

Introducing the PRI & Responsible Investment

James Robertson, Head of Asia (ex-China & Japan)

PRI



Who Is The PRI?

Investor-led, supported by the United Nations

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice.

Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions.

1 We will incorporate ESG issues into investment analysis and decision-making processes.

2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.

2

UN PARTNERS:

UNEP FINANCE INITIATIVE
UN GLOBAL COMPACT



4,000+

SIGNATORIES:

ASSET OWNERS
INVESTMENT MANAGERS
SERVICE PROVIDERS



121.3

US\$ trn

**ASSETS UNDER
MANAGEMENT**



A Consideration of Mission

"We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

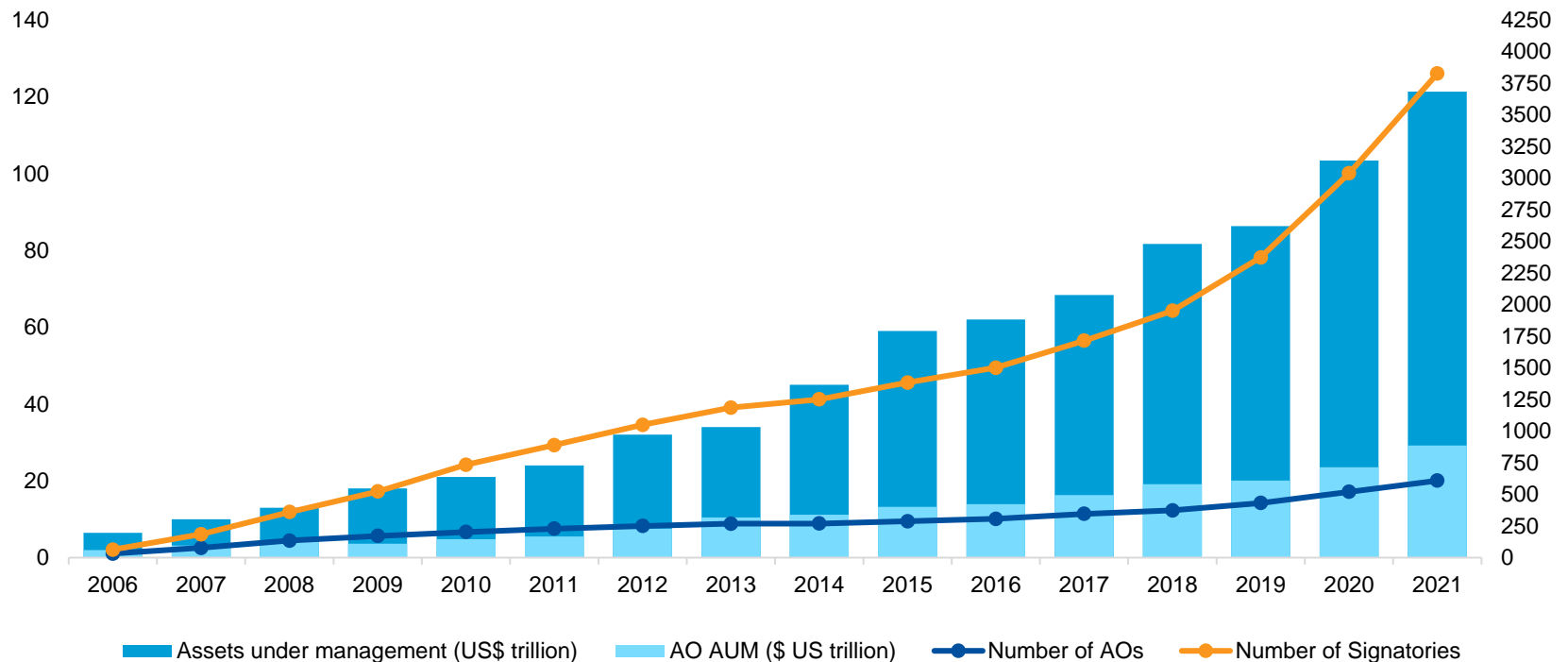
The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation."



Interest in Responsible Investment Has Picked Up Pace...

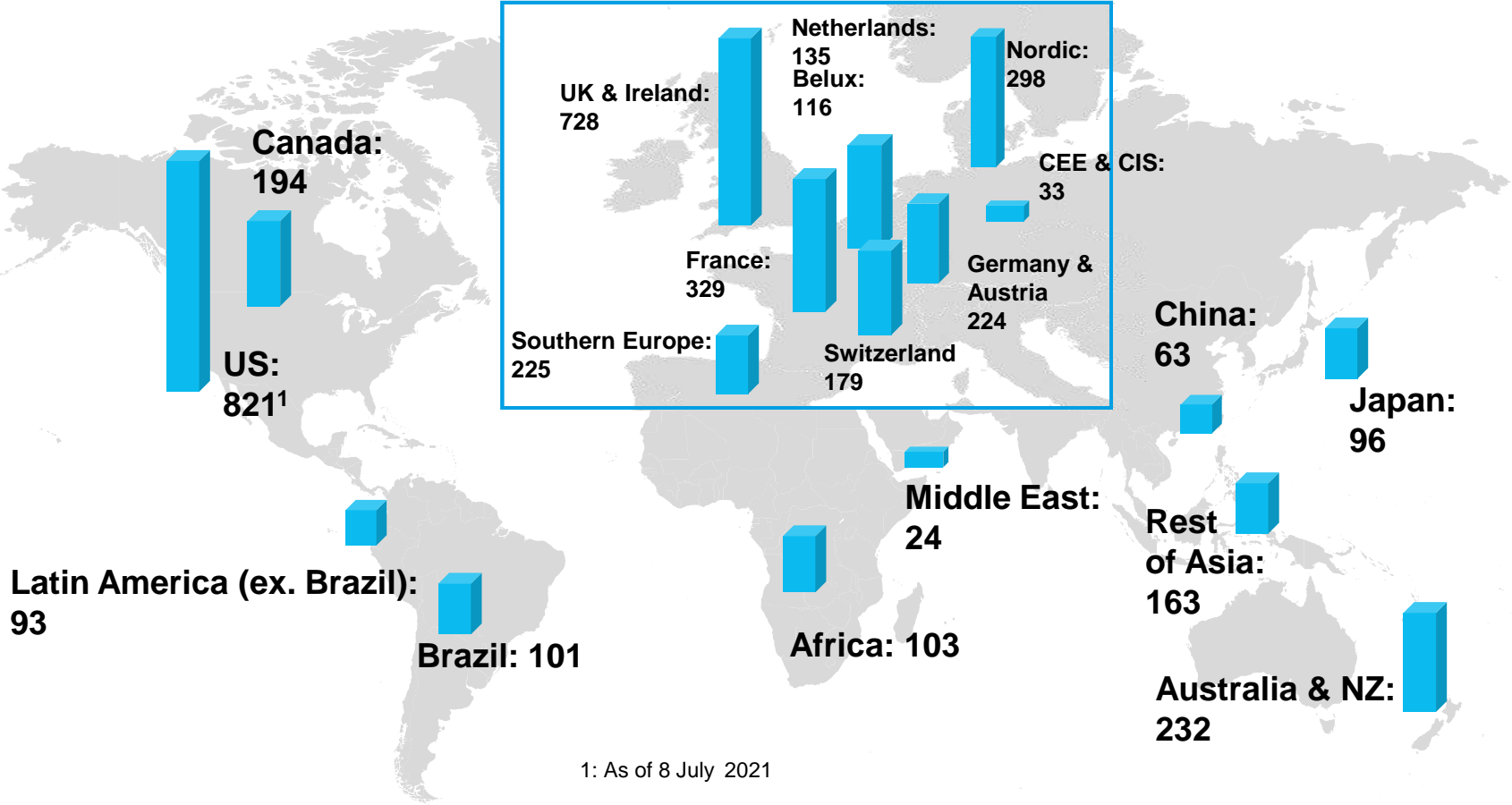
Assets under management (US\$ trillion)

N° Signatories



*Total AUM include reported AUM and AUM of new signatories provided in sign-up sheet that signed up by end of March of that year.

