

Current Issues in Retirement Benefits (16th CIRB)

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ESG Investing

Amit Gopal
Principal, Investment Leader, Mercer India

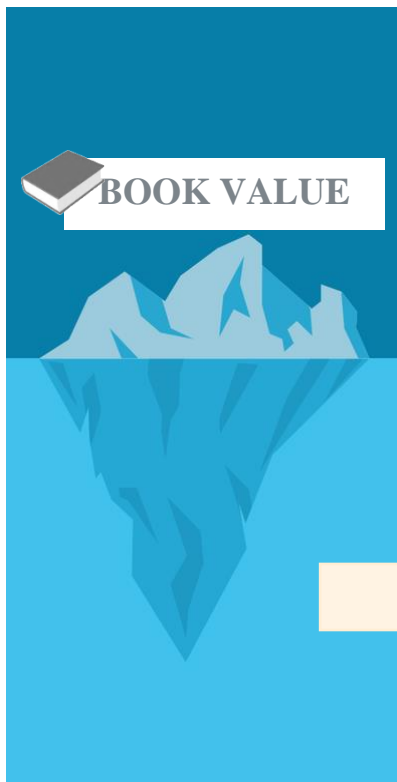


What is ESG?



- Environmental, Social and Governance (ESG) investing refers to the inclusion of traditionally non-financial topics within the investing decision making, to better manage risk and generate sustainable, long-term returns
- ESG has emerged as an important theme in investing – with sustainable investing
 - Common to Benjamin Graham and David Dodds concept of long term investing
 - Context change due to greater populations and lesser resources (oil and gas)
- Other terms commonly used in the ESG context (not necessarily the same)
 - Sustainable investing
 - Responsible investing
 - Socially Responsible investing (SRI)
 - Impact investing
 - Ethical investments
 - Green investment

A broader perspective – An ability to sustain



WHAT IS ESG?

ESG issues which can be considered include:



The diagram features three columns of illustrations: a forest with trees and flowers for environmental concerns, a row of houses for social concerns, and a classical building with columns for corporate governance concerns.

ENVIRONMENTAL CONCERNS	SOCIAL CONCERNS	CORPORATE GOVERNANCE CONCERNS
<ul style="list-style-type: none">• Climate Change• Energy Efficiency• Waste & Pollution• Water & Resource Scarcity	<ul style="list-style-type: none">• Health & Safety• Stakeholder Concerns• Demographics• Labour & Supply	<ul style="list-style-type: none">• Audit Quality• Board Structure• Remuneration• Shareholder Rights

WHY IS INTEREST IN ESG INCREASING?

