Sustainable Investing
Investing for the Greater Good

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REVISED VERSION

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College of the Holy Cross, Worcester, MA

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The SASB Mission
Improved non-financial disclosure results in enhanced market efficiency

Developing and disseminating sustainability accounting standards that help public corporations disclose material, decision-useful information to investors.
Utilizing a rigorous process that includes evidence-based research and broad, balanced stakeholder participation.

SASB is working to develop industry-specific standards to strengthen ESG disclosures and improve connections between sustainability performance and capital markets.

A Growing Need
Global megatrends, economic evolution create challenges for companies, investors

LEGISLATIVE PRESSURE
- Mandates in multiple markets (E.U., China, India, etc.)
- Disclosure reform
- Exchange listing requirements

ECONOMIC PRESSURE
- Resource constraints
- Climate change
- Changing valuations and the rise of intangibles

INVESTOR PRESSURE
- Shareholder resolutions
- Questionnaire fatigue
- Calls for divestment

STATE OF DISCLOSURE
- Proliferation of boilerplate disclosures
- Inappropriate use of materiality in corporate communications

NOTES:
The Evolution of Sustainable Investing

**What's in a name?** Impact Investing; Socially Responsible Investing; Environmental, Social and Governance (ESG) Investing; Sustainable Investing; “Non-Financial Considerations”; Corporate Social Responsibility...

“Investment process that integrates traditional financial analysis with non-financial ESG factors in an attempt to enhance long-term returns and manage risk in investment portfolios.”

-Calvert Investments, “Perspectives on ESG Integration in Equity Investing”, 2015.

**Exclusionary Screening**
- Divestiture from:
  - Tobacco
  - Oil and Gas
  - Coal
  - Etc...

**ESG Integration**
- Enhanced approach for incorporating ESG considerations into investment decisions by identifying both the financial risks and opportunities related to ESG issues.

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**Why Should Investors Care?**

Material sustainability data extends the mosaic of fundamental information

**Components of S&P 500 Market Value**

<table>
<thead>
<tr>
<th>Year</th>
<th>Intangible Assets</th>
<th>Tangible Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td></td>
<td>0%</td>
</tr>
<tr>
<td>1985</td>
<td></td>
<td>10%</td>
</tr>
<tr>
<td>1995</td>
<td></td>
<td>20%</td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td>30%</td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: Ocean Tomo
Compelling Research
Harvard research shows SASB's approach drives superior performance

“Corporate Sustainability: First Evidence on Materiality,”
Working Paper by Mozaffar Khan, George Serafeim, and Aaron Yoon
Harvard Business School, 2015

Stock Returns (in annualized alpha) by Type of Sustainability Performance

Findings:
• Using SASB's framework, Harvard researchers found that firms with good performance on 'material sustainability issues' and concurrently poor performance on 'immaterial sustainability issues' enjoy the strongest financial returns. These results speak to the efficiency of firms' sustainability investments, and also have implications for asset managers who have committed to the integration of sustainability factors in their capital allocation decisions.
• They also found that 80 percent of disclosures are immaterial, having no correlation to positive performance.

Growing Demand
Investors and analysts are increasingly seeking out sustainability data

Customers using ESG data on the Bloomberg Professional service:

Source: Bloomberg LP

NOTES:
Case Studies

Pension Funds and Institutional Investors are interested in sustainable investing from an alpha-generating and risk-reduction approach.

- One of the world’s largest institutional investors.
- Signatory of the UN’s Principles for Responsible Investment, which recognizes ESG factors as critical to investors.
- As of 2015, requires all of its investment managers to identify and integrate ESG factors into their decision-making.
- $91 billion endowment and retirement funds.
- President’s Task Force on Sustainable Investing created to develop framework for the management of ESG considerations for investment decisions.
- UC Regents have voted to divest from coal mining and oil companies focused on tar sands.
Fiduciary Duty
ESG integration consistent with fiduciary duty

Pension funds and their trustees have two fiduciary duties:

- Duty of care
- Duty of loyalty

  Duty of impartiality - Fiduciaries must balance short-term and long-term considerations (US Supreme Court in Varity v. Howe (1996)). They must identify and impartially consider the conflicting interests of different beneficiary groups, including those of current and future retirees (Restatement of Trusts, Third, 1992).