...With Adoption by Investors From Across Over 85 Different Countries



Part of a Wider Sustainable Finance Eco-system

The PRI is just one of many collaborative initiatives existing at a national, regional and global level...



An initiative by Institutional Investors Council Malaysia & Capital Markets Malaysia

What is Responsible Investment & How is it Done?

Responsible investment is a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership

CONSIDERING ESG ISSUES WHEN BUILDING A PORTFOLIO (known as: ESG incorporation)			IMPROVING INVESTEEES' ESG PERFORMANCE (known as: active ownership / stewardship)	
Integration	Screening	Thematic	Engagement	Proxy voting

Getting Started in Responsible Investment: A Structured Approach

It is important to embed responsible investment into an organisation's structure and processes



Key Drivers In The Mainstreaming of Responsible Investment

Manage risks, meet market demand and fulfil investor duty



Materiality

Increasing recognition within the financial community that ESG factors often play a material role in determining risk and return.



Market demand

Growing demands from beneficiaries and investors for greater transparency about how and where their money is being invested.



Regulation

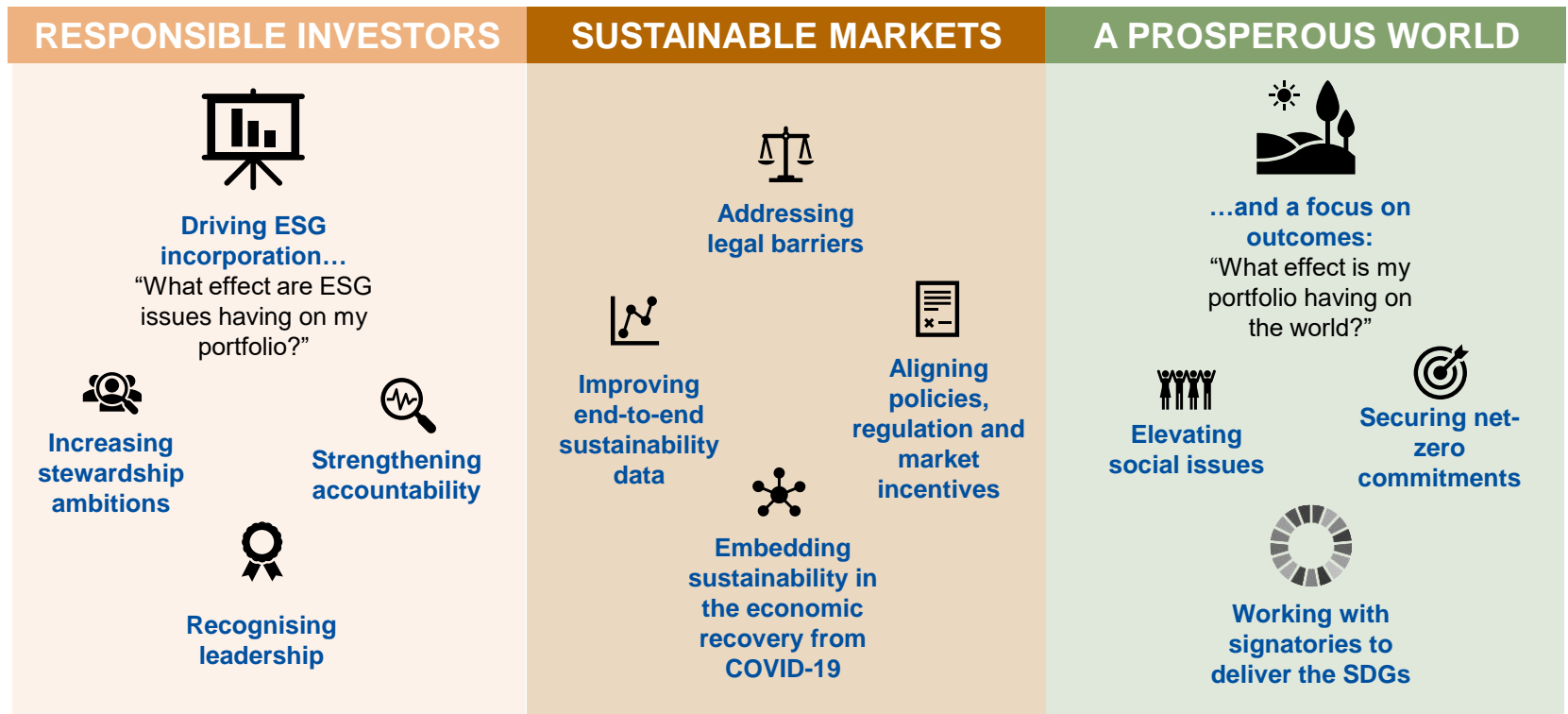
Higher levels of regulatory guidance that incorporating ESG factors is part of an investor's fiduciary duty to their clients and beneficiaries.



Growing academic evidence supports that
ESG incorporation does not come at a cost

PRI's 2021 – 2024 Strategy: Our Priority Work Areas

Mapping what signatories asked for, guided by the PRI Mission, 6 Principles & 10 Year Blueprint



ESG Incorporation & Investment Strategies in Listed Equity

Michal Bartek, CFA, Senior Lead, Listed Equity

PRI



Overview of Investment Approaches

Approaches to Responsible Investment in Listed Equity



Comparing Key Characteristics of ESG Incorporation Approaches

	INTEGRATION	SCREENING	THEMATIC
Provides a more complete picture of the risks and opportunities faced by a company	•		
Is applicable to investors that have no interest in considerations outside of their risk-return profile	•		
Can fit within existing investment processes	•	•	•
Restricts investment in certain industrial sectors, geographic regions or individual companies, typically for ethical reasons		•	•
Non-financially material ESG factors or ethical considerations are incorporated into investment decisions		•	•
Directs capital towards investments that contribute to environmental or social outcomes			•

Comparing Key Characteristics of ESG Incorporation Approaches

ESG incorporation in listed equity across the active-to-passive spectrum

		ACTIVE		PASSIVE
		INVESTMENT APPROACH		
INCORPORATION APPROACH	FUNDAMENTAL ANALYSIS	QUANT AND SMART BETA	INDEX INVESTING	
Integration	<p>ESG factors are integrated into absolute and relative valuation models alongside all other material factors.</p> <p>Investors can adjust forecasted financials (such as revenue, operating cost, asset book value and capital expenditure) or company valuation models (including the dividend discount model, the discounted cash flow model and adjusted present value model) for the expected impact of ESG factors.</p>	<p>ESG factors can be integrated into quantitative models alongside factors such as value, quality, size, momentum, growth and volatility.</p> <p>ESG factors and scores can be used as a weight in smart beta portfolio construction to contribute to excess risk-adjusted returns, reduce downside risk and/or enhance portfolios' ESG risk profile.</p>	<p>Material ESG issues are identified and translated into rules that feed into portfolio construction, alongside traditional factors.</p> <p>The overall ESG risk profile, or exposure to a particular ESG factor, can be reduced by adjusting index constituent weights or by tracking an index that already does so.</p>	
Screening	Filters are applied to lists of potential investments, ruling companies in or out of contention for investment based on an investor's preferences, values or ethics. Filters are typically based on including or excluding particular products, services or corporate practices.			
Thematic	Companies that meet valuation and financial thresholds – and address sustainability challenges and themes – are identified for investment. Includes impact investing.		Indices that focus entirely on environmental and social themes – such as clean technology, climate change, microfinance – are selected for investment.	

Screening: Filtering the Investable Universe

There are three main types of screening...

Exclusionary (negative) screening:

- Excludes sectors and companies, based on:
 - Absolute rules;
 - Relative rules;
- Reduces the investible universe.

Inclusionary (positive) screening & best-in-class screening:

- Actively includes companies that meet an ESG standard;
- Reduces the investible universe but all sectors are investible.

