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Teneo Insights

A weekly update from Teneo: The Rise of ESG Investing

A discussion between Barbara G. Novick, Martha Carter, Matt Filosa, Jerome Hauer Ph.D. and Kevin Kajiwara.

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Kevin Kajiwara (KK): Well, good day, everyone. Welcome and thank you again for joining our weekly Teneo Insights call. I hope you had a chance to enjoy the 4th of July holiday while we were on hiatus for a couple of weeks. I'm Kevin Kajiwara, Co-President of Teneo Political Risk Advisory, calling in from New York City today. Since our last call, the pandemic situation has continued to worsen in many parts of the country, even as numerous states really try to kind of hold the line on their reopening. Meanwhile, the American workforce contemplates the very real possibility that students will not be back in school full time in the fall. And while a number of vaccines have shown some very encouraging results, a deployable and scalable solution remains out of reach at this time. So, to help us sort through all of this, this morning, my friend and colleague, Dr. Jerry Hauer is back.

For those of you who don't know him, Jerry served as the Acting Assistant Secretary for Public Health Emergency Preparedness at the U.S. Department of Health and Human Services during the SARS outbreak and he coordinated the response to West Nile Virus in New York City, where he was the Commissioner of the New York State Department of Homeland Security and Emergency Services. At the same time that they're navigating the pandemic, companies continue to absorb the latest economic forecasts and attempt to adjust planning for an environment where consumer demand remains very, very difficult to anticipate, as does the shape of the economic recovery.

And they continue to work with activists and investors alike to reflect and adjust to the biggest social justice movement this country has ever seen. And one of the most relevant concepts and metrics here on this front is ESG. And to help us understand where we're going on that front, I'm joined today by a special guest. Barbara Novick is the Vice Chairman and one of the original eight Co-Founders of BlackRock. She sits on the Global Executive Committee, Enterprise Risk Committee, and Geopolitical Risk Committee there. She has overseen the firm's efforts globally for public policy.

She also is the Vice Chairman of the Board of Cornell University, which is her Alma Mater. And she is joined for this portion of the conversation with two of my colleagues, Martha Carter, who many of you know is the Vice Chairman of Teneo and the Head of Governance Advisory. And she was formerly the Head of Global Research at ISS. And her colleague, Matt Filosa. He's a Managing Director here specializing in ESG for Teneo. Previously, he was the Director of Corporate Governance at MFS and Associate Director of the Harvard Law School Program on corporate governance.

Barbara G. Novick
Vice Chairman and Co-Founder, BlackRock Global Executive Committee, Enterprise Risk Committee and Geopolitical Risk Committee
barbara.novick@teneo.com

Martha Carter
Vice Chairman & Head of Governance Advisory
martha.carter@teneo.com

Matt Filosa
Managing Director
matt.filosa@teneo.com

Jerome Hauer, Ph.D.
Senior Advisor
jerry.hauer@teneo.com

Kevin Kajiwara
Co-President, Political Risk Advisory
kevin.kajiwara@teneo.com

As ever, please join our conversation. You can do so by submitting your questions at any time via the moderator chat button on your screen. So, Jerry, let's start here with a pandemic update. Since you last spoke on this call, the situation in the United States has worsened considerably, as I said. The White House has essentially abdicated any leadership role here, to the point that they're actively denigrating Dr. Fauci. But where are we in terms of the pandemic progress through the country right now?

Jerry Hauer (JH): Well, thanks Kevin. Good morning, everyone. I think that what we are seeing shows how humbling a virus of this nature can be. It's got a mind of its own and it moves at its will. We are seeing another outbreak in Hong Kong. The Japanese have raised their threat level to a higher level because of ongoing spread in Japan. Here in the U.S., things are spiraling out of control. We are seeing record numbers as far as the number of cases. The number of deaths, once at about 350 to 400 is now over 900. We're gradually creeping up in the number of deaths.

And let me remind everyone that deaths follow cases in ICUs between two to four weeks. People on ventilators with this disease can be on the ventilators 21 to 24, 25 days. Chance of survival at that point in time is extremely low. The good news, as far as the number of deaths, is that we have learned how to better treat these patients in the ICU. We've learned how to better manage them on ventilators. We've learned at least two drugs that have been helpful in reducing the impact of the virus in damaging the lungs, the heart, the brain, and other organs, particularly this formation of really tiny clots that have caused this death.

So, at this point in time, Kevin, things really are not in control. We're seeing Texas, South Carolina, Florida, Arizona, California, where we're seeing literally an exponential rise in the number of cases. And a lot of this I have to say, and I've said this before on the call, because of political pressure, a lot of these states opened prematurely. They were pushed by either the White House or internally because of economic issues. So they opened prematurely. There was a signal from either the White House or their governor that the worst was over. And they went out and the barn doors opened. They went out partying. We've seen that. The pictures from Memorial Day, July 4th weekend, where thousands crowded beaches, pools, had parties. So we're seeing the ramifications of the messaging and the behavior and the political pressure to move things along. And we're paying for it in the number of ill. And we're going to continue to pay for this whole thing with the number of deaths.

