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COLLABORATION IS KEY IN ESG MEASUREMENT

By Joost van Mierlo

ESG policies are often at the core of the investment strategy of asset managers these days, but the way they measure these strategies remains unclear. What are the developments concerning the measurement of ESG strategies and in which areas would one like to see improvements?

Could you elaborate on the specific goals that your organization likes to achieve with its ESG policy?

Jelena Stamenkova-van Rumpt: 'At Anthos Fund & Asset Management, we have based everything we do on our values of human dignity, sustainability and an aspiration to be good. In developing our responsible investment policy, we have transformed these values into sound principles that reflect their identity and strive to enhance society, while providing good financial returns. We use the instruments of responsible investments to make sure the values come to life in the investments we make.'

Martijn Huijnen: 'ESG investing is basically an enhancement of our risk-return strategy. We do have discussions about the values of our ESG policy with our clients, but in the end, it is really about getting a clearer picture of the risks we're taking. By reducing the risks, we improve our risk-return profile.'

Gert van de Paal: 'We believe that by including ESG considerations in our investment processes, we can improve the risk-return profile of our client's portfolios and achieve positive societal returns. These goals are evolving. We have, for instance, recently added an impact related metric to our goals: we now have a policy in place in which our discretionary mandates are targeted to be 30% less CO_2-intense than the equity benchmark.'

Karlijn van Lierop: 'Our investment approach is like a two-way street. We like to think about the impact of the world on our portfolios, but at the same time, we think it is our

> Thijs Jochems started at Credit Lyonnais in the field of research and became CIO of CLBN in 1993. In 1996 he became CIO of Achmea AM and in 1999 he joined CSFB as Country Manager of the Benelux. Subsequently he reorganized CSFB European equities in London and CSFB France. In 2009 he left CSFB but stayed on as Senior Advisor to CS Group EMEA. Since 2009 his activities include membership of several Investment Advisory Councils, lecturing in executive programs at Nyenrode and private investments. Jochems holds a Msc in Macroeconomics.

> Willem Bouwman is Senior Portfolio Manager Fixed Income Sustainable at ABN AMRO Private Banking. Bouwman graduated from Tilburg University in Economics and is CEFA/VBA certified. He has been responsible for managing the discretionary fixed-income asset management portfolios for private banking clients since 2012 and has been responsible for sustainable portfolios since 2018. Prior to that, he held the position of bond specialist within the investment advisory team. Before this period Bouwman worked as Deputy Director at Euronext Indices. He started his career in 1997 at ABN AMRO's dealing room.

responsibility to think about the impact of our portfolios on the world. We can contemplate about carbon intensity and carbon reduction, but in a wider perspective we like to encourage alignment with the Paris Agreement.'

Stamenkova-van Rumpt: 'Investors and businesses will always look for a way to grasp the opportunities, hence the focus on impact. It is also important to look at business responsibility to improve the potential and actual negative impact on society as seen through the lens of human rights.'

Hans op 't Veld: 'We try to structure our investments along the lines of the Social Development Goals of the United Nations. It's clear we have to focus on only a few of the SDGs because it's impossible to focus on all 17 of them. So we look at our stakeholders and, since their participants work mainly in healthcare, it makes sense to focus on related issues. For instance, tobacco has not been included in our portfolio for many years. But more and more, the discussion is not about exclusions but about our impact on the world, just like Karlijn has mentioned.'

Kees Ouboter: 'Our starting point is to maximize financial, environmental and social returns. We foresee a transition towards a sustainable society, comparable to the doughnut economics. We only want to invest in companies that we earmark as 'adaptive' in this sense, or that ultimately will be part of 'the dough'. We want to make sure that we invest within the planetary boundaries, which are formed by the themes 'climate', 'water' and 'land', and the social context. We have translated that into measurable goals like 'becoming water-neutral in 2030' and 'no deforestation' or 'loss of biodiversity'. These goals go for all of our assets under management.'

Exclusion is a last step. Organizations want to try to influence as long as possible before they exclude. Do you recognize this?

Ned Salter: 'I think that's clear. But let me first stress that, with many years of experience in the sector, it's clear to me that, all else being equal, responsible investing is return-enhancing. And yes, we do favour engagement over exclusion. I come from the perspective of someone who operates in listed liquid secondary markets. In this theoretical construct, it's true that, if we all excluded, the cost of capital would rise. But that's not all. After infinite years of quantitative easing, there always seems to be someone who's going to buy junk. Engagement is absolutely crucial. Our analysts meet corporates 16,000 times a year. That's one meeting every 10 minutes. Every single time you sit with a chairman, it's an opportunity. But in meetings with chairmen you don't want to talk about the 140 things they want talk about. You only want to talk about the four things that really matter. We really focus on those conversations, so that we can make a difference.'