Norms-based screening:

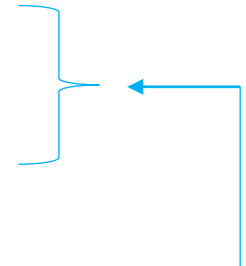
- Screening of investments against minimum standards of business practice based on international norms;
- Reduces the investible universe but all sectors are investible.

Six Key Steps When Using Screening As An Investment Approach

- **Step 1:** Identify client priorities
- **Step 2:** Publicise clear screening criteria
- **Step 3:** Introduce oversight
- **Step 4:** Adapt investment process

- ABSOLUTE EXCLUSION
- THRESHOLD EXCLUSION
- RELATIVE EXCLUSION

No investment in exclusionary criteria
Partial investment,
Best-in-class investments



- **Step 5:** Review portfolio implications:

- Tracking error
- Style factors

- **Step 6:** Monitoring, reporting and audit

Screens are often based on data, obtained from third-party providers, which feeds into internal order management systems to ensure compliance during portfolio construction.

Screening Processes

Two main types of screening process:

- Done by own staff;
- Outsourced to service provider.

Best practice components of a screening process:

- Quarterly reviews of company ESG research/ratings;
- Quarterly updates of third-party ratings;
- Daily audits of portfolio holdings undertaken by internal compliance function or external service provider;
- External, independent committee or internal committee reviews some or all screening decisions;
- Automated IT systems prevent investments in excluded stocks;
- Systematic process that alerts the portfolio manager, compliance team and ESG team of any breaches;
- Set period for divestment when permitted holding becomes ineligible;
- Rules governing when to engage or when to divest.

What Is ESG Integration?

Definition of ESG integration

“The systematic and explicit inclusion of ESG factors into investment analysis and investment decisions”.

What does that mean?

- Analysing financial information and ESG information;
- Identifying and assessing the impact of material financial factors and ESG factors;
- making an investment decision based on all material factors, including ESG factors.

What does it not mean?

- Certain sectors, countries and companies are prohibited from investing;
- Traditional financial factors are ignored;
- Portfolio returns are sacrificed to perform ESG integration techniques.

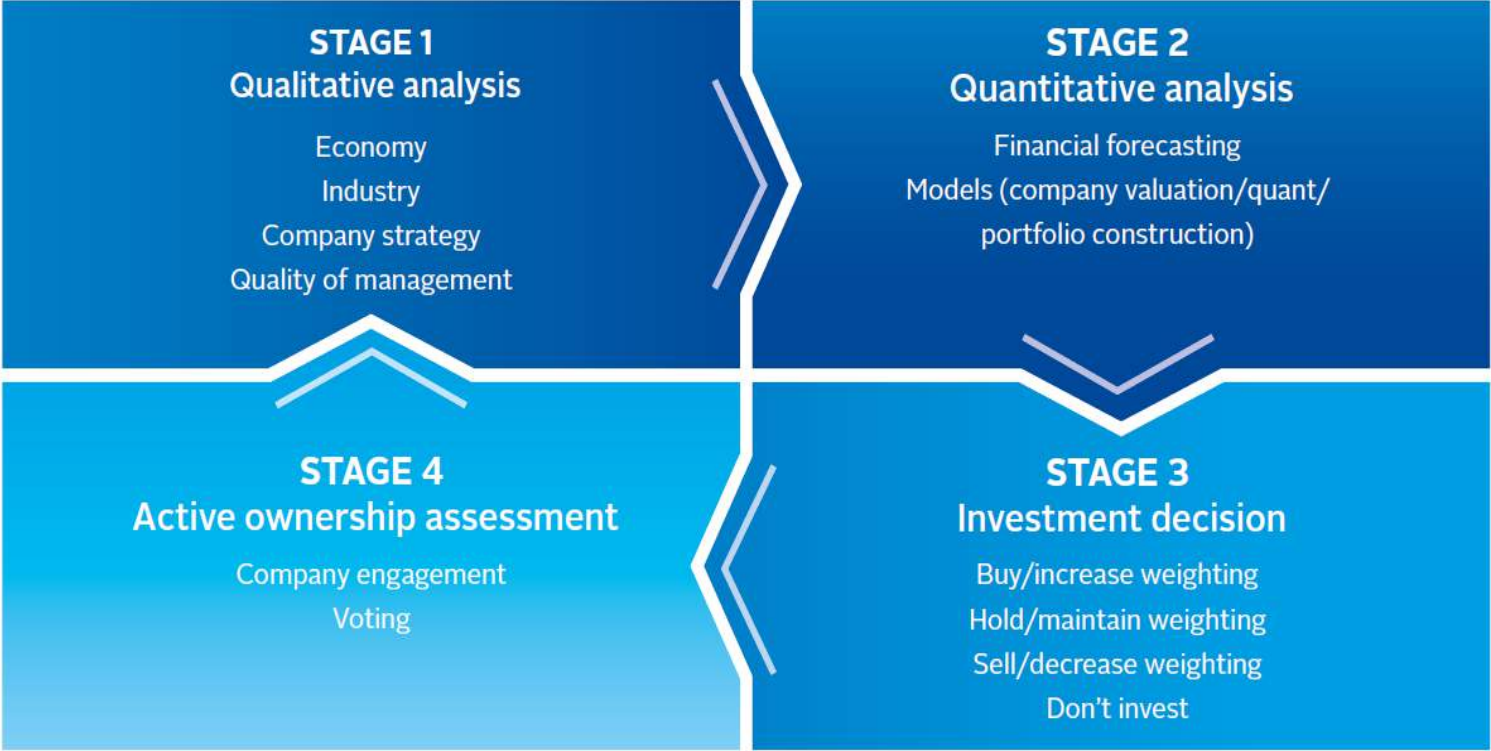
Materiality of ESG Issues

SASB Materiality Map

- Issue is likely to be material for more than 50% of industries in sector
- Issue is likely to be material for less than 50% of industries in sector
- Issue is not likely to be material for any of the industries in sector

SECTORS	Consumption	Financials	Health Care	Infrastructure	Non-Renewable Resources	Renewable Resources & Alternative Energy	Resource Transformation	Services	Technology and Communications	Transportation
ISSUES										
ENVIRONMENT										
GHG emissions	●			●	●	●	●	●	●	●
Air quality				●	●	●	●	●	●	●
Energy management	●		●	●	●	●	●	●	●	●
Fuel management	●		●	●	●	●	●	●	●	●
Water and wastewater management	●		●	●	●	●	●	●	●	●
Waste & hazardous materials management	●		●	●	●	●	●	●	●	●
Biodiversity impacts	●			●	●	●	●	●	●	●
SOCIAL CAPITAL										
Human rights and community relations				●	●	●				
Access and affordability			●	●		●				
Customer welfare	●		●	●			●	●		●
Data security and customer privacy	●		●				●		●	
Fair disclosure and labelling	●		●							
Fair marketing and advertising	●	●	●							
HUMAN CAPITAL										
Labour relations	●			●	●				●	●
Labour practices				●	●				●	●
Employee health, safety and wellbeing			●	●	●	●	●	●	●	●
Diversity and inclusion		●							●	●
Compensation and benefits	●								●	●
Recruitment, development and retention			●					●	●	●
BUSINESS MODEL AND INNOVATION										
Lifecycle impacts of products and service	●	●	●	●	●	●	●	●	●	●
E & S impacts on assets, & ops	●		●	●	●	●	●	●	●	●
Product packaging	●		●				●	●	●	●
Product quality and safety	●		●				●	●	●	●
LEADERSHIP AND GOVERNANCE										
Systemic risk management		●		●				●	●	●
Accident and safety management				●	●	●	●	●		●
Business ethics & transparency of payments		●	●		●	●	●	●	●	●
Competitive behaviour		●							●	●
Regulatory capture and political influence	●			●		●	●	●	●	●
Materials sourcing	●		●		●	●	●	●	●	●
Supply chain management	●		●		●	●	●	●	●	●

ESG Integration – A Four Stage Model



[A Practical Guide to ESG Integration for Listed Equity](#) PRI, September 2016

ESG Integration in Equity Analysis

Income statement

- Adjust revenue or revenue growth rate
- Adjust operating costs or operating margin

Balance sheet

- Adjust asset impairment charges

Cash flow statement

- Adjust capital expenditure

Valuation

- Adjust the discount rate
- Decrease / increase / exclude the terminal value

Example: Integrating Water Risk into Financial Forecasting

Income Statements

Adjust revenue or revenue growth rate

- For example, adjust sales growth rate for future work stoppages, mine shutdowns or delays in mine developments caused by flooding.