KK: I want to ask you a little bit, many of the members of our audience are obviously calling in from New York. And I want to talk about New York here for one second, because New York went through such a challenging period early on in the pandemic, but also made a really Herculean effort to flatten the curve. And I think we saw many of our fellow citizens here doing the right thing for the most part throughout the spring in a city that notoriously doesn't like to be told what to do. But I'm wondering how well-prepared New York you feel is as it continues to get surrounded by these increases in cases that you've just described and the potential for people to travel back into the tri-state area. But also to ask, you just referenced California. California was the first state to lockdown. California made a lot of efforts to flatten their curve as well. And yet now, they're having a very rough time again. Is that a cautionary tale for New York?

JH: Yeah, let me start with California. I think that what happened in California is unlike New York. California never got to a point where the number of cases was so low that a new outbreak or a new little blip somewhere in the state wasn't caught before it started to escalate. New York, on the other hand, they pushed very hard to get down to an extremely small number of cases. They still have cases, but because of the systems, the governor and the health commissioner, Howard Zucker, put in place, they are doing very good surveillance so that if they see a little rebound in the number of cases, they'll in essence be able to surround it and control it. But I do expect that in the Northeast where things are stable, we are going to see some kind of rebound. The magnitude of that rebound will depend on the ability to detect it, get around it, control it, and do contact tracing.

KK: So, I wanted to follow up on what I said at the beginning with regards to schools. And I contextualize this obviously with what you've just said about the differentiated situation throughout the country. And we are obviously still several weeks away from when schools are supposed to reopen. However, the ability to get kids back into the classroom and out of the house is a fairly significant element of economic recovery. So are there general views that you've got on the school reopening issue?

JH: Yeah. This is an extremely sensitive issue. You're absolutely right, Kevin. The ability to get kids out of the house, back to school, allow parents to get back to work is extremely important. We have to temper that with the fact that kids, there is some controversy over whether kids can be carriers, asymptomatic spreaders of the disease. There have been studies that have argued on both sides. I think the bigger concern is teachers. Teachers by and large have been very cautious. And I might say really unwilling to get back to the classroom because a significant percentage of these teachers are over 50, over 60, and they're in the high risk group. So the science at this point in time is really mixed. We have to get some more information about where kids stand, but at this point in time, I think there's enough nervousness that school systems this fall are going to be very hesitant to completely reopen. And I think that that's going to create problems. Having said that, I think what we need is more data about the impact of this virus on kids and whether or not they are good spreaders of the virus.

KK: And one final question to you before I turn to my other guests here. On the bright side, we have heard some positive announcements, just even in the last few days on the vaccine front, most specifically with regards to Moderna. I'm wondering if you have an update on that front, but also whether the announcements and milestones that we're hearing about are consistent with the timing expectation that people have been led to focus on late this year, early next year for a viable, scalable vaccine.

JH: Yes, there is good news from the Moderna vaccine clinical studies. They've done a small group of people and they've showed so far that it appears to be safe. The adverse reactions, there were some, none of them appeared to be so serious that they couldn't go ahead with the next phase or the Phase 3 where you do 30,000 or 40,000 people. So that is good news.

There is also progress with a number of other vaccines here in the U.S. AstraZeneca, Johnson & Johnson, Novavax, and Vaxart are just a few and things are moving along well. We've got to be careful with the vaccine because the scaling up for manufacturing 200 million has some traps. And we've got to understand, while these early clinical studies might be positive, you've got to get through this Phase 3 where you're doing a large number of people, varying ages at different doses of the vaccine.

So, we've got to look for additional adverse events, which tend to show up in the larger population, which you may not pick up in a smaller group. And then you have to get manufacturing up and running and they are already moving large scale manufacturing of some of these vaccines. So there is a positive note here. When do I think we'll have a vaccine? Maybe by the end of the year, early next year. Then it's a matter of even larger scale manufacturing. And then another challenge is going to be widespread distribution. And then finally, it's going to be getting acceptance of the vaccine. The anti-vaxxers are already mobilizing and being very vocal about a distrust of this vaccine, thinking that with the Operation Warp speed, it's going to be rushed through and safety compromised. I don't think that's going to happen, but the anti-vaxxers are going to be a very vocal component of moving forward with the vaccine.

