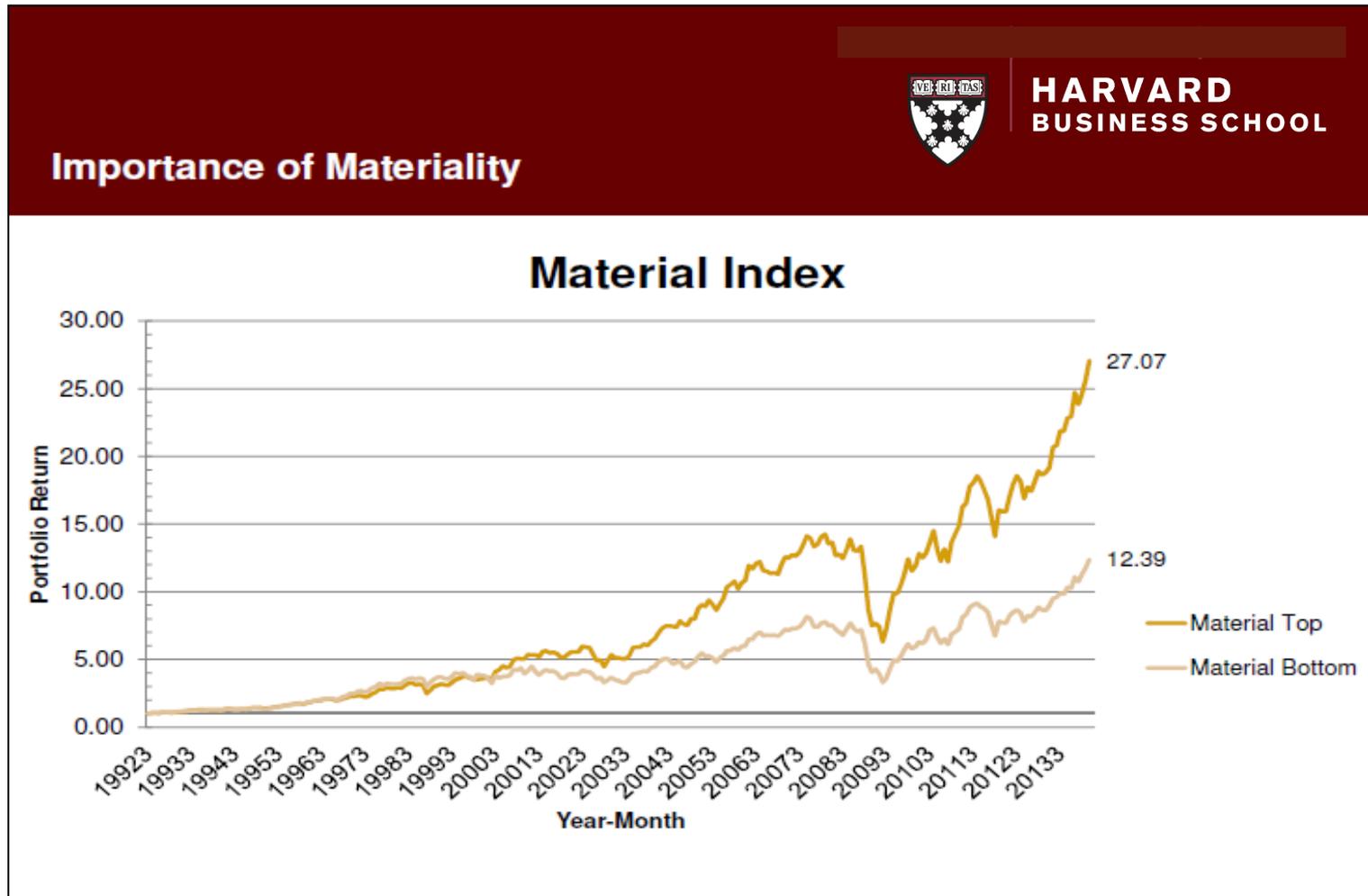
## Canadian and Quebec companies lag behind

