IVEY FOUNDATION

CHAIR'S REPORT

THIS IS THE FOURTH AND FINAL INSTALMENT of the Ivey Foundation's account of an effort to "activate" its endowment – structuring it to be a tool for making progress toward the Foundation's mission and goals. Incrementally shifting the portfolio's allocation to investments that prioritize sustainability as a core value has been a ten-year initiative. Over those same years, the broader conversation around sustainable investing, exactly what it is and how to get there, has moved from being a "side-bar reference" on an asset manager's research report to a central theme in many asset managers' marketing strategies. As this odyssey has unfolded, the level of sophistication among institutional investors has risen alongside the exponential growth of research, data, information and opinions available, and now retail investors are the focus of an increasingly fervent marketing effort.

All this is very good news.

As I write this commentary, the COVID-19 virus continues its assault on the global population. What the outcomes will be no one can know because the inter-related complexities in its path, across so many countries and cultures, are extreme. The unknown unknowns are out there. Amidst the countless observations, however, is one which stands apart and is impossible to ignore: the neglect of societal services in the care of our ageing population. This neglect is symptomatic of wider vulnerabilities, and highlights the need for resilient economies with financial and social infrastructure policies that strengthen, incent and reinforce the enduring benefits of operating sustainably in all that we do. Foundation President Bruce Lourie coined the term "palliative sustainability" whereby we focus on our personal comforts while societies approach collapse. This kind of "sustainable" practice relieves the symptoms of distress, but does nothing to repair underlying causes. We need resiliency to be an urgent battle cry.

The first steps taken to activate the Ivey Foundation's portfolio included buying green bonds and committing to private equity investments in the renewable energy fields, both directly and through funds. The next step was to allocate a portion of the endowment's public equities, also through fund-ownership, specifically to companies operating in solution-based businesses: companies that are selling and servicing in environmental sectors and are actively contributing to fixing the planet's ills. This theme-based approach is an important ingredient in making progress toward the Foundation's mission and goals. In 2019, we added a second public-equities fund with a solutions-based focus. This additional allocation brought our total sustainable investing exposure to 28 percent at year-end.

We made the decision early on to take incremental steps in the portfolio's evolution, in part so that we could evaluate decisions along the way. We see it as a marathon rather than a sprint. An important part of every decision has been to consider the Foundation's resources of time and expertise, as well as our granting goals and achieving the impact we feel is possible with the financial support we deliver. The final phase of the activation process focuses attention on the largest component of the endowment, our bench-marked portfolio of widely-held, geographically-diverse publicly-traded equities. And it is within this component of the endowment that ESG (Environmental/Social/Governance) investing will play a role.

ESG investing is an approach with one of its goals being to bring sustainability to the investing world. And while there is no doubt that this still-evolving movement has brought incalculable change and opportunity to global investors, it travels across an increasingly convoluted terrain and the sheer weight of opportunity can have the perverse and offsetting effect of diluting the very impact that ESG investing seeks.

The intention of players in the field, from banks to investment managers, consultants to advisors, is laudable, but with the efforts of so many contributing to advancing the "cause" of sustainable investment, there is also reason to take pause to ensure that we really know what "cause" the advisors are advocating for, or exactly what the sellers are selling.

The pool of experts in the ESG investing field is global and deep. Experts' opinions about why and how, who and when, are as diverse as the impacts that could be achieved by advancing an ethos of sustainability investing across all economies. The Ivey Foundation's mapping of the terrain over the past few years has included trying to absorb countless research reports, industry newsletters, marketing pieces, editorials, blogs and opinion pieces. From this ongoing exercise, there is plenty to be optimistic about, but few ground-breaking movements offer a smooth path. The need for caution, to overcome a tendency toward palliative sustainability, is real. I recently came across a succinct opinion piece that expresses every reservation that I've experienced in my travels over the ESG landscape, in my natural questioning mode. Fortunately, Tom Steffen, PhD, a London-based quantitative researcher, agreed to let me include an abridged version of his piece (see below) where he addresses some of the current shortcomings of the ESG industry and highlights the areas that need addressing in order to efficiently progress towards a more positive allocation of capital. This excellent piece of writing is worth its weight in ...impact!

So in the year ahead, our goal is to complete the portfolio's activation (for the time being) by first knowing exactly what we are looking for in the ESG field, separating the "tacked on" from the "baked-in" expertise, and conducting the necessary due diligence to find the ESG approach that most suits our overall strategy.

Rosamond Ivey

ESG: SO FAR, A TRIUMPH OF FORM OVER SUBSTANCE

ESG (ENVIRONMENTAL, SOCIAL, GOVERNANCE), the movement that has taken the investment world by storm, is plagued by vague terminology, untargeted solutions, and half-hearted commitments. The term's use by the investment community has increasingly become one of form over substance: too often claims of 'responsible' behaviour matter more than evidence. This article looks at what the investment community needs to do better in order to use its substantial influence to lead the transition to a sustainable and just future more decisively.

