

# Sustainability: integrating investment risks of the future

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# Sustainability

## A perfect storm



### Accelerating change

Average tenure in the S&P 500 has dropped from 50 years to under 15 years over the last five decades



### Global challenges

Require finance's involvement to solve



### Regulatory scrutiny

Regulators trying to make the whole financial chain more sustainable

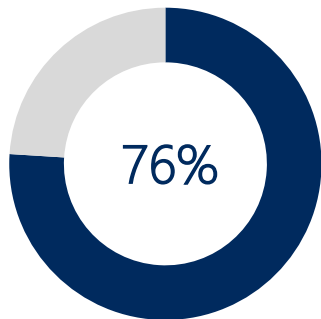
Trustees told to "wake up and smell the coffee"



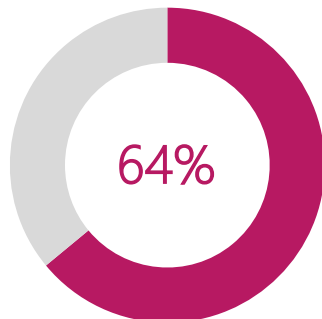
### Member pressure

Savers are increasingly focused on sustainability-related issues

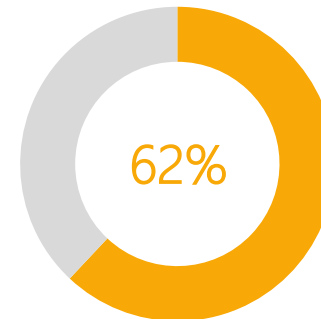
# Sustainable investing increasingly important to end investors globally



of investors felt sustainable investing is more important than 5 years ago



have increased their allocation to sustainable investments over the past 5 years



interested in sustainable investment funds e.g. climate change and good corporate governance



# But sustainable investing is not simple

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## Confusion over definitions