Governance & Accountability Institute Research Results  
**S&P 500® Companies Sustainability Reporting**



Source: 2016 Flash Report, Governance & Accountability Institute, March 2016; <sup>1</sup>Millani research

# Addressing material ESG information is key



Source: *Corporate Sustainability: First Evidence on Materiality*, Mo Khan, George Serafeim and Aaron Youn, HBS working paper, 2014

# ESG integration has measurable and proven benefits...

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90%

of studies on the cost of capital show that sound sustainability standards **lower the cost of capital** of companies

88%

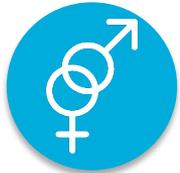
of research shows that solid ESG practices result in **better operational performance** of firms

▶ Lower discount rates, higher multiples in valuations

Source: From the Stockholder to the Stakeholder, How Sustainability can drive financial outperformance?, University of Oxford and Arabesque Partners, March 2015 (An analysis of more than 200 studies on the financial impacts of sustainability for business and investors)

## ... that correlate with stock performance

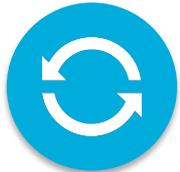
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Companies with **higher levels of female employees** have seen **average annual alpha of 3.3%**



Companies with **low relative levels of energy and water intensity** have performed well, **delivering average annual alpha of 2.6% and 1.8%**



Companies with **low employee turnover** generated an **average annual alpha of 3.0%**



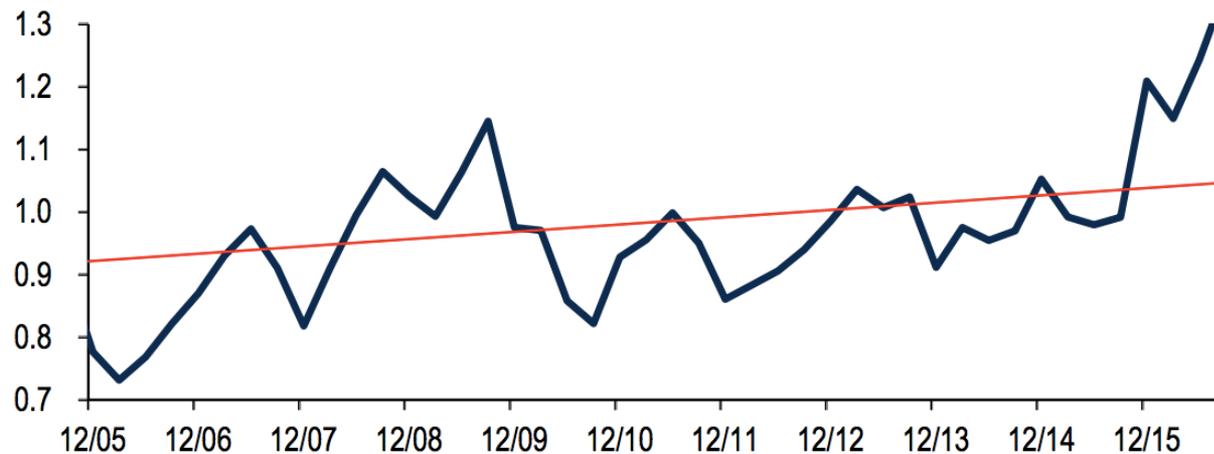
**Low GHG emitters** generally outperformed with a **3.1% average annual alpha**