KK: Yeah. And it's hard to imagine that the prioritization of who gets the vaccine and when won't be politicized, like every other element of the pandemic thus far. But to move on, I have one question that came in from the audience here. And it has to do with going back to the question on the reopening of schools and how do we obtain the data or what data we're looking at here, in addition to the risks surrounding coronavirus that you've just discussed, but what about the other elements that the pediatric associations have been talking about in the light of the emotional and intellectual impact of a prolonged absence from the classroom? We already know that this past semester novel low it was, was not well received and in a lot of districts. So, what about that? What about the beyond coronavirus elements of absence from the classroom?

JH: Good question. It's a very serious issue. Socialization, being away from potential threats, abusive parents, having good meals which they may not get at home are real components of the equation of deciding when to get kids back to school, but we need to look at the infectious disease component and we need to look at the social component. And that's a balance that schools looking at reopening are going to have to strike.

KK: So, I want to pivot now, and obviously everything that Jerry's just been talking about, and thank you, Jerry, is part of a larger story about ESG that we're going to discuss next. Even before the global pandemic and before the Black Lives Matter movement this summer, the rise of ESG investing has been a much-covered topic, both in the global media and of course in the investment community. A 2018 study, for example, concluded that one in every four U.S. dollars is invested with at least some consideration to ESG-related issues. And that trend has accelerated further in the last year. So, I want to spend a little bit of time talking about ESG investing and what it is and how it's impacting companies right now and where it all might be going moving forward. So, Barbara, thank you very much for joining us. In your investor stewardship role, you've obviously seen the transformation of ESG. How has the value proposition of ESG changed? Meaning how has it gone from being a values-based investment strategy to more of a value-based investment strategy?

Barbara Novick (BN): Good morning. First, Kevin, thank you so much for having me today. I think your question is a really, really important one. We're starting to see a series of articles questioning what is ESG and acknowledging that there are multiple definitions. So let me give a historical perspective and explain how it's evolved. And I think it is the cause for some of the confusion, but over time, people I think will grasp new concepts and understand the evolution. And I understand that there are actually multiple definitions within this broader umbrella. So, if you turn the clock back about 20 years, Socially Responsible Investing, and sometimes it went by SRI, became a thing. And what was that? It was very much about expressing your values.

So, let's say you're a healthcare company and you might say, "I want a portfolio that has no tobacco," or you're a religious order and you might say, "I'd like a portfolio that has no defense stocks." Whatever the X is that you wanted to remove, those would be screened portfolios and were called SRI portfolios. As you roll it forward to today, the evidence is building that things like environment and social factors have become essentially investment factors and rather than being about values, it's really about the value of the company.

And so the initial idea is more about screening portfolios to do good, even if that meant giving up return. Whereas today, the sustainable investing portfolios, we would break into three categories. One is the screened portfolios, which is essentially the old portfolios. Second would be at the other end of the spectrum, impact portfolios, where you might select a particular area, let's say renewable energy, for example, where you think there is ability to advance the development of new technologies and new companies. And you want to put a concentrated allocation in that.

And then there's everything in the middle, and the middle category being very much sustainable portfolios where a simple example might be, you take a popular broad market index. And in every industry sector, you select the companies that have the highest ESG scores. So what would that be? You wouldn't be eliminating for example, oil or gas, but you might take within that companies that have better operating characteristics or addressing carbon capture or in some way lower emitters. It might lean you towards natural gas, certainly over coal and maybe even over oil, but you haven't taken carbon completely out of that portfolio.

And that's where I think some of the confusion comes in. Just because you say it's a sustainable portfolio does not necessarily mean it's a screened portfolio. And so we're trying, and we're actually working with a number of other people on how you can start getting a common language and using those three buckets, if you will, of screened impact and just plain ESG. And it'll be interesting to see how much that catches on, but I think we're already starting to see that.

KK: Yeah, absolutely. I want to get Martha and Matt into this conversation on this front as well. Martha, what's your take in response to Barbara?

Martha Carter (MC): Yeah, sure. Thanks, Kevin. And I'll just add to Barbara's points. Like Barbara, I had similar experiences over the last decade watching this, just a tremendous transformation of ESG, of SRI, of moving from screen portfolios to more sustainable portfolios. Kevin, you mentioned at the outset that I led global research at ISS, was there for many years. And from the standpoint of a proxy advisor really saw the growth in the 'G' part of E S and G and the fundamental way in which businesses interact with their investors through the enhancements of some of the governance areas that took place over the last 20 years.

And then of course in the 'E,' the 'S,' and the 'G,' the 'E' came along with the attention being paid to climate change, and those risks, the Paris Agreement, looking at ways to transition more to a low carbon economy and so on. And now with all of the events we're seeing this summer and everything that Jerry talked about, of course at the beginning of the call is really the 'S' part, employee health, workplace safety, human capital management, and importantly, diversity and inclusion are really top of mind for everybody. Just a couple of statistics too, if one measures the interest in the investment community in terms of at the ballot box support for shareholder resolutions. And that's not the only way to measure it, but certainly one way.