Range of different investment products under the broad umbrella



## Performance concerns

Many products in this space have not met performance expectations



## Lack of transparency

Leading to confusion over what the intended approach is

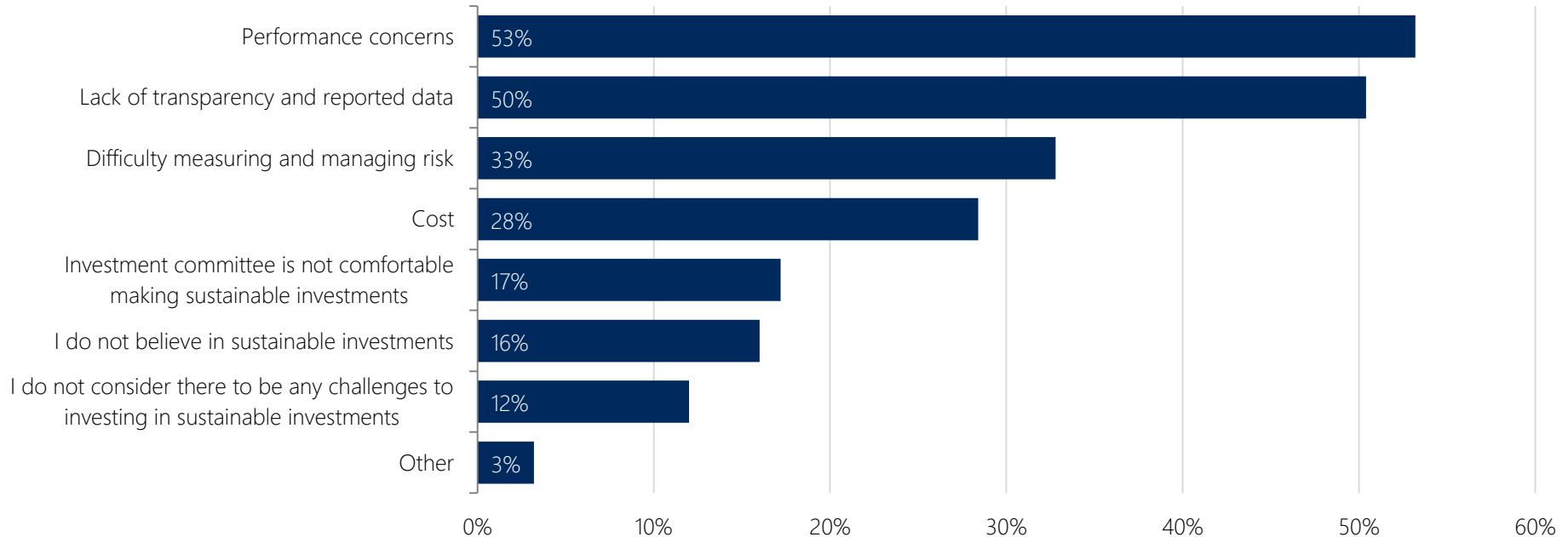


## Questions over members' views

What do they want?

# Barriers to investing more sustainably

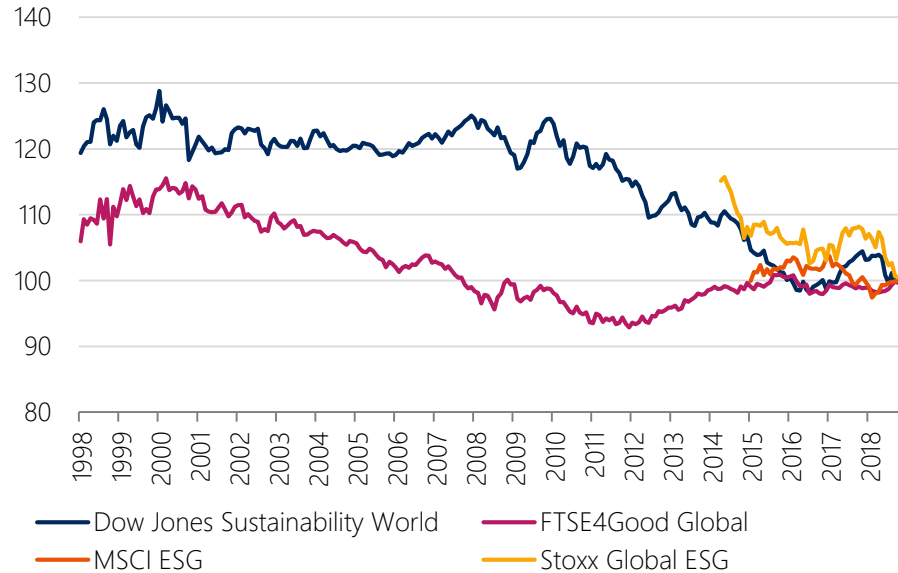
Which, if any, of the following specific factors do you consider a challenge of investing in sustainable investments?



# Performance concerns

## Tick box approaches have struggled

Indexed, latest – 100



Name	MSCI pre event	MSCI change	MSCI post event
BHP Billiton	A	+1	BBB
Volkswagen	BBB	+3	CCC
Toshiba	AAA	+3	BBB
Olympus	AAA	+6	CCC
Siemens	AAA	0	AAA
Compass Group	A	+1	BBB
Carnival	BB	+2	CCC
BP	AA	+3	BB
Barclays	A	+3	B
Comcast	B	+1	CCC
Costco	BBB	+3	CCC
Experian	A	+1	BBB
Target	BB	+2	CCC
Sports Direct	A	+1	BBB
Lloyds	BBB	+3	CCC
Vodafone	AA	-1	AAA