We make a clear distinction between companies that are showing unethical behaviour and companies that are at risk because they do not take into account the ESG-related risks that they are facing.

It's important to connect E, S and G, if you like companies to implement a long-term climate strategy

Ouboter: 'For most of us it's simply not possible to meet CEOs or companies on that kind of scale. Cooperation is crucial. And that's happening. Climate Action 100 is a very good example. An issue like climate change affects all and there are many big asset managers and asset owners behind it. That gives off a strong message to all the companies that are exposed to this issue. We make a clear distinction between companies that are showing unethical behaviour and companies that are at risk because they do not take into account the ESG-related risks that they are facing. These latter companies we call 'non-adaptive'. Basically, that behaviour is also an indicator for us to look at the quality of a company's management. If companies are non-adaptive, we do not spend a lot of time on engagement.'

Op 't Veld: 'You mentioned Climate Action 100. That's going well. But it's a challenge to find similar collaborations on all kinds of issues and to ensure that everyone's on the same page. Another platform that we should mention is PLWF, the Platform Living Wage Financials. And most of our clients have signed the Internationaal Maatschappelijk Verantwoord Beleggen covenant, in which we say that we're going to strive to work together towards engagement on certain issues.'

Stamenkova-van Rumpt: 'I don't consider CEOs and boards to be the only targets. It's my experience that we as investors, when we approach a company, are able to empower the people inside the company, who are doing the work on these topics. We are not only able to get the best kind of information from these people, it also empowers them, because they can say, 'Look, investors want this.''

Jochen Harkema: 'One doesn't exclude the other. It has to work both ways. I would suggest one should start at the bottom of a company and proceed towards the top.'

Huijnen: 'I think it is a cultural issue. It depends a lot on where you are in the world when approaching a company. In some regions it's better to go directly to the top and sometimes it's better to go downstream.'

Willem Bouwman: 'I am wondering if it is deliberate ignorance at the top of a company when they have to be addressed this way, or if it is something they simply do not know. That might make a big difference with respect to how the management can be incentivized to listen better. I personally believe that most companies are in transition too. It's not like if investors don't do anything, companies won't change.'

Van Lierop: 'It's important to connect E, S and G, if you like companies to implement a long-term climate strategy. We like to see both long-term and short-term goals and to see these tied to targets and embedded in remuneration. That's an effective way to make sure that change will really happen.'

Salter: 'You're absolutely correct. This is why we need to have 120 analysts and 80 portfolio managers actually engaging.

> Jochen Harkema works at the Investment Office of ING since 2012. Harkema's role ranges from setting up sustainable investment policies to screening companies for sustainability. He studied Economics at Maastricht University and Investment Management at the VU University of Amsterdam. Together with his colleague Peter Tros, he wrote the book 'Sustainable investing for dummies' (in Dutch).

> **Martijn Huijnen** is responsible for the ESG policy and practice at Blue Sky Group. He advises the pension boards of its clients. Previously at ASN Bank, he developed and managed the ASN Sustainable Mix funds and engaged with pharmaceutical companies. Before that, at SPF Beheer, Huijnen developed and executed the Socially Responsible Investing strategy for its clients. He holds master degrees in both Economics and Applied Ethics.

You have to tackle it from both directions. It takes a lot of knowledge and a lot of specialists to do this.'

Van de Paal: 'We have some values-based exclusions based on product involvement and use norm-based exclusions in the case of serious controversies. But we consider ESG integration and active ownership, with voting and engagement, to be the most important elements of our responsible investment strategy. We think that norm-based and thematic engagement can help companies improve their sustainable performance over time.'

What exactly do you measure in ESG issues and how do you get these factors to one denominator?

Bouwman: 'It's a complicated issue. Sustainability is about the long term. Therefore we should not be too focused on numerating everything in the present. A lot of the data that we use, concentrate on the current status with respect to sustainability within companies and governments. But the long-term effect of their actions is the most crucial. In some ways the actions can even be counterproductive. If an ESG score of a certain company is below average but the company has pledged to be CO_2-neutral by a certain date, should sustainable investors shy away, simply because of the current ESG score? The problem is that long-term data simply don't exist. It thus falls down to a judgement, or a belief on how corporates will behave. I have stated earlier that, even without the pressure of ESG investors, companies are migrating towards a more sustainable path as public opinion is changing.'