If you go back to 2000, the median support for environmental and social proposals was about six percent. So not much take-up overall, but that's increased to about 28, 29%. So nearly 30% support. Still, not majority on average, across all environmental and social proposals, but much stronger showing than we saw 20 years ago. And the proposals receiving at least 30% support in 2000, there were zero of them. And now it averages about a third of them. So, clearly there's some take up in the investment community when they go to the ballot box and look at shareholder proposals. And those proposals, what are they looking at? They're increasingly focused on disclosure, looking at risk assessments and also oversight. Oversight by the board has become an important topic as well.

And then in terms of beyond just looking at the ballot box and the shareholder proposals, we've seen a tremendous increase over the years in stewardship, investor stewardship codes. In addition to the portfolio changes Barbara talked about, things like the UN PRI initiative with signatories from all over the world. So there's been a tremendous amount of transition. And in terms of investor stewardship. Actually I'll turn the mic over to Matt because Matt is head of investor stewardship at MFS. You certainly saw a lot of those changes really firsthand.

Matt Filosa (MF): Yeah. Thanks Martha. And just to add to both Barbara and Martha's comments, from the active management side, and that this was a hundred percent active manager, it was a similar evolution. The terms ESG and sustainability just didn't exist, say pre-financial crisis and then post-financial crisis, we've seen an incredible ramp up, of course. I think one important thing maybe to remember is that investors are still trying to figure this out. What are the material ESG factors that are going to drive long-term value? That's just a fact that we don't know yet. They're still figuring that out. And, by the way, they're competing against each other to try and figure that out and try to find that solution for their clients that makes sense to them. So, that adds to the confusion in the marketplace sometimes when we talk about ESG investing, because there's all different types of flavors out there, both active and passively managed funds that again are a result of this competition, a result of folks trying to figure this out, because this is all relatively new in the investment space.

KK: Yeah. Barbara, I want to pick up on something that Matt just brought up here. And that is that at the same time of the rise of ESG, we've also witnessed the real rise of passive management. Now, certainly BlackRock isn't passive in the true sense of the word, very active stewardship team, but how does passive investing lend itself to ESG investing?

BN: So, first, we don't use the word passive. We talk about index investing because just as you noted, we're not passive investors and neither are our clients. So I think that's a very important point, and one that often gets lost in the discussion. The first level of an investment decision actually rests with our clients who we call the asset owners. They can choose a broad market index, a sector index, a factors based index, a country index, or an ESG optimized index, similar to what I described earlier. And our job is to track the index that they select as closely as possible taking into account flows, in and out of various portfolios and index rebalances, corporate actions, things like that. But that's just one component of investing. A second and really important component is investment stewardship. And you can think of index investors as what I call the ultimate long-term holders of a stock.

Why do we care so much about the long-term value of the company? Because as an index investor, whether we like management or not, whether we like the products or not, whether we like the sector or not, it really doesn't matter. If it's in the index the client has selected, we're going to own that for a very long time. So, unless they reallocate their assets, we find that we are a very long-term holder. And we're interested in these kinds of long-term factors. If you think about things like shifts in regulation or investor sentiment, how companies are dealing with things in the environment, even if you are not a complete believer in some of the arguments, you can't help but see the regulation is going up. Investor sentiment is changing. Those things are going to affect the company's value. Likewise, reputational issues. What if there is a customer boycott, and coming back to your earlier question, this is part of this whole values versus value question.

And we see many of these factors, I would start with governance, then environmental and social, as drivers of value, or sometimes value destruction. And as fiduciaries for our client holdings, we think it's important that companies are addressing these factors, that they're integrating this into their everyday business. And so it's not really about active versus index. And by the way, BlackRock has about 10% of our equities are inactive as well. We really look at it as more of an investment function, part of our fiduciary responsibility. And the index portfolios being those long-term holders, it's even more important. Not that it's unimportant in active, but it's a critical component of the investment process.

KK: So, all three of you have done a phenomenal job of laying the groundwork here. And I want to use that to contextualize the current state that we're in. But before we do, there's a question for whoever would like to take it from our audience. And it is to compare progress in terms of ESG in the U.S. and in North America broadly versus say Europe, and what the trends are there. Anybody want to take that?

BN: I'll take a shot. We operate in markets literally around the world. And I think there are very different aspects of ESG. So starting with the governance, there are today close to 20 stewardship codes in markets around the world, and they differ. There are also different histories of companies. So, you'd go to many of the places in Asia and you have family owned companies or state-owned enterprises. Literally the corporate structure is different. When you go to Europe, the same thing. We did a study that we published in January, where we showed the ownership structure of more than 30% of the companies at a very large, maybe not a majority, but a 30 plus owner, which was either state or family or foundation or things like that. So, you have to understand the markets that you're operating in, and as an investor, what the stewardship code is, what the company structures are.