Adjust operating costs or operating margin

- For example, increase operating costs for rising hydroelectric power prices caused by water scarcity.
- For example, increase operating costs for additional costs from running new desalination plants.

Example: Integrating Water Risk into Financial Forecasting

Balance sheet

Adjust book value by recording an impairment charge

- For example, apply an impairment charge to reduce (“write down”) the book value of a mine to reflect reduced earnings caused by water costs increasing operating costs.
- The same impairment charge is also applied to the income statement, which reduces earnings.

Cash flow statement

Adjust capital expenditure

- For example, increase capital expenditure for construction of desalination plants.

Example: Integrating Water Risk into Valuation Tools

Discount rate

Adjust the discount rate

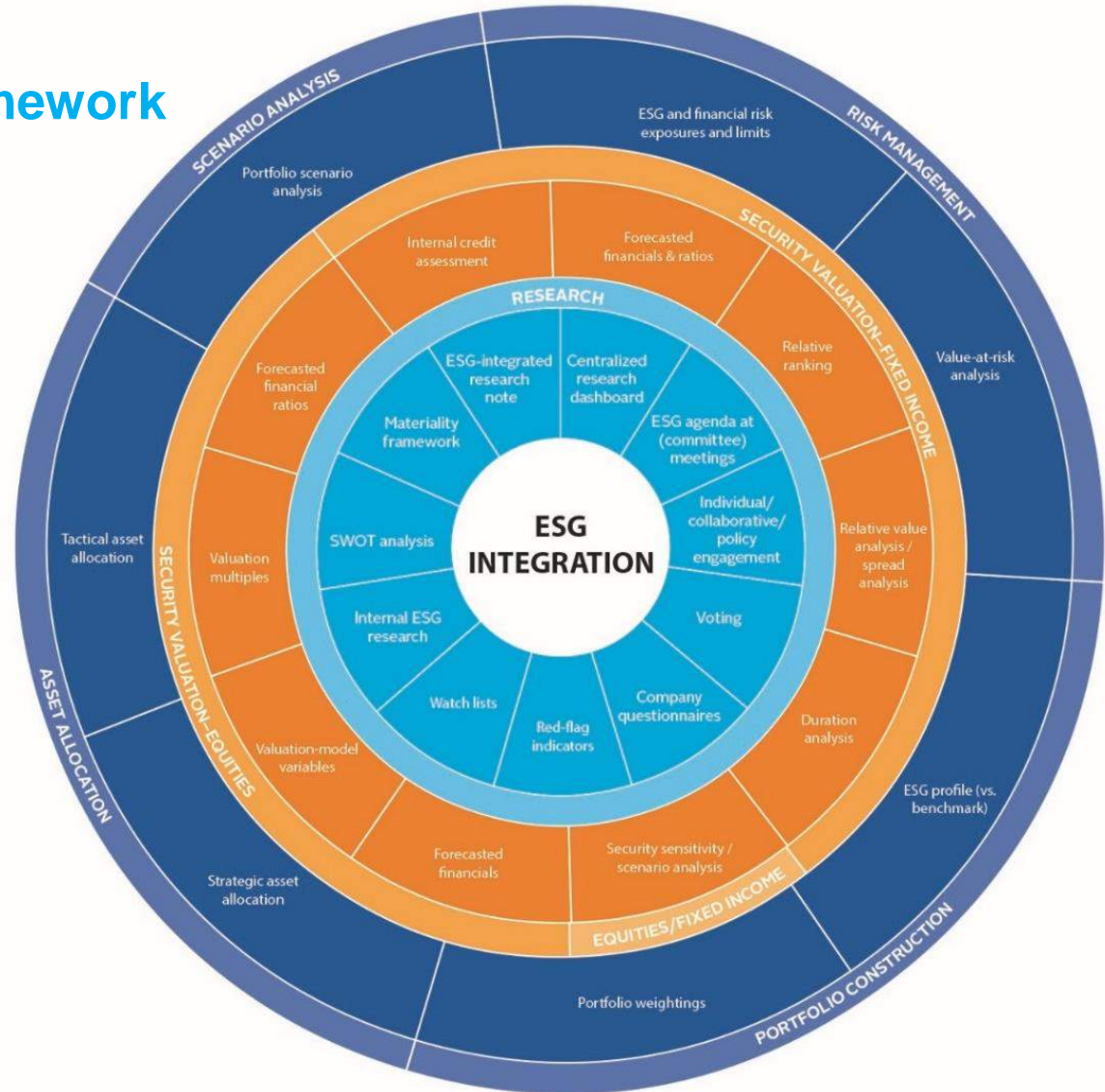
- For example, increase discount rate if a high percentage of mines are in high risk flooding areas;
- Decrease discount rate if company has strong water management practices.

Terminal value

Decrease / increase / exclude the terminal value

- For example, decrease terminal value to reflect reducing value of copper business line caused by lower grade copper production;
- For example, exclude terminal value if it is believed that the company will no longer be able to exist in five years' time.

PRI & CFA Institute: ESG Integration Framework



ESG Integration in Listed Equity: Drivers & Barriers

Key Drivers

- Risk management
- Client demand
- Regulation
- Alpha generation
- Fiduciary duty

Key Barriers (commonly cited issues & challenges)

- Low client demand
- No evidence of investment benefits of ESG
- Lack of historical and comparable ESG data
- Lack of company culture
- Too much non-material information being disclosed
- Limited understanding of ESG issues/ESG integration
- Limited amount of research
- Concerns about negative returns, tracking error, and underperforming the benchmark

Incorporating RI Capacity into Firm Structure

Integrated Investment team:

Portfolio managers and investment analysts conduct the ESG analysis and integrate it into overall investment analysis and decisions.

Pros	Cons
ESG factors and traditional factors are included within the portfolio manager's research.	Portfolio managers may not have time to conduct ESG research.
ESG issues are included in discussions.	Portfolio managers may not be sufficiently familiar with ESG issues and trends.
Engagement activities will include portfolio managers.	Portfolio managers may not have time to engage with companies.

Dedicated ESG team & Investment team:

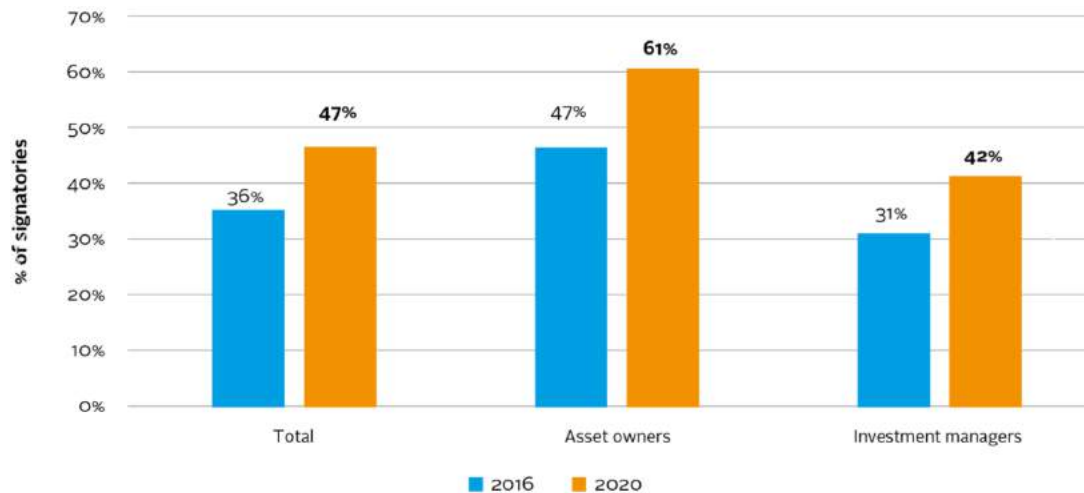
An ESG team conducts the ESG analysis, which the investment teams integrate into overall investment analysis and decisions.