Van de Paal: 'What we need are reliable data to measure those ESG aspects of a firm that matter the most. And rather than taking 'sustainability pictures' at regular intervals - usually based on a yearly questionnaire or annual sustainability report of a company - what we really need is to make a 'sustainability film'. Then we can more accurately and timely track the movement in ESG performance. New techniques like artificial intelligence and new data sources like satellite images or social media analyses can be used to create a more up-to-date ESG profile of a company.'

Huijnen: 'It's very complicated. You've got all these companies that create rankings for ESG-standards, like MSCI and Sustainalytics, but there is no strong correlation between their results. The data that they use, are clearly multi-interpretable. That makes it complicated. Sustainability is important and you want to have clear data. However, it's the situation we're in and maybe it's not that bad. Sustainability isn't one story, there's room for diversity. It's important to measure, but it's not always that clear. Let's take the example of the distance between lowest and highest remuneration in a company. The easiest way to lower that score, is basically outsource your lowest-paid labor. So be careful with what you wish for.'

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Do you mean that there are unintended consequences?

Huijnen: 'Yes, and they can be pretty tough.'

Op 't Veld: 'I agree. I know that what gets measured gets managed, but it also gets gamed. There's definitely a challenge here. Measurement is not a goal in itself. It's a useful step towards actually getting behind the data. It's the beginning of the engagement process and of the conversation to really understand what these data tell us.'

Van Lierop: 'ESG is an anchor point in our investment beliefs. We have determined clear ESG goals for every asset class. We measure how well our invested companies perform against our ESG goals and ESG criteria. One of the challenges we face, is coverage versus depth. The Transition Pathway Initiative provides rich and in-depth data, but the lack of coverage is a limitation. However, the data are useful to really understand to what extend a portfolio is in line with the Paris Climate Agreement.'

How do you deal with the immaturity of the data you receive?

Bouwman: 'I don't have 120 ESG analysts working for me. This forces us to partner with others that have done the effort of developing excellent datasets. We like to invest in EMD governments in a sustainable way and to have a fair comparison with western economies at the same time. We have had discussions on whether high ESG scores of Western economies are more a reflection of the difference in welfare, than a fair comparison with poorer countries. A few years ago this was still considered to be a highly controversial discussion, as poverty and corruption go hand in hand. We eventually found a partner that was able to break this stalemate for us. I was surprised to see so many emerging market governments scoring high in comparison to western governments.'

Harkema: 'It's important to use information from NGOs. NGOs specialize in certain topics and can provide very useful data. Transparency International, for example, is known for its corruption data.'

Salter: 'The data being used, are sometimes ambiguous. How do you reconcile the values-based approach with materiality mapping? For instance, we manage a mandate for an organization and are invested in an industrial conglomerate in Asia. 0.1% of its revenue comes from the production of steel, which gets sold to a country that this particular institution doesn't want to invest in. That's fine in a mandate, because the client gets what he wants. But how do we bring a values-based approach and materiality mapping together? That could be really instructive for a firm like ours.'

Op 't Veld: 'Exactly. We'll always have these kinds of specific

> Karlijn van Lierop is Director of Responsible Investment & Governance at MN, the pension administrator and asset manager of PMT, PME and Koopvaardij, and asset manager for a variety of pension funds including MITT. Van Lierop has final responsibility for the development and implementation of the Sustainable Investment Strategy at MN. The main focus areas are exclusion, voting, thematic engagement, ESG integration, Impact Investing and the execution of the Climate Strategy. Van Lierop is part of the MT of Fiduciary Advice at MN and is Board Member of the Institutional Investors Group on Climate Change (IIGCC).

> **Kees Ouboter** is Responsible Investment Officer in the Sustainability & Strategy Team at ACTIAM. He joined ACTIAM in august 2016. He is responsible for integrating non-financial information into the investment process and measures the non-financial performance of the ACTIAM investments. Before joining ACTIAM, he worked as consultant for True Price, where he built impact models for social and environmental indicators. He advised clients such as AKZO Nobel, DSM and Tony's Chocolonely. Ouboter holds a Master's degree in Econometrics from the University of Amsterdam.

situations and we'll have conversations about them. Ideally, everything is rules-based. So one can just say, 'If I tick this box, I tick that box.' However, it is not that simple. We can only have dialogues around these cases, not only internally, but also with our clients. We will analyse these situations and conclude: 'this is something we need to figure out. This will create jurisprudence on what we need to do in these cases'.'