Are there weighted voting rights? How do all those things fit together? Within that context, certainly Europe has come out with much more prescriptive on things like non-financial reporting and moving more and more towards carbon free or carbon transition. The United States has been more of market-led solutions than regulatory-led solutions, but you do see a shift and the most important shift is in the asset owners. If asset owners make a decision to allocate their money in a certain way, not surprisingly, that has an impact. What we're seeing in our business is ESG products have become much more in demand than non-ESG products. I actually believe over time, and I don't think it's a long time, maybe it's a five-year horizon, that all products will incorporate ESG factors into their analysis, because it will be accepted that these are important drivers of return.

MC: Kevin, I'll jump in on that as well and just to second, what Barbara said, there's definitely differences in local market practices and regulations around the world. If we just look at governance structure, for example, when you go to Europe as to who's overseeing a lot of these topics, you find two-tier boards, you find more employee representation in terms of the diversity and inclusion on boards. So, there's a lot of structural differences, but that said, I think where we're headed is more of a coalescing around global standards. And we saw this in the 'G' part of ESG, over that couple of decades that we talked about at the outset of this call, that over time there tends to be a convergence.

So when we look at, we've got global companies, global investors, a global pandemic, global protests, all of these things affect companies around the world. We can get into this a little bit more in the remainder of the call, but the reporting on it and the disclosure of it and Barbara mentioned the products, all have to really focus around what do global investors need in order to invest, and what types of disclosures are out there? And there are varying kinds of frameworks and standards out there. One of them is SASB, which we can talk about, which is decidedly grounded in a SEC framework. And Barbara, interested in your thoughts on this as well, but really meant for a global audience and hopefully being able to be applicable for a global audience.

KK: I want to, if I can, we've talked about where we've been and where we're going, but I want to bring it all back to where we are, because clearly, as I indicated at the outset, I mean the two big stories this summer are obviously the economic fallout from COVID and how that's impacting everyone, from companies down to individuals. Of course, also the Black Lives Matter movement which has brought a whole new set of stakeholders to become extremely vocal in ways that companies have got to respond to and whatnot. There's been a movement in some media to suggest that, in an era or in an environment of economic distress and in some cases, outright liquidity crisis, that companies will need to put ESG on the back burner. But what I seem to be hearing here is absolutely not. But Barbara, what's your take here?

BN: So, I would take the exact opposite side of that argument. I think COVID has highlighted the importance of ESG in managing companies and while clearly, financial issues, immediate financial issues are critical and I don't want to take away from that in any way, a number of companies are already distinguishing themselves in ways that we think will matter when we return to a more normal environment. So we're interested as we engage with companies in learning about their operational resilience, their flexibility, how have they adapted to the new environment. If you're an international company, the supply chains are key. If you're a financial services company, the pivot to working remotely is obviously much more applicable.

Frankly, what we see is COVID is reinforcing a lot of preexisting trends, such as e-commerce and digitization. Who on this call hasn't ordered things, more things, not necessarily just from Amazon, but from somebody online and had it delivered to home? Who hasn't thought about using, or actually used telemedicine, or other online resources that you might not have used before? I would say some stocks are zooming, but we're not using Zoom for this call. So maybe there's a lot of competitors who are also in the space. As you see, each of them is really taking off. So, the technology sector very broadly defined is really a game changer and the e-commerce.

Likewise, human capital management is top of mind. Is a company retaining employees? Are they furloughing employees? Or are they outright laying people off? How are they addressing health and safety considerations for employees, especially if they're returning to work? What are their plans? How quickly do they think they can implement that and how can they do it safely? Then we haven't really talked that much about it, but this began as a healthcare crisis, it morphed into an economic crisis very quickly, and now it's become a social crisis with the Black Lives Matters and protests. How are companies addressing D&I?

So, a simple thing is even what's your disclosure, can people see what you're doing? And is there a benchmark that they can then measure? Are you doing better, are you doing worse over time? So, I think there's a lot of different ways that you can think of the 'E' and 'S' factors and especially the 'S' factor coming out of COVID. We do think it's not about putting them on a back burner, it's about embracing them and figuring out how you can use those as opportunities to improve your business and actually come out stronger.

KK: Yeah. I want to pick up on that, but Martha, you've also seen some pushback. What else are you seeing out there?