*Source: The PM's guide to the ESG revolution, Goldman Sachs, April 2017*

# Investing in the best ESG scores impacts ROE and multiples...

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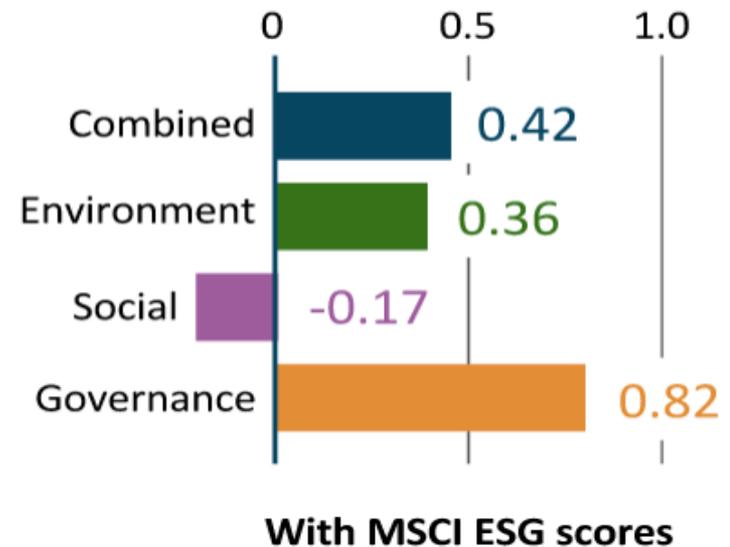
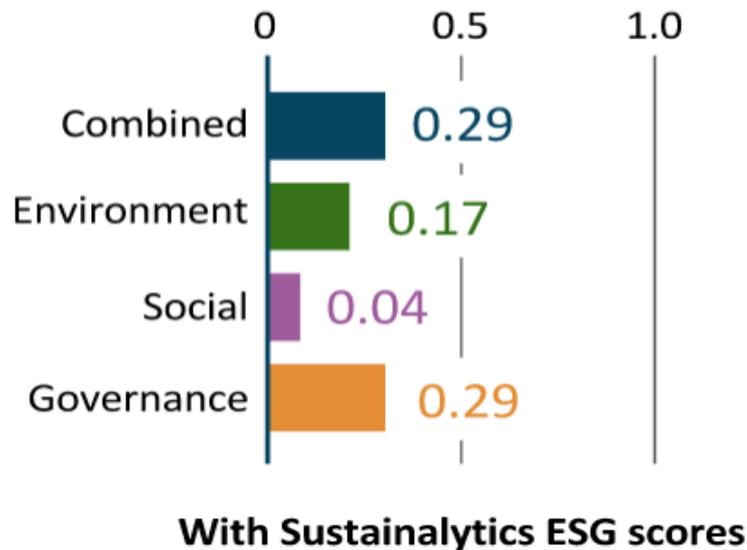
Median EV/EBITDA of high vs. low ESG deciles based on overall ESG scores



Source: Equity Strategy Focus Point – ESG: good companies can make good stocks, Bank of America Merrill Lynch, December 2016

## ...and also impacts bonds returns (reduce risk and volatility)

Return difference (%/y) between bond portfolios with high and low ESG scores



Source: Sustainable Investing and Bond Returns, Barclays Investment Bank, October 2016

# ESG integration and fiduciary duty go hand in hand

## Asset owners'

reasons for considering ESG criteria

1	Minimize risk over time
<b>2</b>	<b>Fulfill fiduciary duty</b>
3	Fulfill mission or values
4	Improve returns over time
5	Meet legislative/regulatory requirements
6	Pursue social or environmental impact
6	Meeting client/beneficiary demand

## Investment managers'

reasons for considering ESG criteria

1	Minimize risk over time
2	Improve returns over time
<b>3</b>	<b>Fulfill fiduciary duty</b>
4	Meeting client/beneficiary demand
5	Pursue social or environmental impact
6	Fulfill mission or values
7	Meet legislative/regulatory requirements

Source: 2016 Canadian Responsible Investment Trends Report, RIA, 2016

# ESG integration offers a competitive advantage

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**“Technology, competition and other factors have made traditional equity markets hyper-efficient and that’s made alpha increasingly difficult to come by. But ESG remains an inefficient or at least immature market where, because ESG factors are not yet fully reflected in valuations, investors who understand how to identify and properly value those factors can still gain an advantage.”**

*Habib Subjally, Senior Portfolio Manager and Head of Global Equities at RBC Global Asset Management*

*Source: RBC Global Asset Management survey reveals opportunities and obstacles in ESG investing, PR Newswire, November 2016*

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