Pros	Cons
Comprehensive ESG research conducted on all investments in the portfolio.	Portfolio managers may not read the ESG analysis performed by the ESG team.
ESG team can liaise with managers for a more holistic approach to ESG analysis.	The ESG research may not be in a form can be integrated into valuation models.
Engagement activities on ESG issues will be performed.	Portfolio managers may not be aware of the engagement activities.

Thematic Investing

Thematic investing identifies and allocates capital to themes or assets related to certain environmental or social outcomes, such as clean energy, energy efficiency or sustainable agriculture

Impact investing is a subset of thematic investing that aims to ensure that investments lead to additionality of impact



Operating Principles for
Impact Management



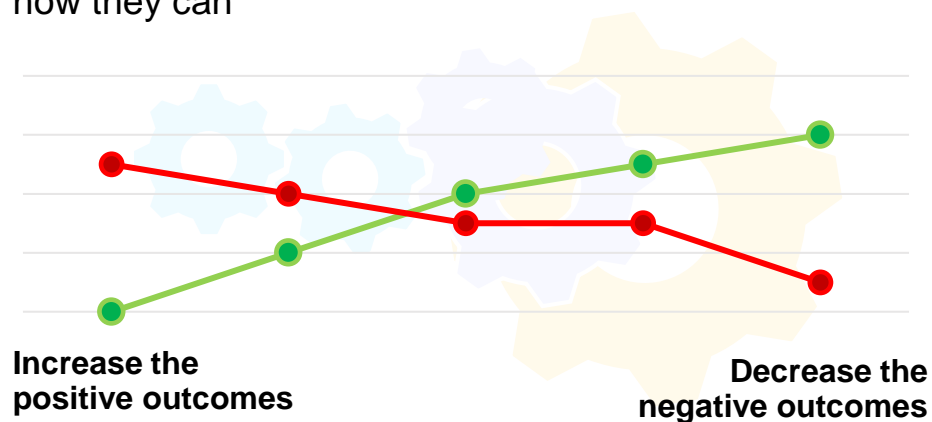
**IMPACT
MANAGEMENT
PROJECT**

Looking Ahead: A Focus on Sustainability Outcomes

Investors are beginning to work individually and collectively to increase positive outcomes, decrease negative outcomes

Key environmental and social issues threaten economies, investor portfolios and society.

To help meet the SDGs, investors must understand how they can



arising from their actions.

A FIVE-PART FRAMEWORK

1. Identify outcomes
2. Set policies and targets
3. Investors shape outcomes
4. Financial system shapes collective outcomes
5. Global stakeholders collaborate to achieve outcomes in line with the SDGs

unpri.org/sdg-outcomes

The State of ESG Integration & Screening in Listed Equity

Based on and adapted from PRI's Listed Equity Snapshot Report 2017-2020

Listed Equity Reporting: ESG Methodology Breakdown

Based on Signatory reporting to the PRI in 2017 and 2020

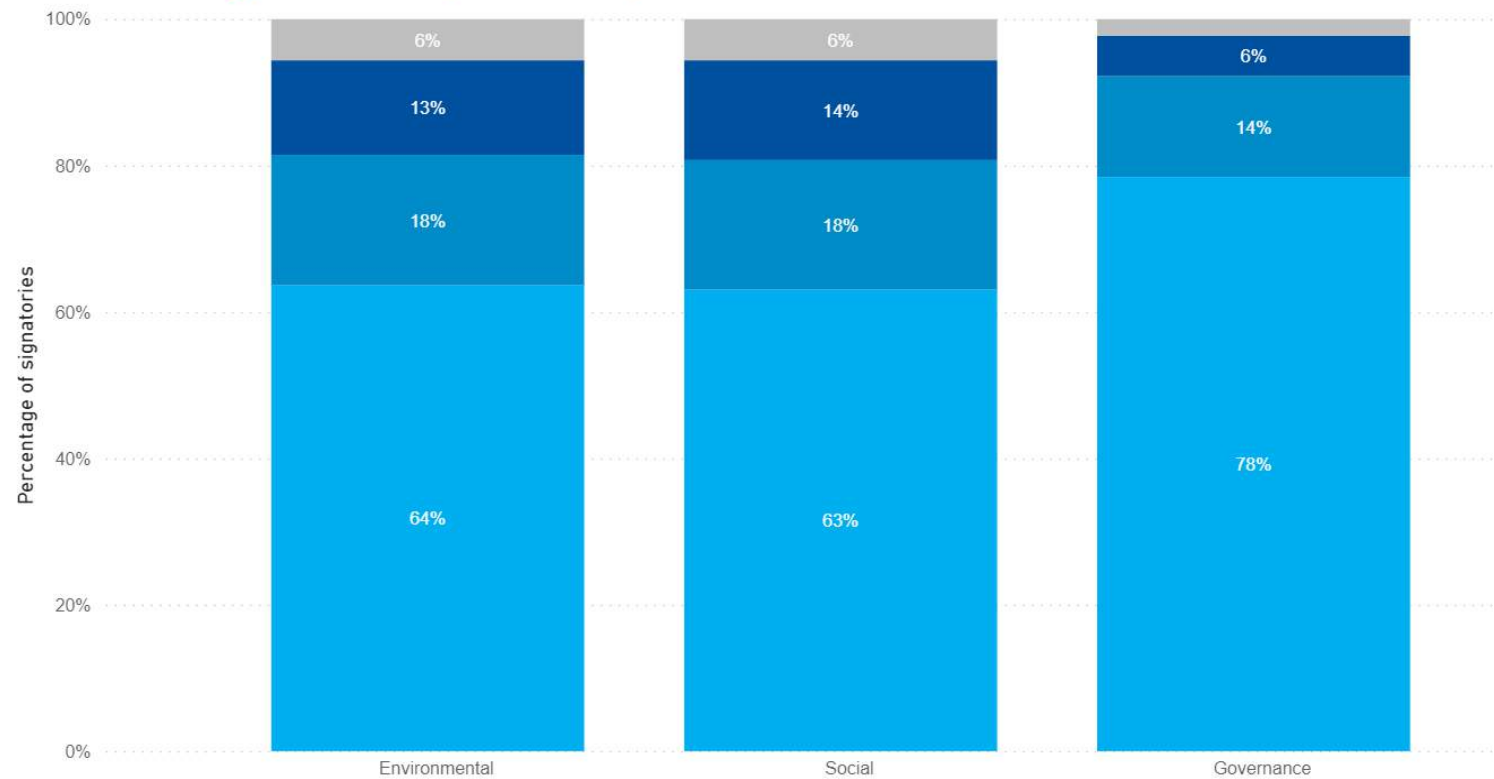
	2020	2017
All three (screening, integration & thematic)	6%	10%
Screening and Integration	33%	27%
Screening only	5%	7%
Integration	49%	41%
Thematic & Integration	1%	2%
No strategy	5%	12%