MC: Yeah, I'll pick up on your back burner question Kevin, and not to get too far in the weeds on this one, but I want to mention it just because it happens to be live, which is the other area that we're seeing pushback is in the DOL proposal on ERISA funds. So, the Department of Labor recently proposed amendments to ERISA, which is the Employee Retirement Income Security Act and it is for employer sponsored retirement plans. ERISA requires fiduciaries to act in the sole interest of the benefits of the plan participants, so of those beneficiaries. The proposal states that plan beneficiaries have to select investments based solely on financial considerations.

I want to contrast that with where the Obama administration was on this, which was looking at guidance that allowed ERISA plans to consider social impact, as long as fiduciary obligations weren't compromised. So, the idea is that the plans in their fiduciary duty to beneficiaries, cannot subordinate return, they cannot increase risk for non-financial objectives. They're seeking to confirm that, and the Secretary of Labor was quoted as saying that private employer sponsored retirement plans are not vehicles for furthering social goals or policy objectives, if they're not in the financial interest of the plans.

So, some could look at this as a good thing, and others could say that's really kind of tightening the reins around 401K plans to be able to offer ESG funds or to have to really prove out that the ESG factor represents a material economic consideration. Whichever side one might be on on that, I think what it does imply is that the industries are looking to have better data, because if they have to prove out that ESG is a material economic factor, the data and the linkages between the ESG factor and the economic considerations is very important. So, as I mentioned, I'm raising this because it is live and the comment period for this proposal ends on July 30th, if anyone is interested in commenting on it.

KK: Yeah. I'm going to also pick up on something Barbara was talking about a moment ago and maybe turn to you Matt, with regards to how some of the ESG ratings might change to incorporate some of what Barbara was talking about in terms of human capital management, D&I, etc.

MF: Yeah, sure, thanks Kevin and ESG ratings, as some of the audience knows, these are the third parties out there that are rating companies, largely based on how well they're managing the ESG risks that are facing their company and then investors in turn use those ratings to either inform their buy, sell decisions or in some cases, as Barbara described, determine whether that company gets included in the index fund or not related to ESG. So, they're obviously an important factor in this whole conversation. Like everybody else, they're reflecting on the world's changes this year and potentially changing their methodologies to determine those ratings on companies. So, they might increase their focus on things like diversity, inclusion, employee health and safety, all those human capital management issues that Barbara described.

The indication here is that companies might have their ratings change, not by anything that they've done, in addition to either policies or disclosures, but just by way of the ratings firms changing their methodologies and perhaps reemphasizing or overemphasizing some of these issues. So the ingredients will be the same, but the recipe in some ways might change. So that exercise of overseeing these really impactful ESG ratings that investors utilize, really is not a set it and forget it exercise, especially this year, because things are going to change, and it might not be due to a company's activities.

KK: Yeah. Interesting. I'm conscious of the time here. So, I want to keep us kind of moving along and there's a number of other questions I've got, but Barbara, as an indication of capital moving into ESG investing, we saw in 2019, a record for inflows into ESG themed funds. I think the early indications, if I'm not mistaken for the first two quarters of this year, indicate that it would be another record year. I mean, obviously, understanding that it's a broad term, ESG investing, what do you think about the movement of capital flows towards ESG themed investment products? You mentioned this a few minutes ago, you referenced five years out, but take us through that process a little bit.

BN: Well, I think as investors come to understand the value implications of the factors more capital will naturally flow in this direction. And that's why I say over time, I think it would be difficult for a portfolio manager not to be incorporating some assessment of these factors in their investment decisions. So I do believe it becomes the primary way that people invest because most of the products will incorporate some aspect of ESG. I also think it's important for companies to think about how these factors can impact value. Sometimes people talk about stakeholder capitalism somehow as a bad thing, or somehow a detractor from shareholders. I would say they're actually symbiotic and I'll give a couple of examples to make it a little more concrete.

Stakeholders include customers, employees, suppliers, communities. So, pick the customers. Who doesn't think you should treat your customers well and have them buy more products, refer their friends, however you want to define it. Why wouldn't customers be an important stakeholder for a business? Likewise, we talked about human capital management and employees in this COVID environment. I think it's quite clear that how you treat your employees is a very important aspect of stakeholder capitalism. For many companies, employees is one of their key assets. So if you're not treating your employees well and not thinking about their health and welfare, where are you going to be afterwards?

I'll mention suppliers. I had an interesting conversation with a company who was doing quite well in this environment. They recognized that they needed to reach back and give long-term contracts to some of their suppliers for two reasons. One, it would enable the suppliers to give certainty to their employees and give them some stability, but they also look at it from a selfish perspective, they wanted to lock in their supply chain. They wanted to have more certainty for themselves. So, I use those three examples because they all show how having a stakeholder capitalism mentality is actually good business. It's not an either or, but in fact it can be quite symbiotic.

