Sustainable, Responsible and Impact Investing
"Money Talks or It Walks" - 2019

Introduction:

The number of people demanding that their investments be managed in a Sustainable, Responsible and Impactful (SRI) way continues to grow quickly. As the range and quality of these investment vehicles rise, they are delivering results competitive with the broader market. The impact goes beyond investment selection. Many SRI managers engage corporations through dialogue and shareholder resolutions, changing company policies on the environment, hiring diversity, gender equality, executive pay, corporate and political transparency and other issues. [i]

Scientific American, in its May 2019 issue, endorsed this brand of shareholder advocacy as key to addressing "the threats that climate change poses to health, national security and the environment…. (I)nvestors need to keep working to bring science and business together. Because money talks – or it walks – it can accomplish things that politicians won't." [ii]

Money invested using SRI screens shot from $639 billion in 1995 to $11.6 trillion in 2016, more than 1,815 percent, accounting for one out of four managed dollars. The number of SRI investment vehicles jumped from 55 in 1995 to 1,002 in 2016 – an 18-fold rise. This rapid growth has seen the entry of new corporate players, and the melding of pioneering firms with mainstream financial companies. [iii] We also have seen the wide-scale introduction of "green" funds by such major players as Blackrock, Fidelity, J.P. Morgan and John Hancock, [iv] and the rapid spread of sustainability grading by more than 100 rating agencies, including Thomson Reuters, MSCI Research and Morningstar. [v] Some SRI pioneers worry about "green washing" or "dilution." [vi]

Strengthening the "Impact" in SRI

A critical difference between pioneering SRI firms and recent entrants is shareholder advocacy. The traditionalists argue that larger mainstream corporations new in the field are not filing resolutions and not challenging the corporations on policies important to SRI investors. [vii]

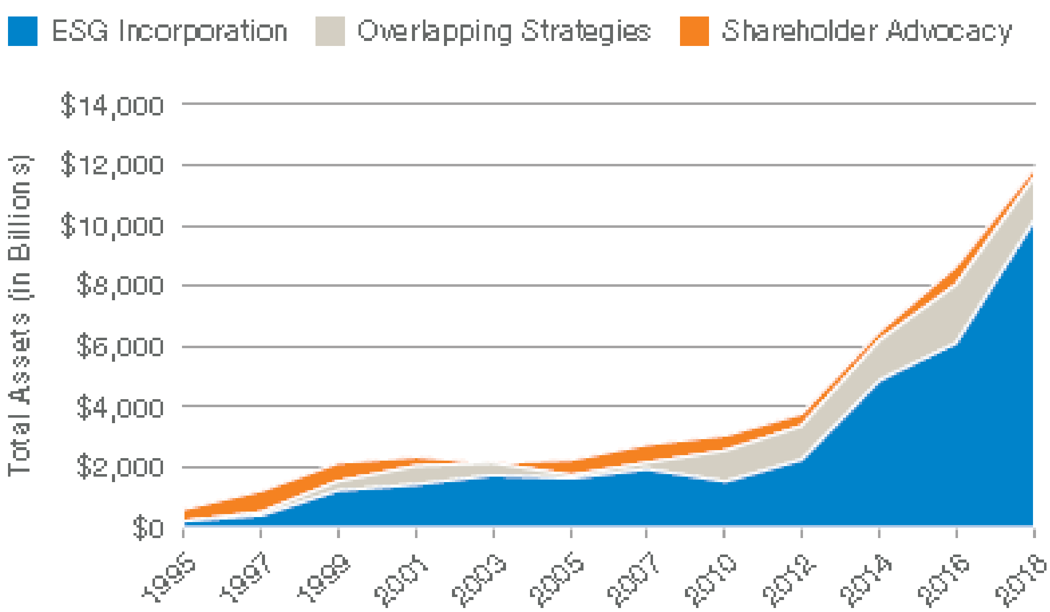
Advocacy yields results. This year, in response to a resolution filed by Green Century Capital Management, Amazon for the first time agreed to disclose its carbon footprint by the end of 2019, and set a target called Shipment Zero, having 50 percent of all deliveries reach net zero carbon emissions by 2030. [viii]

Activists scored a major victory in the spring of 2017 when shareholders in ExxonMobil, Occidental Petroleum and PPL voted that the management should assess and disclose how the companies were preparing for a low-carbon future, as envisioned under the Paris Accord. Investor activists also forced Shell to sell off carbon-rich sands and made the company tie 10 percent of executive pay bonuses to cutting carbon emissions. [ix] Other recent successes include Green Century's persuasion of corporations to buy palm oil only from plantations certified as sustainable. [x]

The number of shareholder motions filed by SRI activists has been rising, reaching 412 in 2014, 433 in 2015, and 386 in 2019. Within that, the percentage of climate change resolutions has grown swiftly [xi].