Inclusion of E, S, and G Data in Investment Research

Based on 2020 Reporting Data

Breakdown of signatories by coverage of systematic ESG research

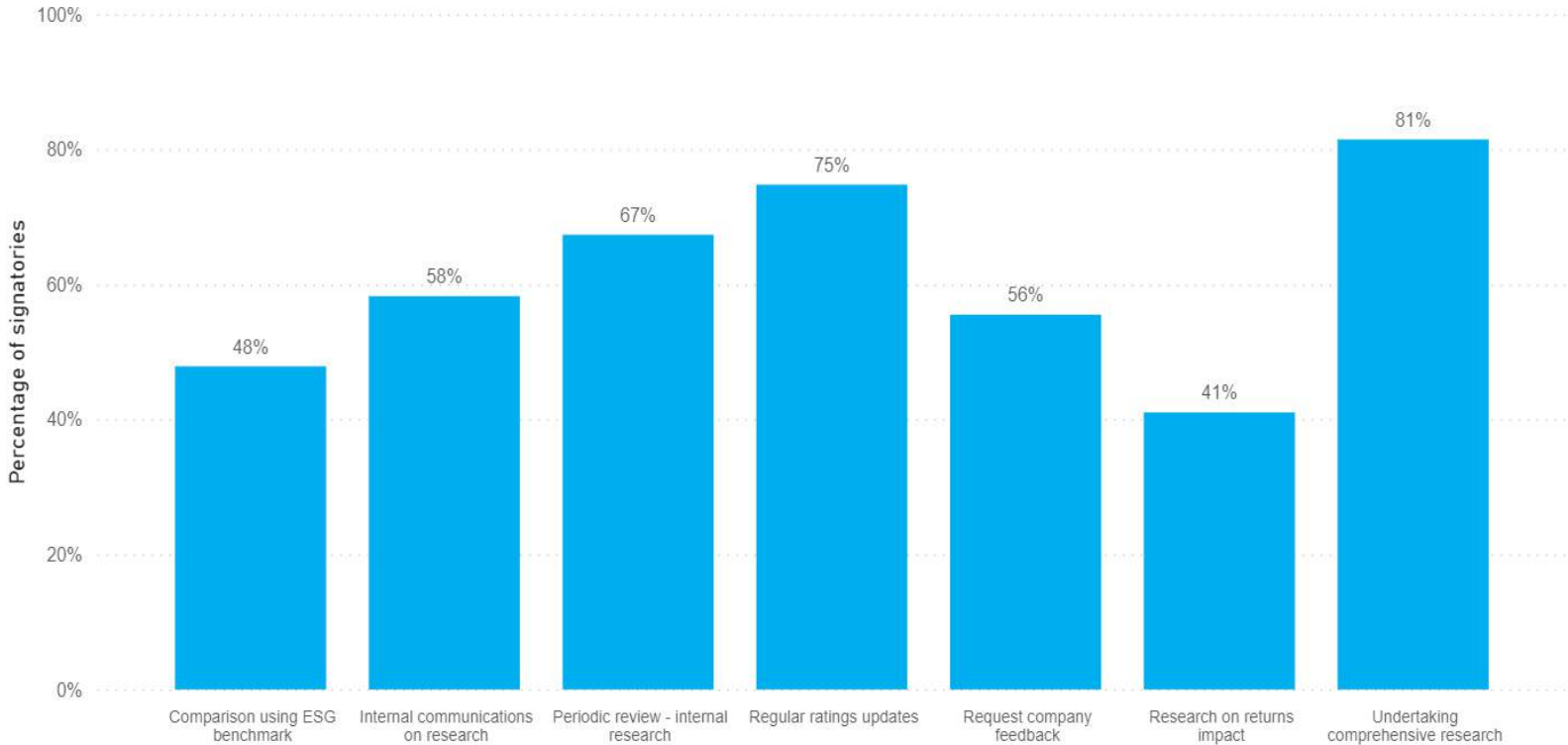
Coverage by portfolio ● Nearly all (91-100%) ● Majority (51-90%) ● Minority (11-50%) ● Small minority (0-10%)