Ouboter: 'The quality of data, and how to deal with these, is an ongoing discussion within our team. We gather ESG-related data from different sources and try either to validate them, or let different types of data reinforce one another. Still then, some data points are at the beginning of being gathered, or lack a widespread definition on how to be calculated. In our view a datapoint is never the ultimate truth. To express it even more stronly: potentially all data-points being used, are wrong. You must think of the purpose of the data. If data are just a guide, we are more willing to use immature or incomplete data. This is always followed by or combined with a qualitative assessment. We also want to be part of the innovation when it comes to data. Data don't have to be perfect; we sometimes just start and improve the quality along the way.'

Salter: 'But still I'm left wondering: Where do we draw the line on materiality? It might be different for companies in transition.'

Ouboter: 'That is absolutely true. It is difficult to draw an exact line. Ultimately it is up to the asset managers or asset owners to make their own decision on what to use. It does not differ that much from other types of information used to assess a company.'

Salter: 'But we're still just stuck without a clear framework. That makes it very difficult.'

What are your ideas about the need for harmonization or standardization of the business and how do you think it will develop in the years to come?

Harkema: 'I think we need to seek cooperation in a much wider field than among normal financial investors. The Platform Living Wage is a good example. It is a diverse group of Dutch investors. Together we're trying to develop a harmonized standard to assess companies on living wage. But it's also about how to engage companies on this topic.
At the World Economic Forum in Davos, the big four accountancy firms have proposed to set standards on metrics for E, S and G. Many of the attending CEOs have backed the proposal. Harmonization on ESG metrics could accelerate rapidly this way. The metrics will look completely different in ten years' time.'

Op 't Veld: 'First of all: we need less frameworks, not more. My clients lose themselves in the whole variety of things they need to be compliant with. Especially since many of the frameworks tend to try and do the same thing. I think that

You've got all these companies that create rankings for ESG-standards, but there is no strong correlation between their results.

> **Gert van de Paal is Responsible Investment Strategist at Rabobank. He started his financial career as an Equity Analyst at IRIS, the investment research centre jointly owned by Rabobank and Robeco. In 2009 he left IRIS as Head of Mutual Fund and Equity Research at the time, and pursued his career at Rabobank Private banking. In his current role, he strives to continuously raise the bar for the responsible and sustainable investment activities of the bank. He is also a Member of Rabobank's Sustainability Policy Committee.**

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convergence will come, but it will be a challenge. At the same time we see new regulation coming in, especially new EU regulation. That might complicate matters, because it might develop different standards. My head starts spinning, when I think about it. It means that we as the ESG community need to spend a lot of time together, in order to think of collaborative efforts. It also means a lot of time spent on lobbying, I'm afraid.'

Stamenkova-van Rumpt: 'I hear Hans talking about the need for fewer frameworks and I agree. There is certainly need for alignment at a higher level on terms and definitions regarding ESG. At the moment all data providers and investment managers introduce their own frameworks, also as a way to achieve a competitive advantage. But what we need, are standards agreed on a higher level, like the EU or the United Nations. Just to clarify: I am not only talking about business here. Society is more than that. Governments, NGOs, religious institutions, they all have a role to play in improving the current state of affairs.'

Van Lierop: 'As an ESG community, we need to take leadership on frameworks that are actually useful to us. Together with our clients PMT and PME, we define what kind of data suit our purpose and what is useful. This differs per asset class and this requires a tailor made approach. Collaboration is the key. In Partnership for Carbon Accounting Financials (PCAF), founded by ASN, we work for example with financial institutions to develop harmonized approaches to assess and disclose carbon emissions of different asset classes.
I agree that measurement is key, but the ambiguity around it can never be a reason to not do anything. Most importantly,

> **Ned Salter joined Fidelity in 2014 as a Director of Research and is now Head of Equities. Salter plays a leadership role running the equity research and portfolio management teams, and sits on the ESG Steering Committee. Prior to joining Fidelity, he was with Putnam Investments from 2001. At Putnam, Salter was a Global Equity Research Analyst and Sector Portfolio Manager, having been based in Boston, London and Singapore. Salter has an AB in Economics from Kenyon College and an MBA from Harvard Business School.**

> Jelena Stamenkova-van Rumpt joined Anthos Fund and Asset Management in September 2019 as a Director Responsible Investment. Before joining, she led the transition work of ESG integration in the front office at PGGM across asset classes with a special focus on private equity and external management. She also wrote policy, implemented and engaged companies on the topic of Human Rights and Labour and contributed to the Dutch Pension Fund Agreement on Responsible Investment. Before PGGM she helped the RI team at Aegon and finished the LLM International Business Law and Globalization at Utrecht University.

it's about the positive change we can make with our investments. And change is happening. We try to make a difference for the beneficiaries we work for, to ensure they can enjoy their well-deserved retirement in a liveable and sustainable world.'

