Thursday 25 August 2022

focus

Q&A with Katie Beith

Katie has been in the ESG (Environmental, Social, Governance) industry for almost 20 years, with the first part of her career spent overseas, predominantly in the UK. On returning to New Zealand in 2015, she joined New Zealand Super Fund as a Senior Investment Strategist for Responsible Investment. In November 2021, Katie joined Forsyth Barr as the Head of ESG to take on the responsibility of incorporating ESG principles into the company's firm wide operations and investment process, including assisting advisers with specific client needs.

We talked to Katie about how her first year is progressing, the media hype around ESG, and how Forsyth Barr is building capabilities in this quickly evolving space.

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Let's start with ESG – what is it and why is it important to investors?

ESG (which stands for environmental, social, and governance) is a term that's been around for about 20 years. It originally started with a group of investors in Europe who recognised that ESG issues, when mismanaged, could evolve into significant financial issues for a company or industry. They believed that ESG factors should be assessed, just like investors do with traditional financial data and other possible influences and risks.

Early examples of ESG issues impacting companies' performance and value include corporate governance scandals (accounting fraud) at Enron, Tyco, Parmalat, and the brand damage to Nike and Gap following allegations of child labour in their supply chains. These issues were unnoticed by investors until significant investment value was already lost.

Investors were trying to get more on the front foot by assessing how companies were managing ESG issues, aiming to identify these risks before they came to light, and factor them into investment decisions. This was when the term 'ESG integration' began to be used.

Can you give us a flavour of what ESG issues are?

ESG encompasses a very broad set of issues.

Under 'E' it is things like the carbon emissions profile of a company, how it manages its waste and water use, how it ensures it's not impacting biodiversity around its operations.

Under 'S' it includes how a company looks after its employees and surrounding communities. COVID increased the focus on things like company policies around flexible working which help to attract and retain employees.

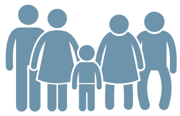
And under 'G' are factors such as corruption prevention, responsible tax management, and corporate governance standards.

Over time, as investors have increasingly focused on these issues and recognised they can meaningfully impact investment performance, companies have responded and talked more about how they are managing them.

Example ESG Issues

ENVIRONMENTAL

- climate change
- resource depletion
- waste
- pollution
- deforestation



SOCIAL

- human rights
- modern slavery
- child labour
- working conditions
- employee relations

GOVERNANCE

- bribery and corruption
- executive pay
- board diversity and structure
- political lobbying and donations
- tax strategy

How do investors use ESG information?

Everybody's values and ESG ambitions are different. This makes investing with an ESG lens complex and nuanced, with a one-size-fits-all solution unlikely to meet a person or organisation's specific expectations. Individual conversations are important. As is education to understand the different terminology. Working through an investor's motivations and long-term ambitions is also important. Are they driven by risk, return, impact, values, or a mix of all? Is it important to have a fossil fuel free portfolio today, or is it important to allocate capital to those fossil fuel companies that are driving the transition to a low carbon economy?

...ESG integration looks to evaluate how ESG issues may turn into investment risks or opportunities for a company or sector...

ESG can be incorporated in an investment portfolio in a number of different ways.

Ethical exclusions look to align a portfolio with an investor's values by excluding certain industries such as tobacco, weapons, or companies that may have breached global standards.

ESG integration looks to evaluate how ESG issues may turn into investment risks or opportunities for a company or sector. It does not, however, seek to assess the impacts on the environment and society of a company's operations, products, and services.

Sustainability investing seeks to take advantage of investible themes connected with the transition to a more sustainable society, for example clean energy or sustainable agriculture.

Responsible investment considers ESG issues while also committing to engage with companies to influence their direction of travel.

Impact investing goes a step further. It seeks to deliver measureable positive benefits to the environment or society alongside meeting a required financial return.

Is ESG making a difference?