Then lastly, I would just mention in the current environment, the whole reputational risk and how are you perceived over time. I think it's very important with social media and how quickly someone can get boycotted or whatever negatives happen, you also get positives. We've been tracking some data, more than 50% of U.S. companies have donated to food banks in their local communities. And it's such an essential aspect of this crisis. Whether someone is donating PPE for local hospitals or donating to a food bank, if they have the means, and we recognize some companies don't, some companies are taking government assistance, but if a company is doing well and has the means, this is an opportunity to really support the local communities and the people who are really in need at this time. So, I think it's a great way of thinking about stakeholder capitalism and how important it is in these ESG factors.

KK: Martha, you brought up a few minutes ago, you brought up SASB, but contextualize what's Barbara just been telling me about here and the advent of standards and frameworks and that impact?

MC: It's so important, Kevin, and to build on what Barbara was talking about, the movement of capital flows towards ESG-themed investment products really depends on a few things, including good underlying data and consistent reporting. And nearly 90% of the S&P 500 right now, have sustainability reports out there, but they're not consistent in their formatting or in the day-to-day present. And then in some cases, while the sustainability reports can be quite good, they also can contain a lot of information that may or may not be material with some of these investment products. And so, that's not surprising that over the last decade we've really seen the advent of all these frameworks. So again, going to the alphabet soups, SASB, TCFD, GRI, along with integrated reporting, to provide some level of guidance on disclosure and reporting for ESG data. And of course, BlackRock was one of the flagship members of SASB's investor advisory group. And just this week, in order to try and sort out some of the confusion around it, SASB and GRI announced a collaborative plan to try and provide more clarity on their two sets of standards, and to effectively understand the differences and the similarities in the information of these standards so we could get some coalescing around these standards and frameworks and some common reporting. But these are very, very important frameworks and standards in order to provide the data that's needed, that underpins all of these changes that we're talking about.

KK: Yeah. And Barbara, we just got a question from our audience asking how international investors such as BlackRock, see regional initiatives to define green activities. For example, the EU, we're trying to develop so-called taxonomy, trying to enhance sustainable investments. And I guess more broadly, it takes us to the subject of the need for common language and common data on this front.

BN: Right. So, I would say there are two different levels of data. One is what Martha just talked about, the company data itself. And there is such a proliferation of surveys, I call it the alphabet soup of reporting. It's I think in everyone's interests, investors, issuers, any other regulators, any other stakeholders who are interested in this area. It's in everyone's interest to have some convergence around what data is being reported by companies and hopefully in some kind of standardized way. So, that if you use a particular word or phrase, you know how it's defined, and it's not, everybody giving metrics, but they're not apples to apples comparison. Which is one of the reasons we've endorsed SASB as a reporting framework.

We're really excited to see SASB and GRI get closer together and have an alliance because those are the two biggest ones. But assuming they get together and there is agreement, it would be helpful if the people who are currently sending out surveys instead drew their data from these reports that would be publicly available. Because companies receiving surveys, some companies say they received 50 surveys in a year. Can you imagine the quality of data that's being submitted back to them? It can't be very high. Because you're just not giving the same kind of attention that you would to a document that's going to be a public document, that you're really going to be putting your name on in that way. So, that's one level of data. The second level of data I talked about earlier, this idea of a product taxonomy.

So today BlackRock calls it Screened ESG and Impact. The Institute for International Finance put out a short paper late last year, similar three categories. I know one of the trade associations is working across with many managers to do something similar, I've seen the draft and I think it will be very much aligned. So, if we can get to that point where we have a common language and I'll give an example, Commissioner Roisman from the SEC, recently spoke at a corporate governance event and he talked about green washing and how it's very difficult to differentiate products and to know what's in them.

And that's exactly our point, is accusations of green washing go to a lack of understanding of the different kinds of ESG investing today or sustainable investing. And we need to really advocate for a product taxonomy that takes that into account. We did a very long report on this in January. I don't think it's that different than where the EU is coming out. In fact, we incorporated some of the EU stuff in that paper, if people want to get a deeper read of that.

KK: And you know, a few minutes ago you talked about some of the extraordinary measures that have been taken by companies, everything from shifting production to PPE, to the food banks. We've seen companies actively encouraging their employees to take political action, etc. What is the ability of large institutional investors like BlackRock, to continue to create and push for social change themselves, in their portfolio companies?

BN: Well, Kevin, I think that's a bit of a tall order. I don't think we can create social change, but we can encourage companies to consider the impact of diversity and inclusion on their business, both at the board level and at the senior employee level. I mentioned earlier, disclosure of data. We put out a statement and when we put out our statement. One of the things we did is we included disclosure and we put a link to our SASB report, because the SASB guidance for financial services does in fact include some disclosure of EEO types of data. And, studies showed that diversity leads to more innovation and better decision making. This isn't just a social issue. Again, it's more about good business in a modern world. And I think once people adjust their thinking about some of these issues and recognize that this is good business, it takes that edge off it. It's not about social causes, it's really about how do you enhance your business, not just short-term, but over a long-term and get to better places.

