momentum
investments

MINDFIELDS

October 2021

The ESG edition

With us, investing is personal

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01

Introduction

Eugene Botha - Deputy Chief Investment Officer

COVID-19 brought on 2020's financial crisis, which was an unforeseen risk that changed our world. It hampered productivity, decimated living standards, and transformed the way we work, communicate and interact.

Despite the wreckage from an economic perspective, it forced introspection on multiple levels: what is our purpose, how do we interact within our communities and what is our effect on the planet? Investors and businesses took a step back to re-assess their practices and conduct, to re-think strategies not only to make sure they survive but also to provide a base to thrive.

ESG (environmental, social and governance) is the acronym associated with responsible investing risk factors. Conceptually, it describes the elements of custodianship and the ripple effects an investment decision has on our world in terms of our environment, society and good governance practices. Once we recognise that our decisions as investors affect our world, our environment and our communities, and also reflect our ethics and principles, we need to consider how we manage this effect.

The level of interest in responsible investing and the range of available ESG-related portfolios have grown impressively over time, locally and globally. This growth raises the question of whether ESG is just a fad or bubble or whether it represents a fundamental change in investment practices. In this edition of Mindfields, we shed some light on these questions. We provide some examples of greenwashing and discuss why it is important to really understand what you are investing in when choosing an investment manager or portfolio positioned as being ESG-based.

Increasingly, business communities realise the importance of integrating ESG factors into their philosophies and processes, and the compounded financial benefits when risks for all stakeholders of a business are effectively mitigated. We are proud in saying that this has been, and always will be, at the core of our investment philosophy and business practices at Momentum Investments. Responsible investment practices resonate directly with our outcome-based investing philosophy. They are completely aligned with our clients' long-term goals to positively influence the world they will retire to. We focus on all of this because it is important to our investors, and what is important to our investors is important to us. Because, with us, investing is personal.

More technically, incorporating responsible investing practices into an investment process leads to a more robust and holistic approach to risk management. The ESG approach to responsible investing qualifies risks related to ESG factors and guides the implementation of risk mitigating approaches in the investment process. It also helps us to assist government in achieving goals for economic growth in the long term – mainly through impact investing funds. Transforming economies to reduce their carbon footprint and climate risks through structural change can lead to innovation, employment, new industries, and growth in the longer term. We are already part of that process and want to have more of an impact in the future.

Investment managers in South Africa have refined their impact investment objectives to encompass National Treasury's goals in terms of structural reforms, making impact investing more relevant for the South African investor. More detail regarding this is explained in the articles to follow.

We manage our investments responsibly through the combination of a responsible investments specialist team and investment processes that explicitly incorporate responsible investing and ESG factors across all the portfolios we manage. In this publication of Mindfields, you will find some detail on how we think about and incorporate responsible investing as well as sound ESG principles in all our investment decision making processes, including in our fixed income and listed property portfolios.

We also recently developed specialist impact funds focusing on achieving an impact in the fields of renewable energy, student housing and other infrastructure-related investments. In every case, it is about more than just achieving the financial investment goal, but also about doing the right thing for the environment and society. More detail on the impact funds, what impact means in these contexts, how it's measured and implemented are discussed in the articles to follow.

In our multi-asset-class portfolios, responsible investing should not only be reflected in what we do from a South African perspective but also globally. In the final article of this publication, Robeco (our global research partner) gives an international perspective on how sustainability can and should be integrated into equity portfolios. The effect of the exclusionary approach, practical ways to increase ESG scores and how decarbonisation in a portfolio can be addressed in a custom way for a client's specific needs are also discussed.

In addition to incorporating sound responsible investing principles in our investment capabilities and processes, there are several national and international networks or platforms that are proponents of responsible investing. They formulate guidelines and requirements that members or signatories are required to fulfil, to make sure we effectively incorporate and implement ESG factors into our investment processes and ownership decisions. The responsible investment principles and compliance advocated by these networks or platforms have been incorporated into our responsible investment policy. We have also built our responsible investment approach by setting goals that guide the effective implementation of responsible investing.