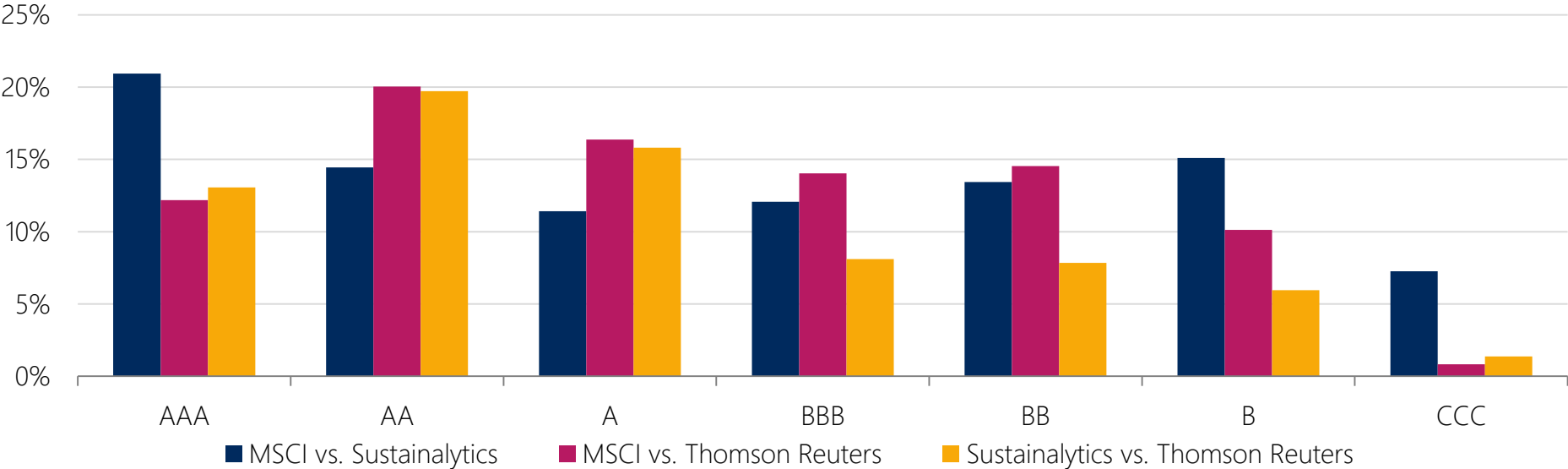
Average rating pre and post **controversy**



# Challenges with conventional ESG ratings

## Little consistency or transparency

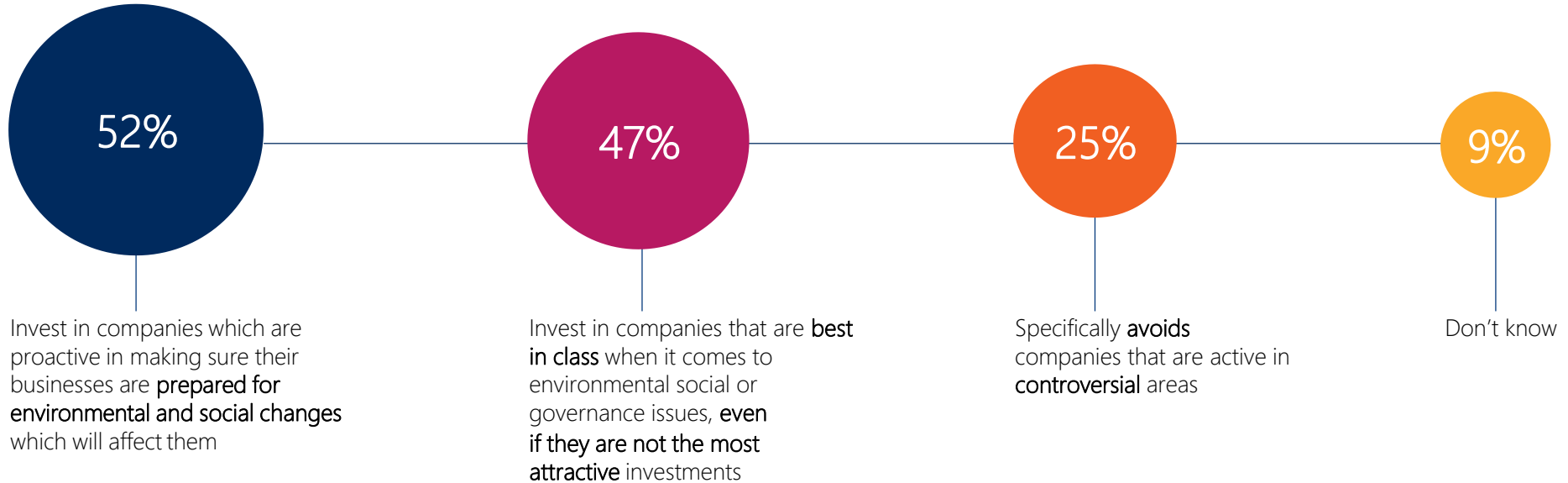
Less than 20% probability of ESG scores being the same across providers