Salter: 'We're all going to carry on thinking about the trade-offs that we need to make, about how we can relate to our clients and to our constituents. We will all continue to do that independently, but on certain issues we can collaborate with one another in order to try to make change. What I would find most helpful, is just to continue doing more of these kinds of sessions, because we're all grappling with very similar problems regardless of who our stakeholders are. The more we collectively share ideas and debate, the more we all can take that back to our own organizations.'

Ouboter: 'Let me start by saying that that is really needed. Even in the calculation of the most advanced datapoint, which is carbon, we still see different ways to calculate, see different numbers from different data-providers and have discussions on what to use; scope 1, 2 or 3 for instance. It is still difficult for asset owners to assess what the real difference is between portfolios.
We've seen some very good initiatives in the Netherlands with the Platform for Carbon Accounting Financials, which is now finding its way in the rest of the world. So it's really about harmonization. I expect it to be pushed even further through regulation. Especially in the Netherlands, we see the supervisor asking for clarity on topics like carbon, scarce water use, natural resources and violation of human rights. Financial institutions need to explain how they cope with the financial risks that go along with these developments.'

Huijnen: 'As a midsized pension fund administrator, we share knowledge with some other pension funds. This is not about competition. By sharing knowledge, we can work more efficiently, which is beneficial for our clients.
I have one concern though. There's a development in ESG measurements towards, what I will call, profit and profit accounting. It's opposite to the profit and loss accounting that we're used to in financial accounting. When addressing different SDGs, quite often parties are basically scoring on how much they do for water or for land. They basically count all their pluses and don't talk about minuses. That's not desirable. I hope we won't see this any more in five years' time. Initiatives like PCAF are a positive example of what takes into account both sides.'

Bouwman: 'We all know more or less what we want. The ESG rating agencies will understand this, although sustainability and the means of measuring it, will remain subjective. The correlation of opinions of the rating agencies is 0,5 or 0,6 at the moment. But that will trend towards 1 in the coming

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> **Hans Op 't Veld** is Head of Responsible Investment of PGGM. In this capacity he is leading a team of thirteen professionals looking after the implementation of Responsible Investment in the investment portfolio of PGGM. Op 't Veld joined PGGM in 2007 and headed up the listed real estate department before starting the current position in 2018. With ESG fully integrated in the PGGM investment teams, he is a Member of PGGM's Public and Private Markets management teams. Furthermore, he serves on the General Board of Eumedion and he is a Research Fellow at the Amsterdam School of Real Estate.

years, as it becomes clearer why their opinions deviate. The difference in the scores of the company Rockwool is exemplary. One rating agency scores it as being poor, as the process of making insulation is CO_2 intensive, whereas another rating agency gives the company the highest rating, as the insulation of houses reduces CO_2. It's something we've seen with credit rating agencies like S&P and Moody's. Their opinions correlate 0.99, nowadays.'

Van de Paal: 'What we see in this industry, is that asset managers or rating agencies are actually competing for data. They try to 'outsmart' each other; that's part of their business model. Some financial institutions are competing for standards. Although the intentions are good, this doesn't always help. The competitive focus should be more on analysing the data, than on gathering the data. I see improvements however, partly because of regulation and emerging frameworks like the Sustainability Accounting Standards Board. If we get more reliable data through engagement and regulation, there's less need for guesstimates. However, even if we all use the same 'perfect' data, there will always be differences of opinion, which is inherent to the fact that sustainability is in the eye of the beholder and each of us weighs various sustainability aspects in different ways. And it's all right if we have different opinions in the end. That is, after all, what creates a market.'

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CONCLUSION

The world of sustainable investment is progressing fast. Data providers are still developing their own measurements, but asset managers are longing for harmonization. Regulation might help in the long run, but will cause disturbance in the near future.

Collaboration is necessary, but asset managers also need to look at their own values. The standardized data they ask for, are just a stepping stone towards a meaningful dialogue with the companies they've invested in. Everyone agrees that meetings like this roundtable can help speed up this process.