The main principles of our responsible investment policy are as follows:

- Advocating acceptance and implementation of ESG into investment decision making (ours and those of the external investment managers we use)
- Reporting on activities and progress to show our commitment to acting in the best interest of our stakeholders
- Encouragement of transparency through disclosure of our responsible practices
- Integration of ESG overseen by our investment committee and ESG specialists
- Participation in active ownership through engagement and proxy voting as well as compliance to rules and regulations

The following are regulations and codes of practice to which we comply:

- The United Nations Principles for Responsible Investment (UN PRI)
- The Code for Responsible Investing in South Africa (CRISA)
- The International Corporate Governance Network (ICGN)

We also support the following:

- Task Force on Climate-related Financial Disclosures (TCFD)
- CDP (previously the Carbon Disclosure Project)
- Paris Agreement of 2015
- Just Transition on Climate Change

Finally, we are also a member of the Association of Savings and Investment South Africa's (ASISA) responsible investment committee.

We cover the topic of the future of responsible investing in this publication, and we hope you enjoy the examples of greenwashing and how the proverbial 'green' wool should not be pulled over your eyes. You should get some further insight on how we practically implement these various concepts into our portfolios and, as a result, do the right thing with our clients' investments.

We take investments and the outcomes for our clients very personally. Responsible investing practices, therefore, must be at the forefront of what we do. We hope you will find the insights in this publication useful. We certainly look forward to engaging in future.

02

ESG investing:

– a fad or the future?

Mike Adsetts - Deputy Chief Investment Officer
Paulina Mwenda (intern) and **Bafana Motshweni** (intern)

Introduction

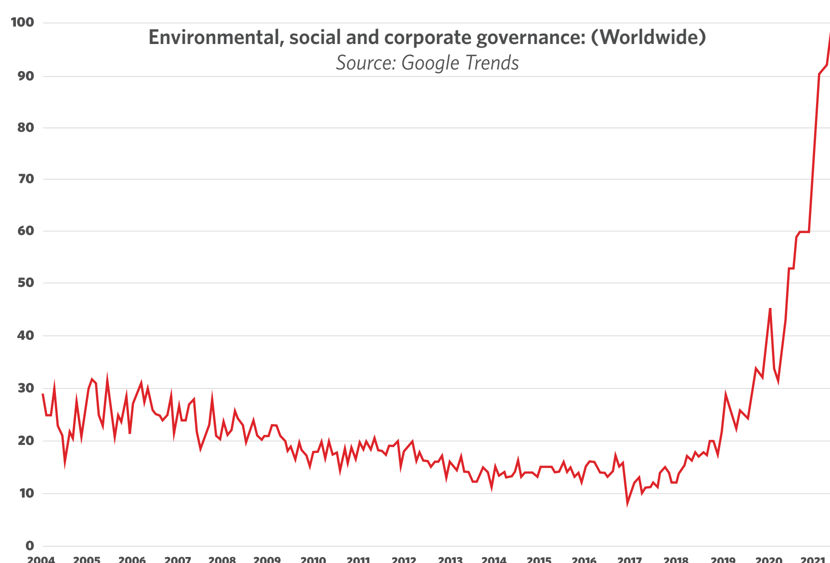
Modern Portfolio Theory, introduced by Harry Markowitz in 1952, has provided the lens for the way investments have been viewed for more than 60 years. In its most basic sense, it suggests the most efficient portfolio is one that maximises the return at a set risk level. Despite its success, it does have some drawbacks, most importantly the assumption that investors solely focus on the risk and return of their investments. There is little to no consideration to what the environmental, social, and governance (ESG) and other sustainability-related effects of their investment decisions are in the long term.

ESG-based investing is based on the growing belief that ESG factors are increasingly important in determining an organisation's financial performance. Traditional investing promised to deliver value by translating investor capital into investment opportunities that carry risks commensurate with expected returns. Sustainable investing adds value to this by combining ESG considerations to improve the portfolio's long-term results while achieving the goal of sustainability.

ESG-based investing is not a new concept. Religious and ethical beliefs influenced investment decisions hundreds of years ago. Muslims established investments that adhered to Shari'ah law, which included interest prohibitions. Quakers and Methodists created the first ethical unit trusts in the United States and the United Kingdom, again based on an exclusion principle. The growing importance of corporate social responsibility and social sustainability has raised investor awareness of the importance of ethical market participation. Following the release of the Principles for Responsible Investments (PRI) in 2006, which is a set of United Nations guidelines, ESG investing has officially entered mainstream investing discourse.