# What might members want?

Understanding of sustainable investing has become more sophisticated

Which of these phrases describe what you think a Sustainable Investment fund is?

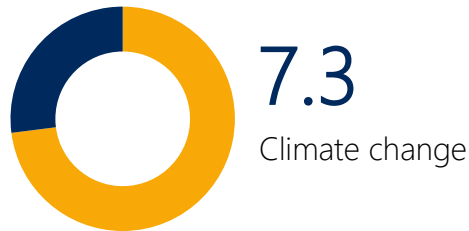
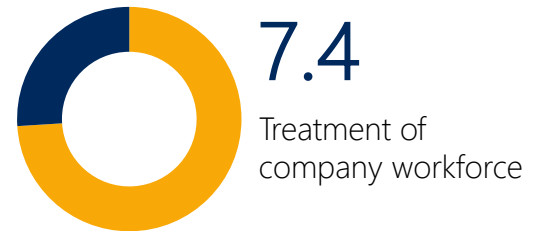
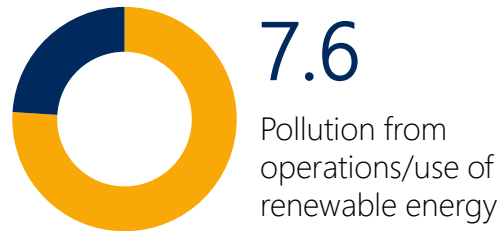
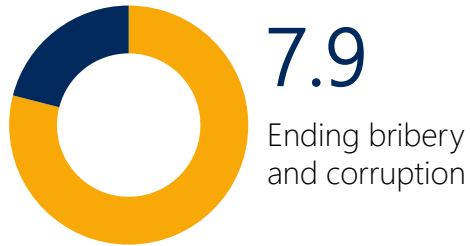




# What do investors care about the most?

## Priorities for engagement and influencing company behaviours

Areas of importance to potential investors on a scale of 1 (not at all important) to 10 (extremely important)



# Bridging the gap

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## Comprehensive approach

Integrating the risks of the future, in investment terms



## Active ownership

Deeper and more meaningful engagement



## Transparency

Reporting on engagement, voting and the sustainability profile of portfolios



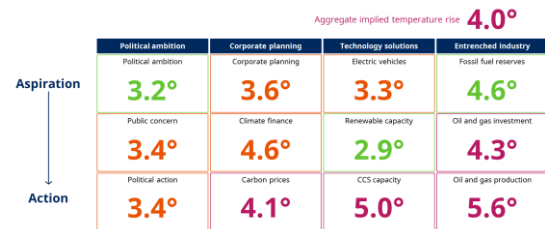
## Providing clarity

Being clear on what we are targeting with different approaches

# Comprehensive approach

## Unique sustainability insights

### Climate progress dashboard



Shows how climate change will impact a number of industries, and the scale of the challenge

Demonstrates the gap between winners and losers between and within sectors



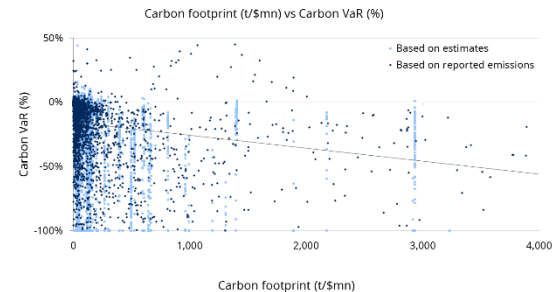
**Equities:** highlighted benefits of being the cleanest player in challenged industries. Reflected in stock selection