Duty of impartiality requires competence in long-term value creation and risk management.

Investor Uptake
Investors use SASB to engage with companies held in their portfolio

Harvard Management Company
Selects companies for engagement based on ESG risks identified as having a direct impact on business operations and shareholder value, risk management oversight and disclosure practices, and the value of holdings.

HMC’s current engagement focus is on encouraging better management and disclosure of climate risk among companies in the energy sector. **HMC is encouraging companies in its engagement efforts to use SASB standards** to report material sustainability risks, including climate risk, in their existing public filings so that investors can make more informed long-term investment decisions.
A Market-Driven Response
SASB addresses needs of all market participants—both investors and issuers

Issuers
- A minimum set of disclosure topics that are likely to constitute material information for companies in an industry, and a cost-effective model for disclosing that information in a decision-useful way for investors
- A method to understand and improve performance on ESG-related value drivers
- A way to meet the requirements of Regulation S-K

Investors
- Comparable data for benchmarking and evaluating performance
- Standardized, decision-useful information in a trusted channel (i.e., 10-K)
- Tools and resources to analyze and understand sustainability risks and opportunities at the company, industry, and portfolio level

SASB INDUSTRY WORKING GROUPS REFLECT BROAD-BASED INTEREST

>2,800 $23.4T $11.0T
PARTICIPANTS ASSETS UNDER MANAGEMENT MARKET CAP

A Shared Definition of Materiality
SASB is guided by the Supreme Court definition in identifying disclosure topics

“Material information” is defined by the Supreme Court as presenting a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.

EVIDENCE OF INTEREST
Issue frequency in five data-driven tests:
- Financial disclosure
- Legal drivers
- Industry norms
- Stakeholder concerns
- Innovation opportunity

EVIDENCE OF FINANCIAL IMPACT
Issue impact on three business value drivers:
- Revenue and costs
- Assets and liabilities
- Risk profile (cost of capital)
## Explicit Financial Links

Each of SASB’s evidence-based metrics is tied to specific financial impacts

<table>
<thead>
<tr>
<th>Value Impact</th>
<th>SASB Metric</th>
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<tbody>
<tr>
<td>REVENUE</td>
<td><strong>Medical Loss Ratio (MLR):</strong> Medical costs as % of premium revenue&lt;br&gt;Managed care firms with higher MLR spend more on patient care, likely improving outcomes which may lead to improved customer satisfaction and market share; meanwhile, firms with lower MLRs may be required by the ACA to offer consumers a rebate which may affect operating profits&lt;br&gt;<strong>Investor use:</strong> Comparative valuation</td>
</tr>
<tr>
<td>COST</td>
<td><strong>Total Energy Consumed, % Grid Electricity, % Renewable</strong>&lt;br&gt;Energy-intensive firms may be overexposed to volatile energy prices, vulnerable to certain risks if reliant on the grid, and/or incur indirect costs from internalization of carbon prices; investments in self-generation, energy efficiency, and renewables may require new processes (R&amp;D)&lt;br&gt;<strong>Investor use:</strong> Comparative analysis and fundamental valuation</td>
</tr>
<tr>
<td>ASSETS &amp; LIABILITIES</td>
<td><strong>Total Loans to Companies in the Non-Renewable Resources Sector</strong>&lt;br&gt;Energy-intensive firms may see associated with their outstanding loans and leases, decreasing interest income to commercial banks and devaluing collateral and loans; weakened balance sheets can lead to higher cost of capital&lt;br&gt;<strong>Investor use:</strong> Comparative analysis, fundamental valuation</td>
</tr>
<tr>
<td>COST OF CAPITAL</td>
<td></td>
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## Rigorous, Transparent Process