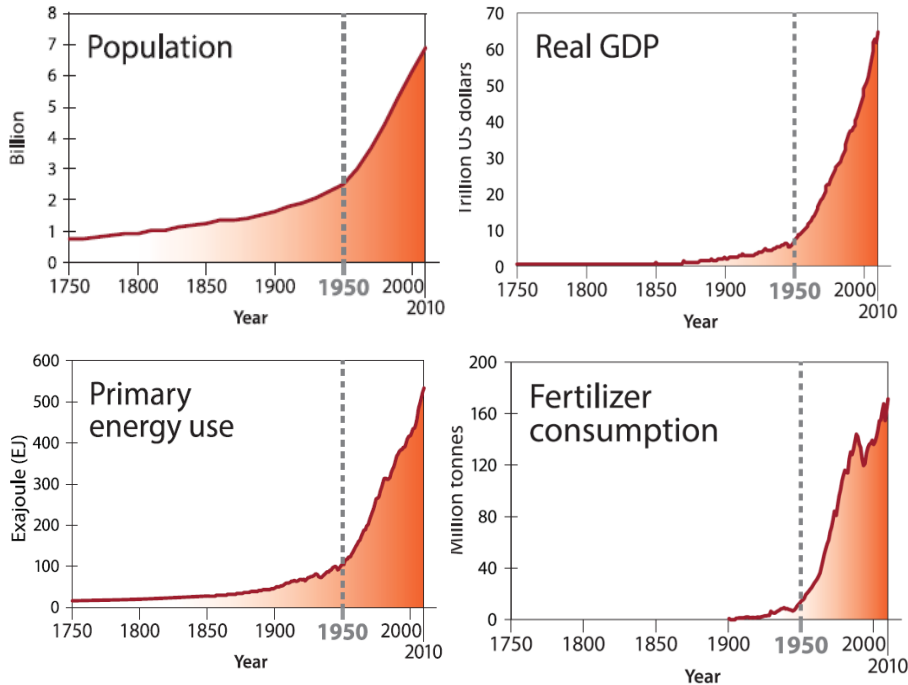
THE FACES OF CHANGE AND HOW IT IS IMPACTING US



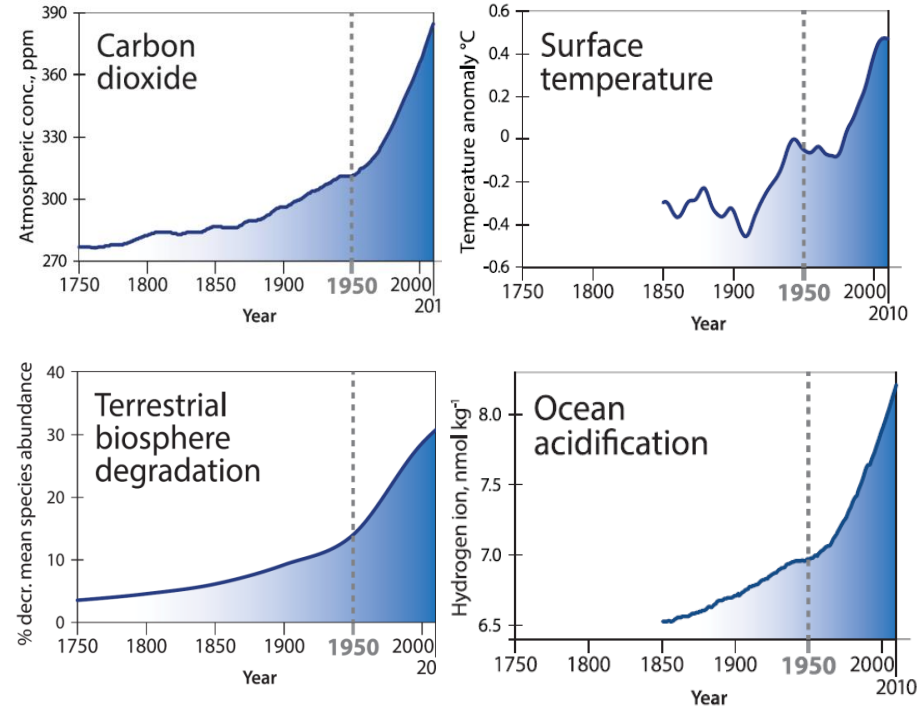
Population + Consumption

Fossil Fuel Energy - Industrialisation - Deforestation – Agriculture - Construction

Socio-Economic trends (1750 – 2010)



Earth system trends (1750 – 2010)



Source: Steffen et al (2015)

CONCERNS ABOUT ENVIRONMENTAL RISKS HAVE INCREASED



Top 5 Global Risks in terms of likelihood

■ Economic
 ■ Environmental
 ■ Geopolitical
 ■ Societal
 ■ Technological

Asset price collapse	Asset price collapse	Storms and cyclones	Income disparity	Income disparity	Income disparity	Interstate conflict	Involuntary migration	Extreme weather	Extreme weather	Extreme weather
Slowing Chinese economy	Slowing Chinese economy	Flooding	Fiscal imbalances	Fiscal imbalances	Extreme weather	Extreme weather	Extreme weather	Involuntary migration	Natural catastrophes	Climate change mitigation and adaptation failure
Chronic disease	Chronic disease	Corruption	Greenhouse gas emissions	Greenhouse gas emissions	Unemployment/ under-employment	National governance failures	Weak climate change response	Natural catastrophes	Cyberattacks	Natural catastrophes
Global governance gaps	Fiscal crises	Biodiversity loss	Cyber attacks	Water supply crises	Climate change	State collapse	Interstate conflict	Terrorist attack	Data fraud	Data fraud
Retrenchment from globalisation	Global governance gaps	Climate change	Water supply crises	Aging population	Cyberattacks	High unemployment	Natural catastrophes	Data fraud	Climate change adaptation failure	Cyberattacks

For each of the 30 global risks covered in the survey, respondents were asked to assess (1) the likelihood of the risk occurring globally within the next 10 years, and (2) its negative impact for several countries or industries over the same timeframe.

Note: Over the ten years, the report has adjusted the list of global risks and moved risks between categories. The depiction here assigns a consistent category for risks.

Source: World Economic Forum, *Global Risks Report 2019*

CONCERNS ABOUT ENVIRONMENTAL RISKS HAVE INCREASED



Top 5 Global Risks in terms of impact

■ Economic
 ■ Environmental
 ■ Geopolitical
 ■ Societal
 ■ Technological

Asset price collapse	Asset price collapse	Fiscal crises	Systematic financial failure	Systematic financial failure	Fiscal crises	Water crises	Weak climate change response	WMDs	WMDs	WMDs
Retrenchment from globalisation	Retrenchment from globalisation	Climate change	Water supply crises	Water supply crises	Climate change	Infectious diseases	WMDs	Extreme weather	Extreme weather	Climate change mitigation and adaptation failure
Oil and gas price spike	Oil price spike	Geopolitical conflict	Food crises	Fiscal imbalances	Water crises	WMDs	Water crises	Natural catastrophes	Natural catastrophes	Extreme weather
Chronic disease	Chronic disease	Asset price collapse	Fiscal imbalances	WMDs	Unemployment/ under-employment	Interstate conflict	Involuntary migration	Water crises	Climate change adaptation failure	Water crises
Fiscal crises	Fiscal crises	Extreme energy price volatility	Volatility in energy and agri-cultural prices	Weak climate change response	Critical ICT systems breakdown	Weak climate change response	Energy price shock	Weak climate change response	Water crises	Natural catastrophes

For each of the 30 global risks covered in the survey, respondents were asked to assess (1) the likelihood of the risk occurring globally within the next 10 years, and (2) its negative impact for several countries or industries over the same timeframe.