ESG Integration Controls

Based on 2020 Reporting Data

Processes used by signatories to ensure fundamental research is robust

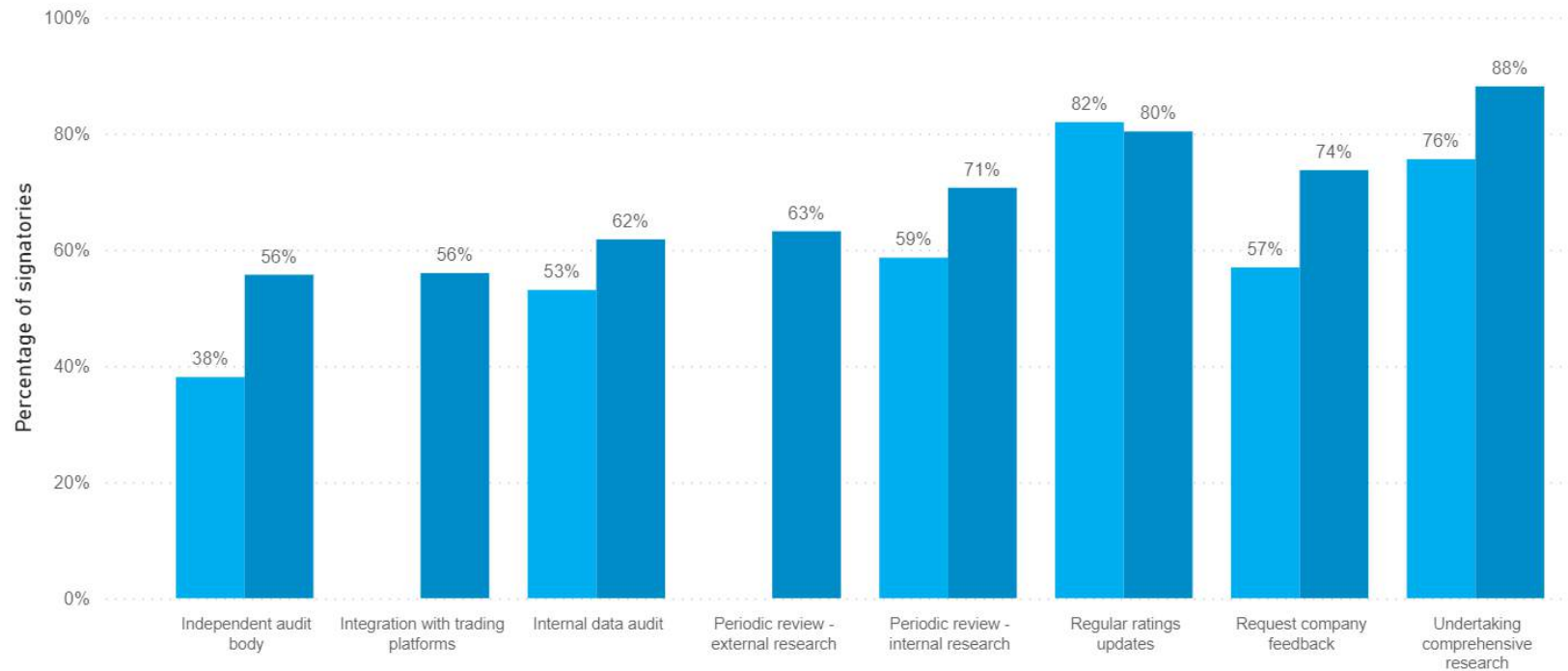


Screening Controls

Based on Signatory reporting to the PRI in 2017 and 2020

Processes used by signatories to ensure screening decisions are robust

Year ● 2017 ● 2020

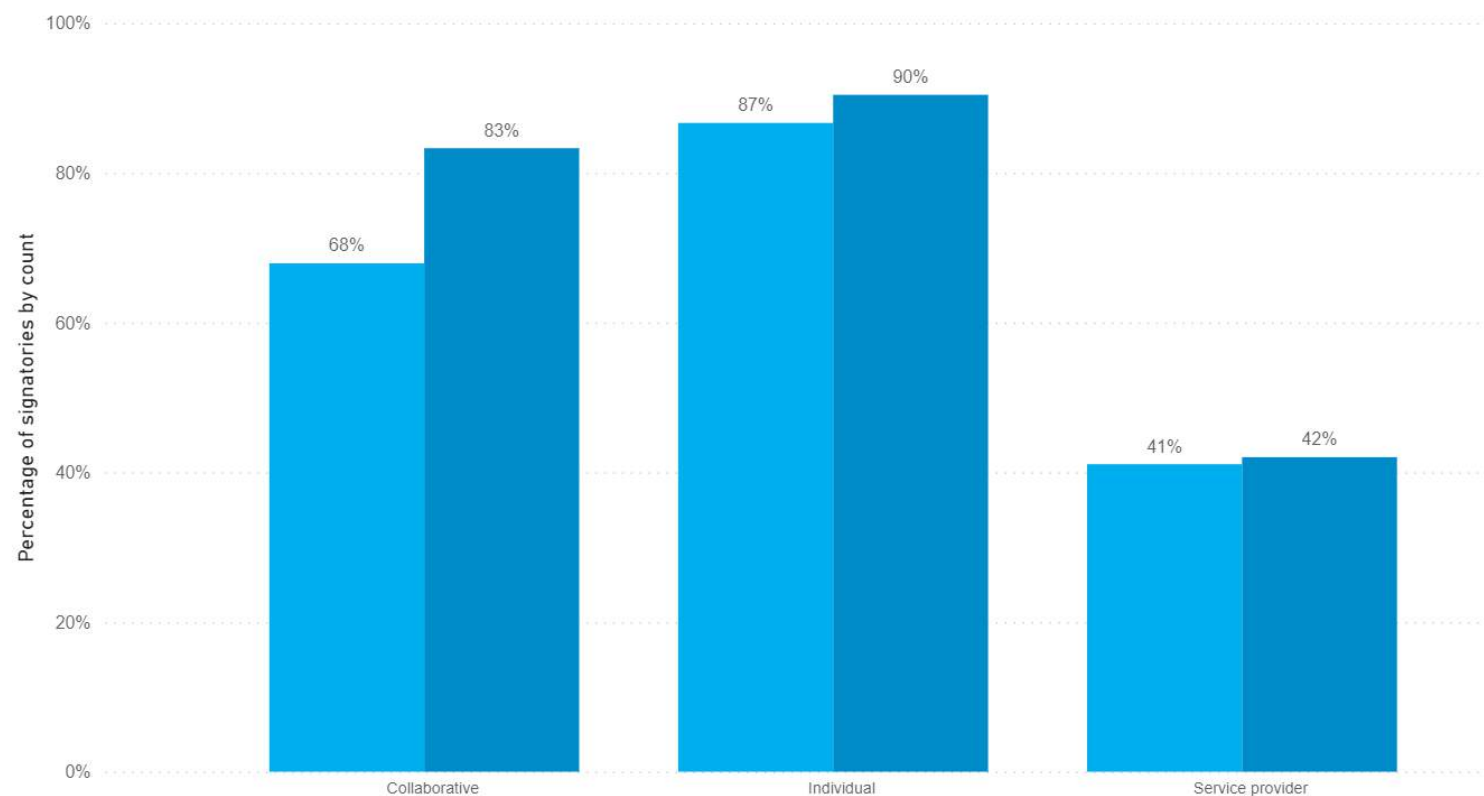


Signatories Undertaking Engagement in Listed Equity: Methods

Based on Signatory reporting to the PRI in 2017 and 2020

Breakdown of signatories by engagement method

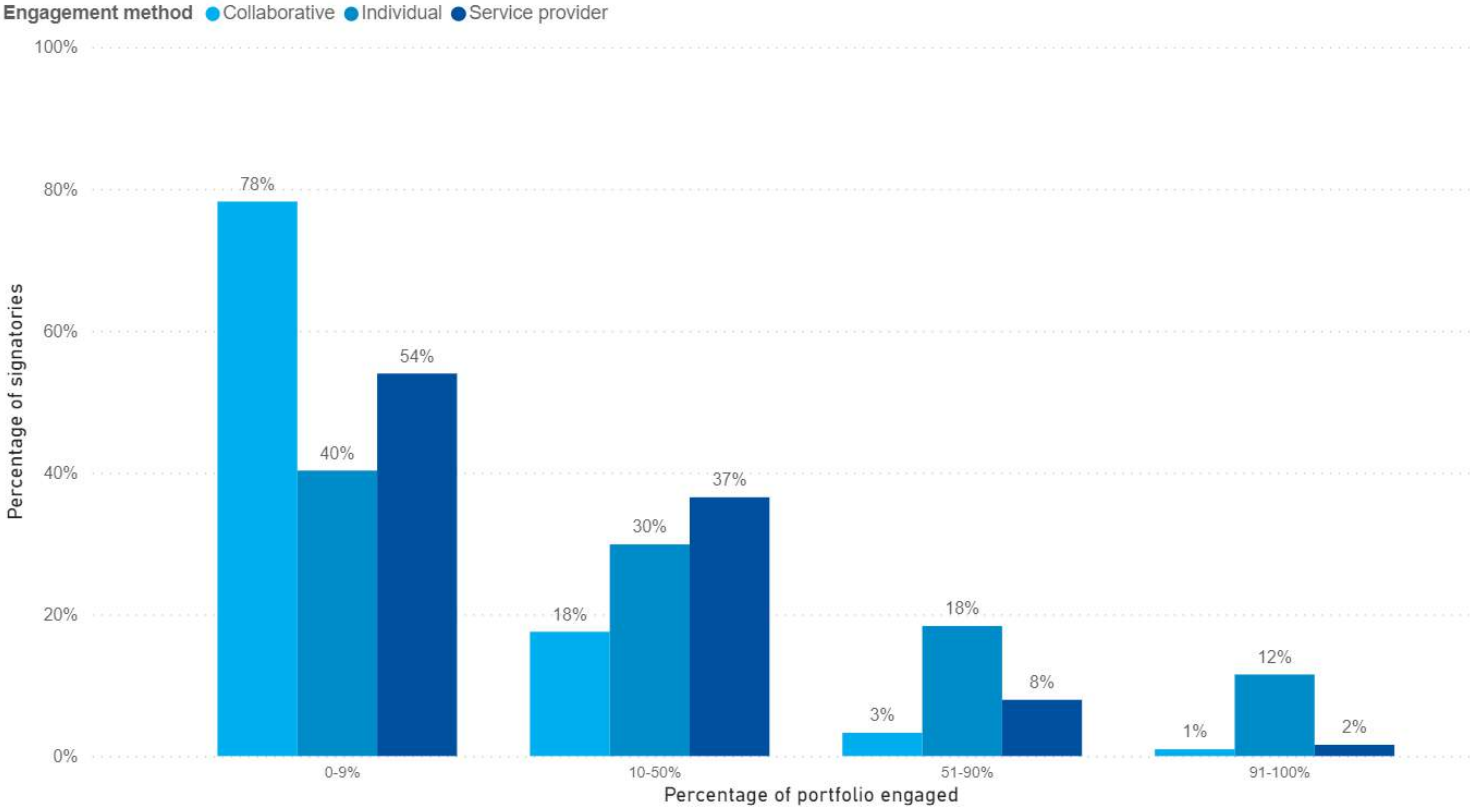
Year ● 2017 ● 2020



Breadth of Engagement

Based on 2020 Reporting Data

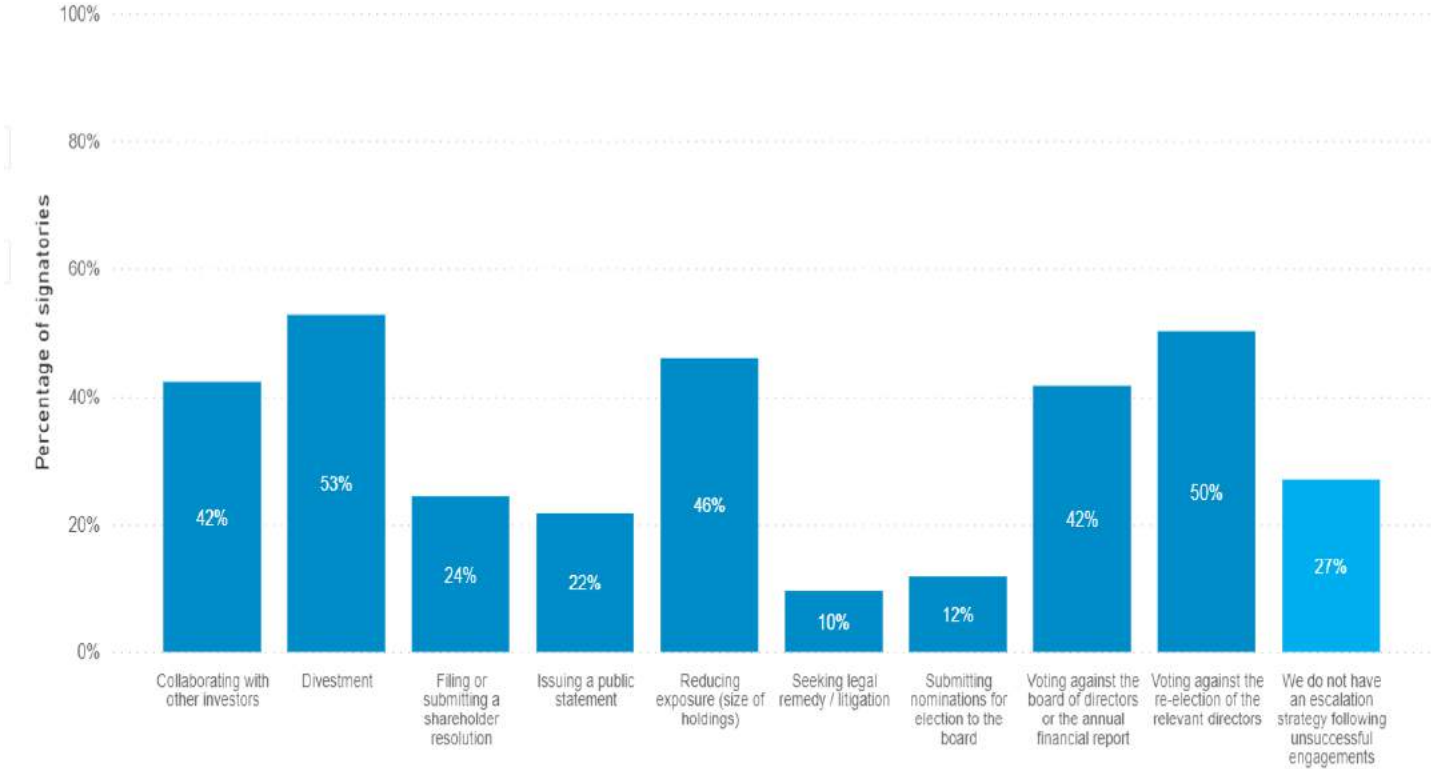
Breakdown of signatories by percentage of portfolio engaged



Escalation Strategies Following Unsuccessful Engagement

Based on 2020 Reporting Data

Escalation strategies incorporated into policy or used at least once after unsuccessful engagement

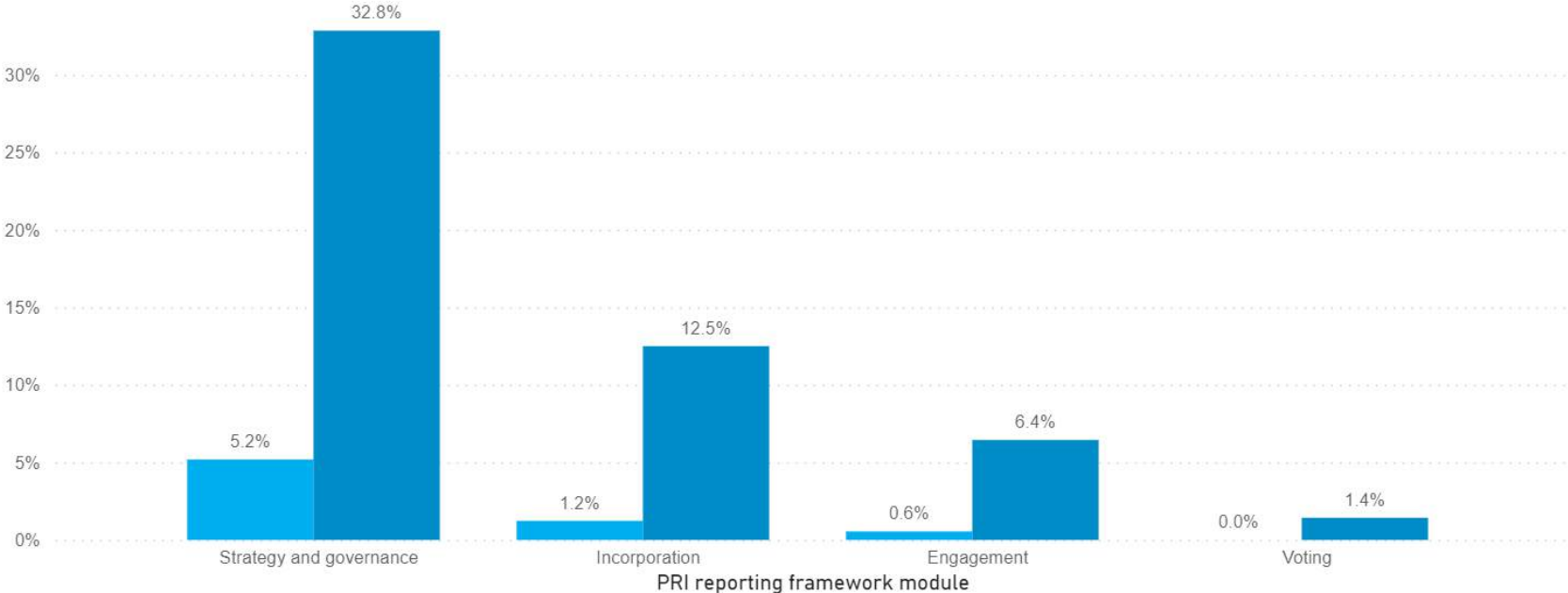


SDGs in Listed Equity

Based on Signatory reporting to the PRI in 2017 and 2020

Signatories mentioning SDGs in strategy and governance, incorporation, engagement and voting modules

Year ● 2017 ● 2020



PRI Resources for Listed Equity Investors

What PRI Provides for Listed Equity Investors (1)

Visit <https://www.unpri.org/investment-tools/listed-equity>

Listed Equity Snapshot

- Explores the state of the approaches to incorporating ESG, active ownership and proxy voting in listed equities.
- Explores current practices among our global signatory base.
- Data can be shown on per-region basis.
- Based on key elements of data from PRI's annual signatory reporting