FIGURE A

Sustainable and Responsible Investing in the United States 1995–2018



SOURCE: US SIF Foundation.

The myth of underperformance

The rush of money into SRI and the expansion of the field has been accompanied by changing perceptions of performance. For many years SRI managers concentrated on excluding companies to which their investors objected, and returns could lag other types of portfolios. As the managers gained expertise, and began to seek out companies that exhibited greater responsibility or were best in their class, SRI portfolio performance came into line with more conventional investments. [xii]

The Domini Social Index:

An example of an SRI investments that matches or surpasses its index.

Domini Social Index: A market cap weighted stock index of 400 publicly traded companies that have met certain standards of social and environmental excellence. Potential candidates for this index will have positive records on issues such as employee and human relations, product safety, environmental safety, and corporate governance. Companies engaged in the business of alcohol, tobacco, firearms, gambling, nuclear power and military weapons are automatically excluded.

S&P Index ; The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general

An investor cannot invest directly in an index. Past performance does not guarantee future results

History of Socially Responsible Investing

For centuries, religious investors from Jewish, Christian and Moslem faiths shunned financial vehicles that violated their core beliefs. In colonial America, Quakers and Methodists steered away from investments that might benefit the slave trade. In the early years of the 20th Century, a number of mutual funds screened against such "sin stocks" as tobacco, alcohol and gambling. Sustainable investing moved toward its current form with the social and cultural upheavals of the 1960's and 1970's, as broad numbers of people focused on civil rights, environmental, feminist and other human rights issues. The movement gained momentum as investors sought to pressure corporations doing business with apartheid South Africa.

Socially Responsible Investing turned a deeper green in the 1980's in the aftermath of environmental disasters in Bhopal, India, and the Exxon-Valdez oil spill. Faith-based organizations were active, coordinating their actions through the Interfaith Center on Corporate Responsibility [xiii] and Ceres, [xiv] a non-profit that includes SRI financial services companies, corporations, and public bodies.

Definition

As the SRI sector has grown and evolved, it has been described by many names, causing some confusion. The industry group US-SIF, or U.S. Social Investment Forum, in a comprehensive report, noted that "the terms sustainable, responsible and impact investing, sustainable investing, responsible investing, impact investing and SRI are (used) interchangeably to describe these investment practices." Other commonly used terms are value-based investing, or simply "green investing." The screens or filters that SRI investors use to select stocks are based on Environmental, Societal and Governance (ESG) criteria. [xv]

Recent Issues in Sustainable, Responsible and Impact Investing

Another point of contention among SRI investors is whether to divest from fossil fuel companies, especially the 200 coal, oil and natural gas companies that have the largest reserves in the ground. The global environmental justice movement 350.org and other activists argue that those companies are risky investments because much of their market value is in assets that cannot be extracted if we expect to slow human contribution to climate change. [xvi] The 2015 Paris Accord and other international agreements are aimed in part at slowing the burning of fossil fuels. The recent change in U.S. administrations has complicated the debate over the financial wisdom of divestment.

How to make your investments socially responsible

Investors who want to define carefully how their portfolios are screened, and who want to maximize the impact of their investments, are advised to seek out financial advisers who have SRI expertise and can guide them through such debates as advocacy and divestment. These advisers also have a fiduciary responsibility to always put their clients' interests first, and have the education and background to help investors develop and work toward their financial goals while minimizing risks.

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Endnotes:

[i] See Report on US Sustainable, Responsible and Impact Investing Trends, issued biannually by US SIF (the Social Investment Forum). http://www.ussif.org/trends

[ii] Scientific American, "Climate-Friendly Capitalism," page 10, May 2019.