SASB standards are rooted in evidence and shaped by consensus

**UNIVERSE OF ESG ISSUES**

- **Industry Research**
  - Evidence-based discovery
- **Vetting**
  - Industry working group engagement and evaluation
- **Standards Development**
  - Disclosure topics and metrics consensus and definition
- **Public Comment**
  - Feedback and refinement
- **Provisional Standards Release**
  - Road testing by companies
- **Codification**
  - Use by companies, data for investors
Delivering Data
SASB research provides analysts with data on performance and financial impacts

<table>
<thead>
<tr>
<th>Investment Analysis</th>
<th>Risk Management</th>
<th>Portfolio Construction</th>
<th>Active Engagement</th>
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<tbody>
<tr>
<td>Integrate sustainability into fundamental analysis</td>
<td>Consider sustainability in portfolio risk evaluation</td>
<td>Incorporate sustainability into active, passive strategies</td>
<td>Interact directly with issuers on key sustainability factors.</td>
</tr>
<tr>
<td>Analysts, Portfolio Managers, ESG Teams</td>
<td>Asset Owners, Chief Risk Officer</td>
<td>Portfolio Managers</td>
<td>Asset Owners, Governance Teams</td>
</tr>
<tr>
<td>How</td>
<td>Who</td>
<td>How</td>
<td></td>
</tr>
</tbody>
</table>

Integration Guide for Asset Managers
Industry Research Briefs
Data Provider Partners

Materiality Map™
Sustainable Industry Classification System™ (SICS™)
Industry Research Briefs

Materiality Map™
SICS™
Data Provider Partners
Investible Products

Engagement Guide for Asset Owners
Industry Research Briefs
Issues Tables

For a Range of Investors
SASB standards, tools, and resources support a broad range of investment decisions

<table>
<thead>
<tr>
<th>What</th>
<th>Who</th>
<th>How</th>
</tr>
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</table>
| Integrate sustainability into fundamental analysis | Analysts, Portfolio Managers, ESG Teams | Integration Guide for Asset Managers
Industry Research Briefs
Data Provider Partners |

Consider sustainability in portfolio risk evaluation | Asset Owners, Chief Risk Officer | Materiality Map™
Sustainable Industry Classification System™ (SICS™)
Industry Research Briefs |

Incorporate sustainability into active, passive strategies | Portfolio Managers | Materiality Map™
SICS™
Data Provider Partners
Investible Products |

Interact directly with issuers on key sustainability factors. | Asset Owners, Governance Teams | Engagement Guide for Asset Owners
Industry Research Briefs
Issues Tables |

Industry-specific range of performance

Topic-specific financial impacts

Data availability

SASB Disclosure Topics & Metrics

NOTES:
A Smarter Benchmark
SASB standards yield performance data, emphasizing quality over quantity

Existing sustainability indexes:
- Maximize data points, masking correlation
- Rely on disclosure as a proxy for performance
- Track the S&P 500

SASB data will spur “smart” investible products using companies’ performance on material, industry-specific factors rather than the universe of available data.

Source: S-Network, Thomson Reuters

Empowering Investors
SASB is developing guidance for asset owners and analysts

SASB Engagement Guide for Asset Owners
SASB Integration Guide for Financial Analysts

NOTES:
What Investors Can Do Now
Engage with companies, members, service providers, and SASB

- Use SASB standards to help guide engagement activities
- Incorporate sustainability into your investment policy statement
- Ask your data provider(s) to incorporate SASB standards
- Share feedback on the Standards and their use in your organization
- Make a statement of support for SASB
Learn More
Increase your understanding of the link between sustainability and corporate value

Fundamentals of Sustainability Accounting Credential
The world’s first credential in sustainability accounting

Level I: Principles
- The context for materiality and sustainability
- How to identify the sustainability factors impacting financial performance

Level II: Practices (2016)
- How to analyze SASB standards for any industry
- How to interpret sustainability information for strategic decision-making or investment analysis

FSA.sasb.org/prep for curriculum, free resources, and registration

Accounting for a Sustainable Future

NOTES: