

Anthony Ginsberg: Session Notes

Good morning, welcome to this discussion on the relation between disclosure and shareholder value, with particular attention to the views of the sustainable and socially responsible investing community.

I would like to begin by introducing our two panelists and myself. Since today's seminar materials include biographical information about panelists, I will limit myself to mentioning the current professional positions of our panelists.

Adam Seitchik is Executive Vice President and Chief Investment Officer of Trillium Asset Management in Boston, the nation's oldest and largest independent investment firm dedicated solely to socially and environmentally responsible investing. He is a member of Trillium's Executive Committee and chairs the Asset Allocation Committee. He is the lead portfolio manager for the Green Century Balanced Fund, an environmentally focused mutual fund owned by a consortium of non-profit environmental organizations.

Bruce Kahn currently is the Senior Investment Analyst for Climate Change Strategies in the NY office of DB Advisors, which is the brand name for the institutional asset management division of Deutsche Asset Management, the asset management arm of Deutsche Bank AG.

Anthony Ginsberg. As for myself, my current work as a consultant embraces both my work as a non-SRI, mainstream equity research analyst and research in the area of sustainability. I am currently the Chair of the SRI Committee of the NYSSA.

The objective of my introductory remarks is to set the context about how the Socially Responsible Investing community conceptualizes the relation between shareholder value and disclosure; in doing so I will describe SRI from various perspectives. SRI, of course, is a concept which continues to evolve. In fact, major changes in the concept are occurring at the present time, changes which some describe as a major generational shift within the SRI community. One reflection of this current change is the terminology itself, as we increasingly hear references to "sustainable investing" and "ESG investing." I will address differences in SRI perspectives in just moment, but for the sake of simplicity today I will use the phrase "SRI" to refer to all perspectives.

To begin, any discussion about SRI is always about change in at least four important ways:
(1) SRI has always been a response to many kinds of economic and social change;

- (2) SRI articulates a vision of what ought to be in the future;
- (3) SRI has to do with how and how well companies anticipate and manage change.
- (4) SRI has to do with how and how well financial fiduciaries anticipate and manage change.

I raise this preliminary point about change because I would like to make an initial general point regarding resistance to SRI practices that I believe is ultimately related to the issue of disclosure and shareholder value. I would argue that one factor of the **analytical** resistance to SRI is the entanglement and disagreement with certain SRI values and beliefs. Let me invite you to consider the idea that ignoring what SRI talks about can constrain the ability to anticipate and capture actual and potential macro- and microeconomic change, limit the capacity of corporations to manage such change, and inhibit the ability to identify new growth industries and opportunities. I believe the willingness to put aside differences of opinion about specific social values and consider issues raised by the SRI community is what is behind the relatively recent and significant uptick in interest and activity among some of the world's largest investment firms and among the mainstream analyst community in general. Indeed, increasingly we see examples of the business case, legal support, and structural frameworks for considering and incorporating ESG factors into financial analysis, investment decisions, and investment portfolio construction. Consider the following examples:

- (1) The CFA Institute, which is the main global professional association of financial analysts and portfolio managers with over 100,000 members worldwide, notably included a panel at this year's annual conference entitled "Why environmental, social, and governance (ESG) factors have become mainstream."¹
- (2) The CFA Institute's Centre for Financial Market Integrity undertook the global launch in New York this past July 8 of a publication entitled "Environmental, Social, and Governance Metrics for Listed Companies: A Manual for Investors." That launch was co-sponsored by the Bloomberg corporation, which has committed to providing customers with an exhaustive range of ESG data.²
- (3) The CFA Institute's local NY chapter, the more than 10,000 member NY Society of Security Analysts, counts some of its members among those involved in the joint effort of the financial services industry and the

¹ www.cfainstitute.org

² www.cfainstitute.org/centre

Environmental Protection Agency to improve the quality and accessibility of the EPA's numerous databases for the purpose of being better able to judge the environmental performance of corporations.³

- (4) In 2007 the Carbon Disclosure Project received responses from over 1300 of the 2400 global corporations solicited about their emissions. The solicitation was sent from investors representing more than \$41 trillion in assets. This very morning, as we speak, the Project is holding its annual meeting here in NY, revealing the results of its 2008 survey, which was sent to over 2800 of the world's largest public corporations with a letter signed by 385 investors.⁴
- (5) The UN Principles for Responsible Investment, launched at the NYSE in April 2006, claims 381 signatories representing \$14 trillion in assets under management. The number of signatories doubled over the past year. The Principles represent an important step in the process of creating a framework for incorporating ESG factors into financial analysis.⁵
- (6) The Enhanced Analytics Initiative was launched in October 2004. It is an incentive-driven collaboration between asset owners and asset managers aimed at encouraging investment research that takes into account the impact of ESG factors on long-term investment. The Initiative currently represents \$2.4 trillion in assets under management.⁶
- (7) After many years now of SRI practice and performance data, academic studies are showing (1) that taking ESG factors into account does not necessarily lead to financial under performance and (2) that current approaches to socially responsible investment can enhance investment performance.⁷
- (8) The Investor Network on Climate Risk, founded in 2003 and now representing over 50 institutional investors responsible for over \$3 trillion in assets, published in 2004 an Investor Guide to Climate Risk. The 10 key steps for investor action in that Guide include 4 steps regarding disclosure.

³ www.nyssa.org

⁴ www.cdproject.net

⁵ www.unpri.org

⁶ www.enhancedanalytics.com

⁷ <http://sri.typepad.com>

SRI is estimated to encompass \$2.71 trillion out of \$25.1 trillion in the US investment marketplace.⁸ SRI believes that corporate responsibility and societal concerns are valid parts of investment decisions and therefore considers both the investor's financial needs and the investment's impact on society. SRI investors encourage corporations to improve their practices on environmental, social, and governance issues, believing that by doing so corporations will deliver more long-term wealth to shareholders. SRI investors also believe in building wealth in underserved communities worldwide.

SRI techniques traditionally are described as three: screening, shareholder advocacy, and community investing. Screening includes both positive and negative filters which evaluate investment portfolios or mutual funds based on social, environmental, and corporate governance criteria. As such SRI investors may either exclude certain categories of companies altogether or use a "best practices" approach across sectors. SRI investors believe that their responsibilities as owners of capital require them to engage companies on issues of social, environmental or governance concern through dialogue and, at times, through filing shareholder resolutions. Dialogue and resolutions are perceived as generating pressure on company management, creating media attention, educating the public on ESG issues, improving company policies and practices, enhancing corporate citizenship, and promoting long-term financial performance and shareholder value. Community investing directs capital from investors and lenders to communities underserved by traditional financial services institutions, seeking to provide access to credit, equity, capital, and basic banking products such communities otherwise would lack.

In terms of concepts and issues common to the different threads within the SRI community, I think it is important to single out two: the notion of "externalities" and the debate over the relation between corporate ownership and management. The idea of externalities assumes that the activities of corporations create environmental and social consequences—usually, but not exclusively, negative—that are not factored into traditional accounting schemes. SRI practitioners for the most part accept the combination of government actions to facilitate market-based solutions for both the negative consequences and positive opportunities created by these externalities. The debate concerning the fundamental governance issue about the relation between corporate management and ownership found its classic statement in the US in 1932 with the publication of Adolph Berle and Gardiner Means' book entitled The Modern

⁸ This and the following paragraph contain data and information from the Social Investment Forum, the professional association of SRI practitioners. <http://socialinvest.org>

Corporation and Private Property. In the broadest sense this book was an important statement within the sociological literature about the nature of economic and social development in the modern world which looked at the rise of public corporations and their effect on economic and social development. When I describe “sustainability” and “sustainable investing” in just a minute it will be even clearer how long the lineage is of these issues and debates. The current character of these debates along with the development of SRI in the 1960’s and 1970’s at first saw a merging of notions of social and environmental stewardship common to many religious traditions along with the emergence of ethical consumerism which occurred in the cauldron of the 1960’s debates over numerous social, economic, and political issues, including the war in Vietnam, civil rights, women’s rights, the anti-nuclear movement, environmentalism, and international human rights. The very terms which emerged—“ethical investing” and “socially responsible investing”—reveal much about the nature of the intentions and practices of the pioneers of contemporary SRI: it was a reflection of the social values and visions of social change of SRI adherents and the desire to align those values with investment choices. Importantly, as the notion of market solutions to externalities gained acceptance, the realm of corporate responsibility expanded to embrace these varied concerns.

An important event in the development of SRI came in 1987. In that year a report was issued by the UN’s World Commission on Environment and Development, often referred to as the Brundtland Report, after its main author. The report coined the term “sustainable development,” calling upon the world community to seek a new pattern of development that “meets the needs of the present without compromising the ability of future generations to meet their own needs.” Sustainable development was, therefore, squarely within the traditions of modern theories of economic, social, and political development, seeking in its case to resolve the tension between development and the environment. As the concept developed and gained acceptance within the SRI community, it has come to define a much more comprehensive definition of SRI which more firmly integrates not only many of the social values of prior SRI approaches, but also defines the central role of finance and investment—that is, the capital markets—in the overall effort. Thus, “sustainable investing” is becoming the dominant approach within SRI, making SRI of greater relevance to institutional investors as well as corporations. As finance and investing are seen as the levers of change for a more sustainable future, they also are transformed in practice for the analyst and portfolio manager. They more clearly and fully define what is asked of corporations in terms of internal practices, reporting, and

therefore of disclosure.

Proponents of Sustainable Investing believe they are taking the original concepts of ethical and socially responsible investing a step further by placing the pursuit of financial returns within the context of the world's economic, environmental, and social challenges.⁹ As such, all asset classes and all regions of the world are included. Two key premises, therefore, are (1) that the best way of generating risk-adjusted returns is to incorporate fully long-term environmental, social and economic trends within investment and ownership decision-making; and (2) that achieving global sustainability requires the mobilization and reshaping of global capital markets. These two premises, therefore, cover both the micro and macro realms, that is the focus on financial value of the individual corporation and a focus on broad economic structural reform. It also therefore provides directional guidance for both the purely financially motivated investors who seek to mitigate risk and benefit from positive opportunities and for civil society organizations seeking social and environmental progress. Finally, Sustainable Investing embraces both individual investors who want to be sure that social and environmental factors are related to how they allocate their savings and institutional investors who appreciate the financial materiality of environmental, social, and governance factors. The Sustainable Investing approach therefore also includes investors interested in clean technology and microfinance opportunities. Again, the common thread is the view that value can only be created on a long-term basis through new approaches to financial analysis, fiduciary duty, and capital market regulation. One final way to describe SI is that it seeks to go beyond the traditional SRI approach of seeking a double, triple, or quadruple bottom line—meaning some combination of environmental, social, governance, and financial returns. Rather, SI seeks a unified single bottom line which integrates ESG and financial factors as part of a fundamental analysis and valuation.

The views of sustainable investors have very specific and important implications for the way “materiality” and “fiduciary duty” are understood and therefore for the way disclosure and shareholder value are approached. In a paper on climate change and investors, our panelist Adam Seitchik has described these implications in the following

⁹ For the self-description of sustainable investing proponents I have relied on a draft of the forthcoming publication (fall 2008) Sustainable Investing: The Art of Long-Term Performance. Krosinsky, Cary and Nick Robbins, editors. Earthscan Press, UK and USA, 2008.

way.¹⁰ Institutional investors today are for the most part universal owners of the global economy because of the effects of portfolio diversification. Portfolio returns, therefore, reflect market returns. Consequently, an investor's fiduciary duty includes the responsibility for the world that underpins our universal economic and financial prosperity. This means dealing with the externalities created by economic activity, asking corporations to stop creating the externalities which harm the larger economy and therefore their portfolio-level returns. Through the prism of climate change, this means that portfolio managers must actively manage climate change through their investing activities if they are to obtain good future portfolio returns. The materiality of the climate change issue and the resulting fiduciary duty for portfolio managers requires disclosure regarding emissions and corporate strategies as well as the support for public policies concerning the risks and investment opportunities surrounding climate change.

Having now an understanding of the premises underlying requests for disclosure and the assumptions about the relation between disclosure and shareholder value, we nonetheless confront questions, criticisms, and challenges about the disclosure-shareholder value relation. As we move into a discussion based on the perspectives of our SRI practitioners and corporate representatives, such issues probably can be divided into two broad categories dealing with disclosure itself and then the disclosure-shareholder value relation. Regarding disclosure we can discuss:

Differences over materiality and fiduciary duty and legal questions about these

The kinds of requests for ESG data coming from SRI and mainstream analysts

Formats for reporting ESG data

The quality and consistency of ESG data

Voluntary and mandatory reporting requirements

The respective capacities of corporations and research analysts to handle increasing requests for ESG data and the processing and interpretation of such data

Regarding the disclosure-shareholder value relation we can discuss:

Differing views on the relation

Empirical data related to the relation

¹⁰ Adam Seitchik, "Climate Change From the Investor's Perspective." <http://users.rcn.com/aseitchik/>

To conclude, I would like to return to a point I made at the outset as we enter the discussion about disclosure and shareholder value. That point was to invite you to suspend any differences over social values one may have and rather consider the analytical issues raised by SRI from the perspective of managing change; and then consider that change often is driven and managed by transparency through the act of disclosure.

Now I would like to turn things over to Adam Seitchik.