As more and more investment funds flow into an ever larger number of ESG products the spotlight on the industry continues to grow. There have been mounting criticisms that many of these products fail to deliver on their promise. Pressure is growing from both investors and regulators for the substance of ESG solutions to match up with the rhetoric. In our view this scrutiny is needed, and hopefully a sign that the industry is maturing, creating the impetus to deliver tangible improvements.

KiwiSaver funds touting themselves as ethical are falling short of their claims, FMA says

Deutsche Bank's DWS and allegations of 'greenwashing'

ESG Whistleblower Calls Out Wall Street Greenwashing

ESG Backlash Has Fund Clients Demanding Proof It Works

SEC investigating Goldman Sachs for ESG claims

Whilst ESG isn't perfect, it is important not to lose sight of the key goals of ESG:

> *1. Globally there are many significant environmental and social issues. The behaviour of corporations will influence how those issues evolve over the decades ahead.*
>
> *2. Many investors want their values reflected in their investment portfolios.*
>
> *3. Investors can potentially influence the behaviour of companies with how they allocate capital and engage with those organisations.*

We recognise that it is easy to talk the talk on ESG but more difficult to walk the walk. Investors need to fully understand the options and make informed choices to ensure their ESG strategy delivers on more than simply branding.

What is Forsyth Barr doing to help clients incorporate ESG in investment portfolios?

We are building deep expertise and capability within our investment team in the areas of ESG, climate, responsible and impact investing. Further, we have significantly boosted our resources in recent years. In particular:

Forsyth Barr is a subscriber to Sustainalytics and Eikon Refinitiv, enabling us to screen and access ESG information for around 13,000 securities.

We are members of the Responsible Investment Association of Australasia (RIAA) to boost our connectivity with the RI community.

We are developing proprietary ESG investment ratings, which include a specific focus on climate; and ESG-enhanced Model Portfolios.

We are building relationships with external managers with ESG products.

Forsyth Barr has partnered with local impact investors and has facilitated investment in this space.

MOVING TOWARDS A PORTFOLIO WITH ESG AT THE HEART

Immediately able to implement:	Implementable in the medium term:	Longer term aspirations:
Clearly defined exclusions aligned with values	ESG Model Portfolio	Net zero portfolio commitment
RI Policy	Proprietary ESG and carbon ratings for NZ companies	More impact / sustainability themed / ESG investments
Identification of ESG and carbon risk, UN Global Compact compliance, media controversies (international)	Increasing NZ impact investments for consideration	Reporting on 'actual' outcomes
Identification of revenue streams from sustainable products (international)	Climate change assessment of Model Portfolio companies	
Switch some global equities into ESG themed ETFs	Carbon analytics on portfolios	
Take up new green bond issues in NZ	Increased externally managed ESG options	
Fixed income allocation to the Dimensional or Daintree Funds	Enabling of private market investment	
	Engagement and voting	

…it's important to progress the conversation on ESG…

Building our ESG capability is a work-in-progress. However, for clients ready to move quickly there are some actions which can be undertaken immediately. Other tools and services will take a bit longer to develop. Some may actually take a few years such as ensuring all companies within a portfolio are committed to meeting the agreements of the Paris Accord. We do have a number of work streams underway and in the pipeline which will broaden the ESG options for our clients over time.

Katie Beith
Head of ESG

To conclude

It's been a busy year but we've made good progress. A key message for our clients is that it's important to progress the conversation on ESG. The initial steps for any individual or organisation wanting to incorporate ESG within their investment portfolio are:

1. *Education: understand the terminology.*
2. *Ensure values are defined.*
3. *Identify what you want to achieve (risk, return, impact, alignment of values).*
4. *Take the first steps to incorporate authentic ESG solutions.*
5. *Establish longer-term ambitions.*

This will not result in a perfect outcome on day one but should be viewed as the first steps in a long-term evolution.

If this article has piqued your interest, please talk to your adviser. They are always happy to help.

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