Cynics could point towards ESG investing being the most significant marketing initiative to seize the industry in years. While some managers are creating and applying ESG frameworks that offer quality and expertise, many are simply jumping on the ESG bandwagon to capitalise from the trend. For the growth in sustainable assets under management not to lose momentum by breaking the trust of investors and society at large, investment managers need to understand and address the key issues surrounding the way in which they define and apply ESG.

Confusion over definitions

ESG investing, sustainable investing, socially responsible investing, ethical investing, and impact investing are terms often used interchangeably. They describe, however, heterogenous investment approaches with important differences. A socially responsible investment fund and an ethical investment fund sound relatively similar at the outset, but comparing funds and mandates with different goals and strategies on a like-for-like basis can lead to erroneous conclusions. Without a universally agreed-upon taxonomy, each investment manager has a responsibility to be clear about the intent, objectives and expected outcome of each investment strategy, no matter the lens applied.

On complexities

E, S, and G are three connected categories, each covering a wide-ranging set of distinct challenges. ESG rating agencies use hundreds of indicators to measure a firm's performance on the diverse concepts within each category (such as carbon emissions in the E; human rights in the S; executive compensation in the G, just to name a few). The rating task is further complicated by the categories being closely interlinked: climate change clearly impacts society directly; droughts and water security have geopolitical implications, which in turn can threaten social justice and education. And the issues within each category are, by themselves, extremely complex.

There is no favouring of any of the categories. Each has merit, but it must be recognized that trying to address the concerns of ESG simultaneously across a complex matrix is inherently difficult, if not impossible. How do we objectively assess a company with strong pollution prevention but poor diversity credentials or alleged tax avoidance? This interrelatedness thereby cautions against a general-purpose approach, where impact is lost trying to solve too many issues at once.

Adequate expectations

'Doing well by doing good'. The decade old question of whether ESG investing is beneficial or detrimental to investment performance is difficult to answer without being more specific about the category that is being studied. Is the aim to address E, S, and/or G issues while also improving financial performance? Or is the objective solely to do good, but potentially accept financial sacrifices in favour of non-financial benefits? As such, the question of whether ESG considerations are value-enhancing strongly depends on the targeted outcome of risk, return, or non-financial benefits.

Do ESG metrics only have merit if they improve performance? No. It is, however, important to offer investors clarity about the objectives (and potential trade-offs) of including ESG considerations in their investment strategies. Do all elements of ESG improve returns? The answer is also no, and the costs and benefits should be evaluated. That said, specific indicators within the E, S, and G categories can be statistically related to return as well as risk. If the objective is to achieve both financial and non-financial benefits, 'doing well by doing targeted good' should be the preferred approach. Evidence also suggests that addressing ESG issues reduces downside risk for some categories more than others. No one-size-fits-all, and the devil is, as ever, in the detail.

About data

Data are key. ESG investing should be evidence-based using high-quality, detailed data with wide coverage. Data are most useful when retrieved directly from objective sources and when measuring quantifiable indicators. As more granular E, S, and G data become available, relevancy, accuracy, and the appropriate use in modelling will lead to the decision-making that distinguishes the leaders from the laggards.

On human capital

Human capital will provide an edge. While it is a considerable achievement that ESG concerns are increasingly acknowledged by professionals in the financial industry, it is crucial that broad generalist knowledge is supplemented with specialist knowledge from the fields of environmental economics and science, engineering, sociology, anthropology and many other experts from a range of academic disciplines.

Walk the walk

Cut through the noise: a conventional investment strategy with a standard aggregate ESG filter does not allow for today's complexities but rather, allows investment managers to do little while claiming a lot. More targeted investment strategies, run by specialist teams with adequate expertise and knowledge, are needed to successfully navigate the dynamic and complex ESG environment. The suggestion that $30 trillion of assets are now assigned to ESG strategies dramatically overestimates the actual state of the industry and is misleading about the level of dedicated assets.

While contributing many positives to the sustainable investment movement, organisations such as the Principles for Responsible Investment (PRI) inadvertently aggravate the situation with minimum compliance requirements that lead to memberships exploited as marketing ploys by the investment community. In addition to greenwashing, there is 'green-hoping'—the reliance of the ESG community on promised targets and corporate non-financial reporting quality to evaluate companies, rather than measuring achieved environmental, social, or governance improvements.

Conclusion

Overpromising on ESG achievements and investment performance will do substantial harm to the sustainable investment agenda; investors and society will lose faith in both the managers and the strategies on offer. This will in turn draw criticism and cynicism regarding the role of the financial sector in driving the transition to a sustainable and responsible future. Self-service and opportunism could sabotage the continuing development of the sustainable investment sector. The problem of greenwashing and green-hoping is ever-present, and it is debatable whether investors are doing enough to distinguish those that walk the walk from those that merely talk the talk. As such, specialist investment teams, evidence-based investment signals, and well-defined strategies are needed in order for substance to triumph over form and to drive the global transition to a sustainable and just future.

Tom Steffen, PhD

Dr. Steffen is a quantitative researcher at London-based sustainable investment firm Osmosis Investment Management. The full version of the article can be found here
https://www.responsible-investor.com/articles/esg-so-far-a-triumph-of-form-over-substance.