**Fixed Income:** demonstrated need for ongoing R+D for auto. Positioned in best invested names

Engaged with companies not disclosing enough on the risks

Event for non-exec directors to educate them on the systemic risks

### Carbon Value at Risk (CVaR)



**Schroders** Source: Schroders.

# Comprehensive approach

## Identifying emerging trends and actively engaging with companies

2015: Thematic research



Adjust portfolio positioning

Fixed income portfolios reduce their sugar exposure ahead of the announcement of many sugar taxes

2016: Sugar roundtable



- Engaged with companies to better understand how they are managing their exposure

TESCO

KERRY

Morrisons  
Since 1899

WHITBREAD

Nestlé

Coca-Cola

BARR  
SOFT DRINKS

Unilever

Associated  
British Foods  
plc

BRITVIC  
plc

TATE & LYLE

2017: Investor expectations



- Calls for greater transparency and more consistent data
- Outlines five core principles for board consideration
- Provides suggested KPIs and categories
- Endorsed by over 20 investors globally representing **£1.8 trillion**



# Comprehensive, forward-looking approach

Analysing impacts not yet reflected in financial statements



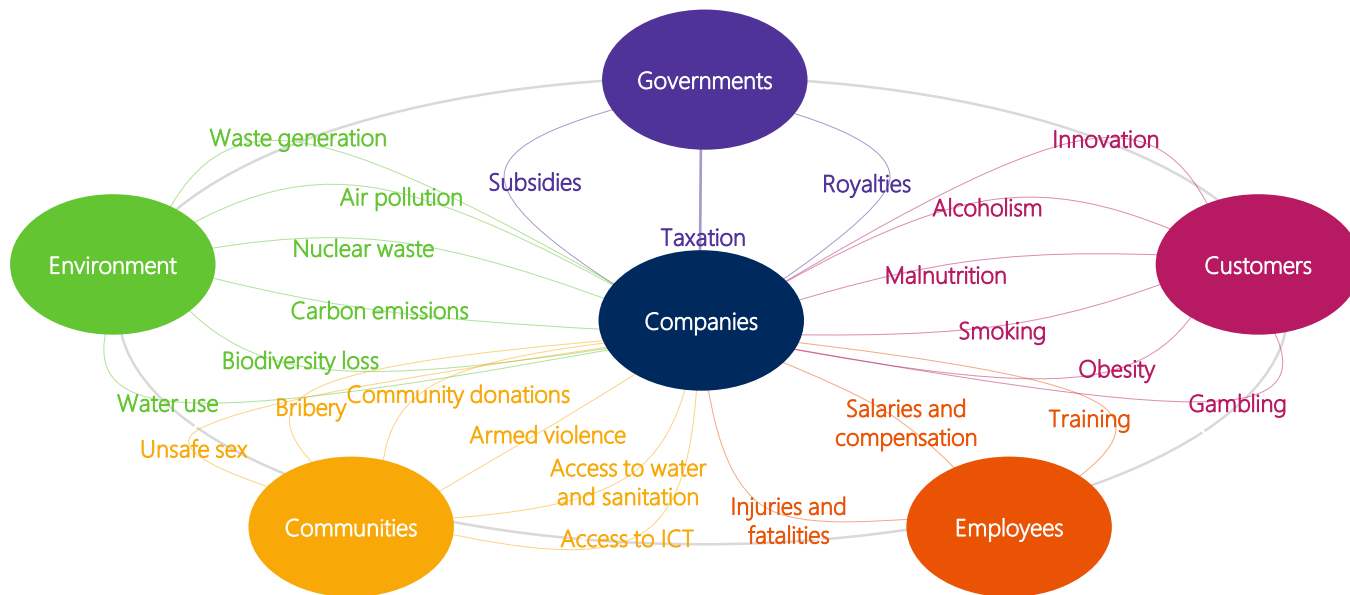
Companies **contribute to society** and **impose costs** on it, neither of which are reflected in their financial statements.



Those **social deficits** and **credits** can be quantified. They are borne by the public sector today or create debts that will be repaid in the future.