[iii] These include the merger of Portfolio 21 and Trillium Asset Management, the purchase of Calvert Investment by Eaton Vance, and that of First Affirmative Financial Network by Folio Institutional.
[iv] Blackrock has two ESG Exchange Traded Funds, DSI and KLD, plus fossil fuel free offerings; Fidelity announced a U.S. and an international fund, https://www.fidelity.com/about-fidelity/institutional-investment-management/first-two-sustainability-focused-index-funds; Hancock recently introduced four ESG funds, two in cooperation with Trillium Asset Management, an established SRI manager: http://www.trilliuminvest.com/trillium-asset-management-manage-john-hancock-esg-cap-core-fund/; J.P. Morgan's Intrepid Advantage Fund "Looks for companies that thoughtfully approach environmental, social and governance issues with attractive value, quality and momentum characteristics." https://am.jpmorgan.com/us/en/asset-management/gim/adv/products/d/jpmorgan-intrepid-advantage-fund-select-4812a1308
[v] See "Why and How Investors Use ESG Information: evidence from a Global Survey," Amir Amel-Zadeh and George Serafeim, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925310. See also https://www.msci.com/esg-sustainable-impact-metrics. And http://news.morningstar.com/articlenet/article.aspx?id=745467. Morningstar notes whether a fund intentionally invests in companies judged to follow SRI practices, and therefore is likely to remain socially responsible.
[vi] Interviews with Anthony Eames, senior vice president of Calvert Investments, Carsten Henningsen, founder of Portfolio 21 and current director of Progressive Investment, Steven Schueth, president of First Affirmative Financial Network (FAFN), FAFN chief operating officer Rebecca Jackson, and Erin Gray, vice president of Green Century Funds.
[vii] Lively discussions on this topic arose at the November 2016 SRI Summit sponsored by First Affirmative Financial Network. In particular, Timothy Smith, current head of shareholder advocacy for Walden Asset Management and for 24 years Executive Director of the Interfaith Center on Corporate Responsibility, engaged representatives of mainstream investment firms, including Blackrock.
[viii]https://www.cnbc.com/2019/03/08/jeff-bezos-to-end-secrecy-over-amazons-role-in-carbon-emissions.html;and https://www.greencentury.com/pressured-by-green-century-proposal-amazon-commits-to-cut-delivery-emissions-by-50-by-2030/
[ix] Scientific American, *op cit.* See also: Ceres website, https://www.ceres.org/news-center/press-releases/shell-announces-comprehensive-carbon-emissions-reductions-commitment; and Shell announcement: https://www.shell.com/media/news-and-media-releases/2018/leading-investors-back-shells-climate-targets.html.

[xi] See As You Sow's "Proxy Preview" for 2019, https://www.asyousow.org/reports/proxy-preview-2019; and also the US SIF trend report.
[xii] The case regarding corporate bonds is well established. See for example a report by PCA (the Pension Consulting Alliance), dated Sept. 17, 2015 to John Skjervem, chief investment officer for the investment division for the Oregon State Treasury. The report found that divesting state investments of bonds from the Carbon tracker 200 would not pose extra risk or diminish expected returns. The report stemmed from a conversation between the author of this paper and then State Treasurer Ted Wheeler. Other reports have reached the same conclusion. In the words of Jes Staley, Chief Executive Officer of Barclays Bank (U.K.): "As ESG considerations play out over a long horizon, and as they increasingly become a priority for company managers, they may help alleviate the pressure for short-termism and encourage a focus on long-term value creation – to the mutual benefit of the firm, its investors and the world at large." A comprehensive Barclays report found: "Our research into the impact of ESG on the performance of US investment-grade corporate bonds in the past seven years has shown that portfolios that maximise ESG scores while controlling for other risk factors have outperformed the index, and that ESG-minimized portfolios underperformed. The effect was most pronounced for the Governance tilt and least pronounced for the Social tilt. Favouring issuers with strong Environmental or Social rating has not been detrimental to bond returns. These conclusions hold using ESG ratings data from two different ratings providers, despite significant differences between the two ratings methodologies," page 34.
https://www.investmentbank.barclays.com/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/esg/barclays-sustainable-investing-and-bond-returns-3.6mb.pdf
Data on equities also is solid. A review of more than 2,000 academic studies on the subject reported: "The results show that the business case for ESG investing is empirically very well founded. Roughly 90% of studies find a nonnegative ESG–CFP relation. More importantly, the large majority of studies report positive findings. ESG and financial performance: aggregated evidence from more than 2000 empirical studies." Gunnar Friede, Timo Busch & Alexander Bassen. Journal of Sustainable Finance & Investment, 5:4, 210-233, DOI: 10.1080/20430795.2015.1118917. To link to this article: http://dx.doi.org/10.1080/20430795.2015.1118917.
Moreover, the impact of sustainable investors on corporations has been significant and positive, according to a 2015 report from Oxford University. From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Performance, by Gordon Clark; Andreas Feiner; Michael Viehs; University of Oxford and Arabesque Partners; 2015.http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11.The report, which drew on more than 200 sources, found that: "We now live in a world where sustainability has entered mainstream. That much is evident from the fact that over 72% of S&P 500 companies are reporting on sustainability, demonstrating a growing recognition of the strong interest expressed by investors. "In this enhanced meta-study we categorize more than 200 different sources. Within it, we find a remarkable correlation between diligent sustainability business practices and economic performance. The first part of the report explores this thesis from a strategic management perspective, with remarkable results: 88% of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cash flows. The second part of the report builds on this, where 80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance."

[xiii] http://www.iccr.org/about-iccr;
[xiv] https://www.ceres.org/about-us/coalition
[xv] http://www.ussif.org/trends, pg. 12).
[xvi] See the 350.org annual report: https://350.org/2015-annual-report/; for more on the Carbon Tracker 200, see https://gofossilfree.org/top-200/.