Introductory & Technical Guides

- Responsible investment, explaining the approaches to:
 - Considering ESG issues when building a portfolio – Integration – Screening – Thematic and explains the investment approaches in Fundamental Analysis, Quant and Smart Beta and in Index Investing
 - Improving investees' ESG performance – Engagement & Proxy Voting
- Screening – explaining the different types of screening and implications for portfolio characteristics
- ESG & passive investment strategies



What PRI Provides for Listed Equity Investors (2)

Visit <https://www.unpri.org/investment-tools/listed-equity>

Guidance and Case Studies

- Practical examples of ESG incorporation in the investment process provided by signatories

Podcast series

- Recently launched series of podcasts focusing on the topic of “Leadership” in the listed equity space.
 - [Episode 1](#) with Alex van der Velden, CIO, Ownership Capital.

PRI & Academic Blogs

- [ESG factors and equity returns – a review of recent industry research](#)
- [Highlights of the signatory survey on passive strategies and ESG](#)
- [ESG in listed equity – evolution or revolution?](#)
- [The evolution of screening: from ‘sin’ to sophistication](#)

Thank You... Interested to Learn More?

- Visit [Become a Signatory](#)
- Explore range of publicly available resources via [PRI website](#)
- View [PRI Events & Webinars](#) via BrightTALK
- Listen to [PRI Podcasts](#) & read [PRI Blogs](#)

Contact:

Michal Bartek, CFA
Senior Lead, Listed Equity

michal.bartek@unpri.org

James Robertson
Head of Asia (ex-China & Japan)

James.Robertson@unpri.org