# We have identified a range of quantifiable impacts

Business activities with measureable social costs or benefits



# SustainEx: focusing on the 'E' and 'S' of ESG

## Comprehensive research-driven process



measures of social or environmental impact



large global companies examined

Over 400 academic and industry studies of social impacts and externalities



70 reported data points for each company, estimated where not disclosed e.g. wages, taxes



Unconventional data from public sources e.g. patent registrations, stress perceptions



# Calculating impacts

## Three approaches to calculating company level impacts



### Global value

Estimated annual global social burden/impact



Define activity responsible for impact



Share global cost between companies based on activity



### Unit activity

Estimated impact of individual actions



Quantify or estimate level of activity for each company



Calculate burden associated with company actions



### Geographically defined

Impacts which vary between countries



Calculate baseline requirement based on company exposure



Compare actual contribution to required baseline



# SustainEx: analysis based on economics

## Objective and quantifiable

1

### Identify impacts

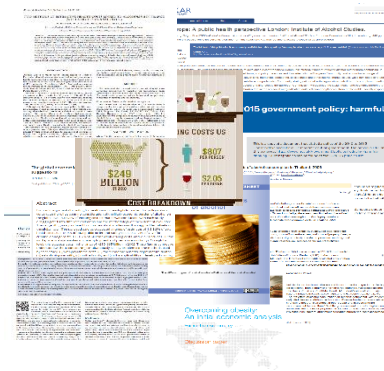
Alcohol consumption results in significant health costs and indirect social costs



2

### Definition and assumptions

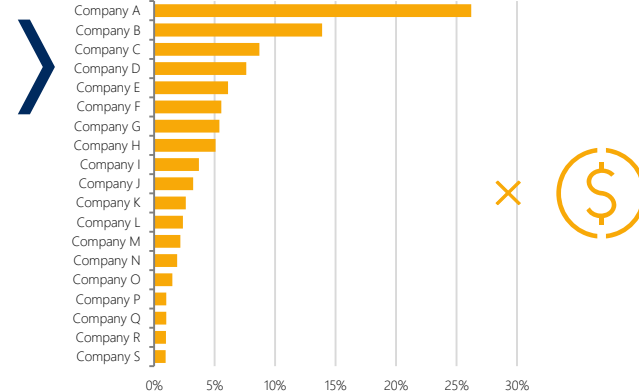
Attribute global social burden of alcohol use based on companies' share of production