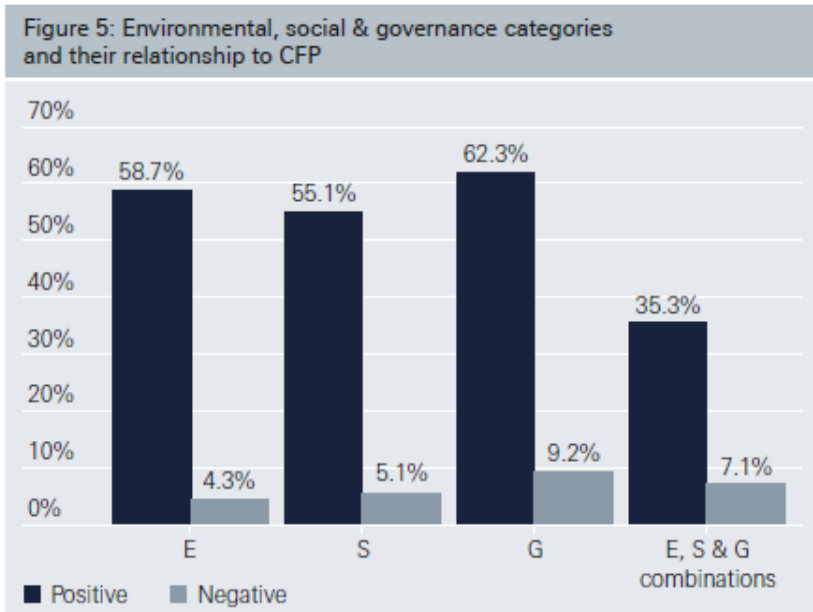
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INVESTMENT RETURN CASE FOR ESG



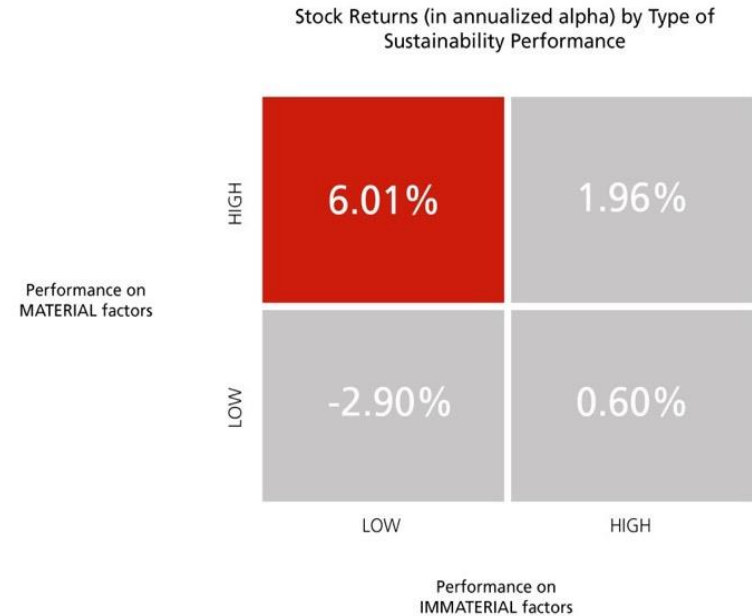
Consensus Building



Source: Friede, Busch, Bassen (December 2015)

Source: Deutsche Asset Management/University of Hamburg; ESG & Corporate Financial Performance: Mapping the Global Landscape; 2015.

Materiality Matters



Source: Working Paper by Mozaffar Khan, George Serafeim, and Aaron Yoon, Harvard Business School (2015)

APPROACHES TO ESG



- Integration
 - Include ESG factors in investment decisions with an explicit approach to climate range transition and physical risks, which are portfolio wide
- Stewardship
 - Exercise active ownership through voting and engagement with underlying companies and by engaging with policy holders
- Investment
 - Allocate to sustainability themes or impact investments for new opportunities – eg renewable energy, water
- Screening
 - Screen out sectors or companies deemed to be irresponsible or not acceptable

THE INDIA PERSPECTIVE

Why has ESG investing not caught on in India?

- Unfamiliar terrain; 10 wealth managers
- Investor apathy; Returns focus; “I pay 40% tax, how much more good should I do”?
- Investor cynicism; “India is not a place for ESG”
- Absence of track record; little or no data
- Abuse of ESG; the rating agency analogy

But pension funds can (and should) lead the way...

- Patient capital
- Institutional play with ability to effect changes
- Volumes and fees
- Potential regulatory capture

But it may not be easy.....



- Asset allocation is driven by regulation
- Stakeholder apathy
- Absence of choice; Funds (3, 4?) and underlying (corporate India lags global standards in ESG reporting and disclosure)
- Absence of expertise in India
- Absence of data to make choices
- Costs of implementing an ESG strategy

To conclude...

- Ex- investments, ESG factors are now a way of life
 - Plastics
 - Electric vehicles and transportation
- Elsewhere, ESG is very important in decision making
- For India to embrace ESG, pension funds and retirement plans should lead the way