KK: And Martha and Matt, I know you've been working with clients on this front as well. What are you seeing?

MC: Yeah, I'll just pick up on two points and then turn it over to Matt. One is that we are on the diversity and inclusion side of things. We're already seeing letter writing campaigns that are no doubt going to reflect in shareholder proposals in 2021 on diversity and inclusion. And then, the second point is really how boards are now reacting, looking at their own structures and where in their committee charters diversity and inclusion falls. And if you look at the S&P 500, only a couple of companies have separate D&I board committees. And I think that's starting to change with boards looking at separating that function into a separate diversity and inclusion committee.

KK: And Matt?

MF: Just to quickly add to Barbara and Martha's comments, I think I totally agree with Barbara, it's certainly a tall order to have investors affect social change. But I think, to think about why this is happening from the investor lens, and Mr. Fink has said this a couple of times now, it's not the asset managers money, right? The customers are driving a lot of this, and like any other good company, the asset managers are trying to respond to the customer's views, that these issues are going to have an impact on whether they choose to buy a particular asset managers' funds or not.

So as long as their customers, and I'm thinking both on the retail side, you and I, who might buy funds from these shops, as well as on the institutional side, the pension funds and the like. As long as those folks are advocating for these types of issues to be baked into investments, it seems reasonable to me that an asset manager will continue on this push, as long as that momentum continues, the asset managers will continue. So, it's kind of a push/pull or how you want to describe it, about what's going on in this industry. And as long as that's happening, it should continue.

KK: So, all three of you have made some really excellent points here. So, I'm going to put you on the spot one final time and ask you to distill it all down. Because what is, if there is, is there one action or strategy that companies should be doing or thinking about now, to meet the new demands of investors and other stakeholders, regarding ESG specifically. Maybe Martha and Matt, I'll ask you first, then Barbara, I'll give you the last word.

MC: Okay, great. I'll start with the word integration. So for companies to integrate internally, the typical or old school way of doing things is to have a sustainability team that essentially sits off to the side and writes a sustainability report. And as I mentioned, those are not reports that are necessarily consistent across information and companies. But having sustainability teams and goals that are really integrated with the overall strategy, and we essentially call it moving from a sustainability strategy to a sustainable business strategy. And where the rubber meets the road on all of that is we're seeing more demonstrations of ESG being integrated in that strategy through executive compensation.

So, a lot of companies, already approximately half of the S&P 500 incorporates ESG goals into executive incentives. We're probably going to see more of that. Right now, most of those goals are embedded in annual incentives, despite the long-term time horizon that we talk about when we talk about ESG factors. But I think we're going to start seeing more companies move towards those ESG goals being baked into long-term incentives as well.

KK: And Matt?

MF: Yeah, I guess I would say one proposed takeaway is don't let the ESG acronym soup or I like to call it more like a porridge or a stew. It's not even as clear as soup, right? Don't let that prohibit folks from trying to dive in and figure this out. It's definitely confusing in some ways, for sure. Sometimes I even start scratching my head on what's going on in this space, but at the same time of all this confusion, money is moving in this direction. Companies are being impacted already, amidst the soup, on access to capital and shareholder engagement and the like. So, hopefully folks don't let the confusing part of the ESG space, prohibit them from taking a dive in and then trying to figure this out.

KK: Thanks, and Barbara.

BN: So, I completely agree with Martha and Matt. Now, that's not all I have to say. But I think it's important, ESG, it's just not a side committee. It's thinking about these issues, how it's integrated into your business, that's going to really move the needle and change how people think about the issues and how they execute on the issues. And of course, you can guess from my prior comments, having a common language, both adopting SASB-aligned reporting, and having a product taxonomy. These are critical things for the overall business landscape. And if we don't have a common language, it really becomes a bit of a tower of babble and I don't see how we can make as much progress.

KK: Well, thanks very much. And we've sped through another hour here. We actually have quite a lot of questions coming in. If I didn't get to yours, or if you come up with something, please do not hesitate to reach out to us at Teneoinsights@teneo.com, and we'll try to get back to you. We will be back next Thursday. The topic of our call is going to be the impact of the new National Security Law on Hong Kong and the ability to do business in Hong Kong going forward. We'll have our China analysts as well as our Hong Kong head on the call next Thursday. But in the meantime, I would like to thank very much Barbara Novick for joining us today. And of course, as always Martha Carter and Matt Filosa, and Jerry who I'm sure will be back with us next Thursday as well. Thank you everyone for joining us, have a great rest of your week and a good weekend. Thank you very much.

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