3

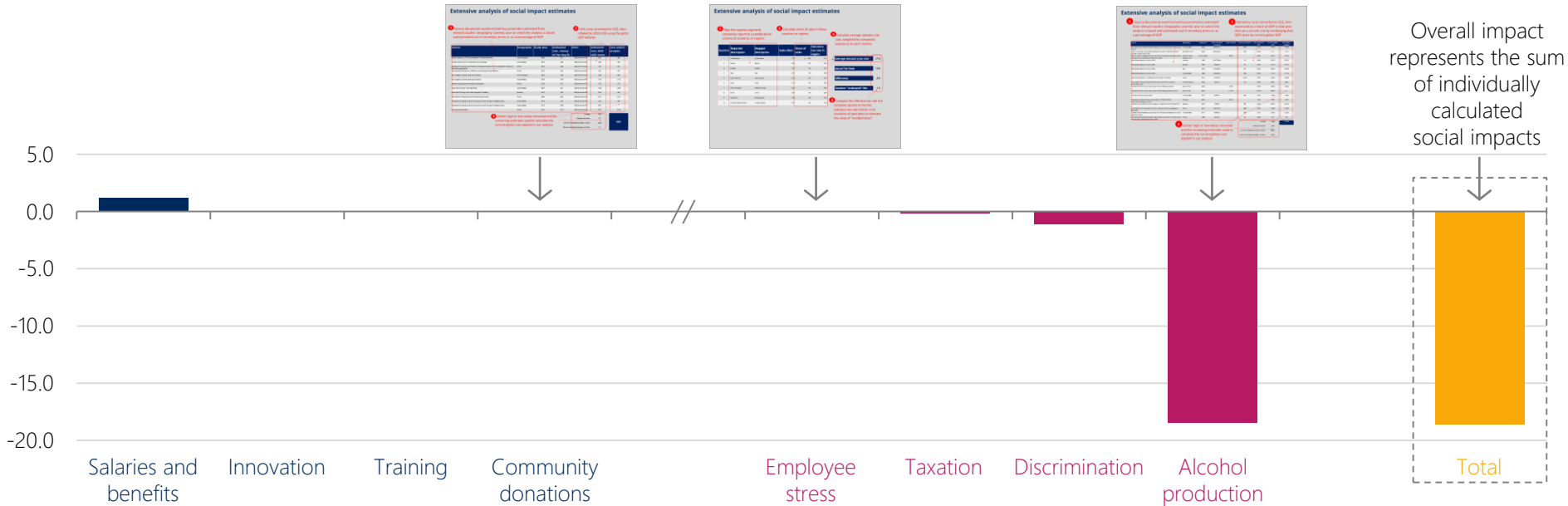
### Calculation

Estimate share of global alcohol sales for each company using reported data. Multiply by global cost estimate



# Bringing the analysis together

## Issue-by-issue analysis for each company



# Active ownership and transparency

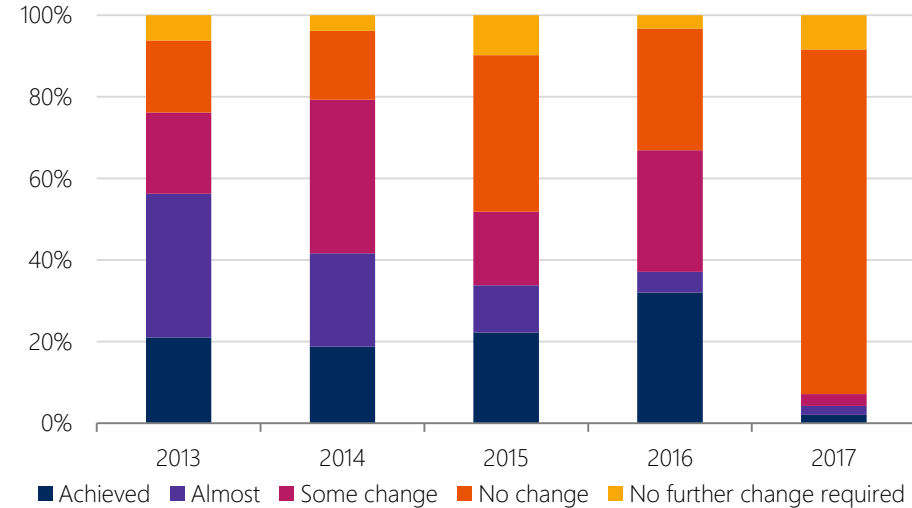
## Engaging with companies on material ESG issues

### 2017 engagement topics

Environmental	Social	Governance
Biodiversity	<b>Customers</b>	Accounting practices
<b>Climate change</b>	Data security	Auditors
Environmental policy/ strategy	Health and safety	Board committees
Environmental products and services	<b>Human capital management</b>	Board structure
Environmental supply chain	Human rights	<b>Business integrity</b>
Forests	Labour standards	Corporate strategy
Pollution	<b>Nutrition and obesity</b>	<b>ESG governance and sustainability strategy</b>
Waste management	<b>Product safety</b>	<b>Governance oversight</b>
Water management	Social policy/strategy	<b>Remuneration</b>
	<b>Supply chain management</b>	Shareholder rights
		Succession planning
		Transparency and disclosure
		Voting

### Effectiveness of requests for change (by company engaged)

Success level of company engagement



# The benefits of a sustainable approach



## Investment insight

A deeper understanding of how the world is changing



## Delivering alpha

A forward looking approach to capital allocation



## Better stewardship

Active ownership to mitigate the risks that cannot be eliminated



## Investment focused

Products that meet beneficiary expectations in performance and sustainability terms

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