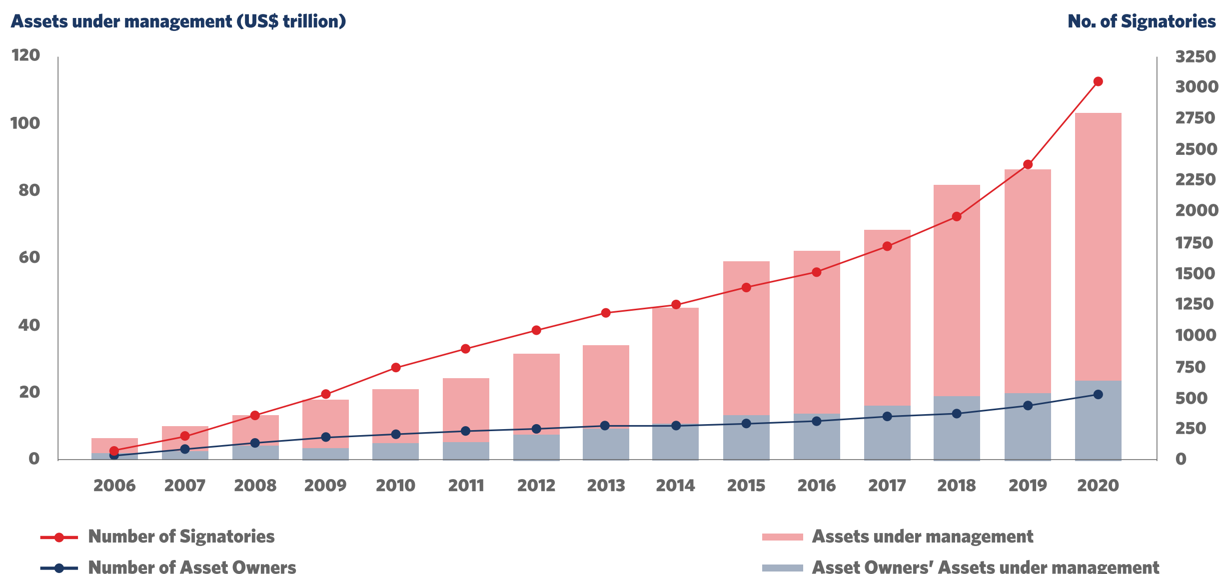
Growth in interest in ESG-based investing

In 2020, ESG investing grew by leaps and bounds. According to Google Trends, the topic 'environmental, social and corporate governance' has never been as popular as it is today.



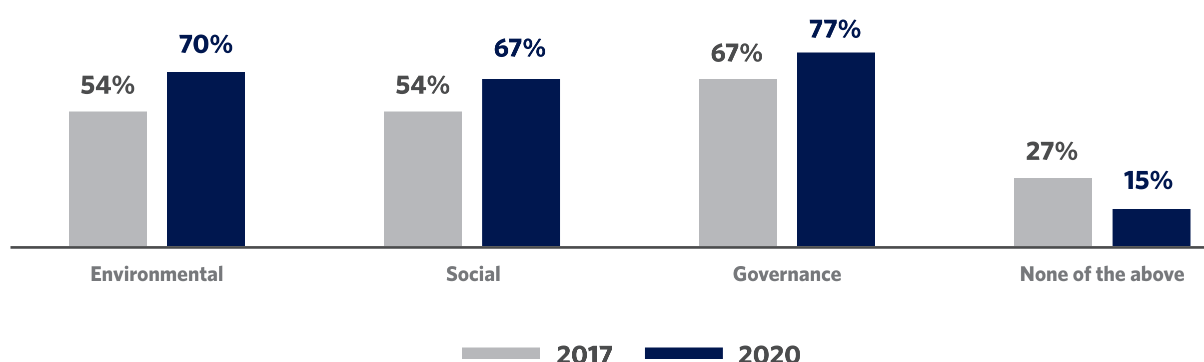
Source: https://www.unpri.org/annual-report-2020/how-we-work/building-our-effectiveness/enhance-our-global-footprint

The growth in signatories of the United Nation's PRI indicates that investment organisations have increasingly been committing to integrate ESG considerations in their processes. It has grown at a 16% compound annual growth rate in the 10 years to 2019. More recently, this has accelerated: in the first half of 2020 alone, the number increased by 28% to more than 3 000 entities, and the assets under management (AUM) of these entities grew 20%, to more than US$100 trillion[1], boosted by demand as well as strong relative returns.



In a practitioner survey of 2 800 CFA Institute members in March 2020, a total of 85% said they take E, S, and G factors into consideration in their investing, up from 73% just three years ago. The largest increase was consideration of environmental factors.

Which, if any, of the following ESG areas do you and/or your organisation take into account in your investment analysis or decisions?
(Select all that apply)



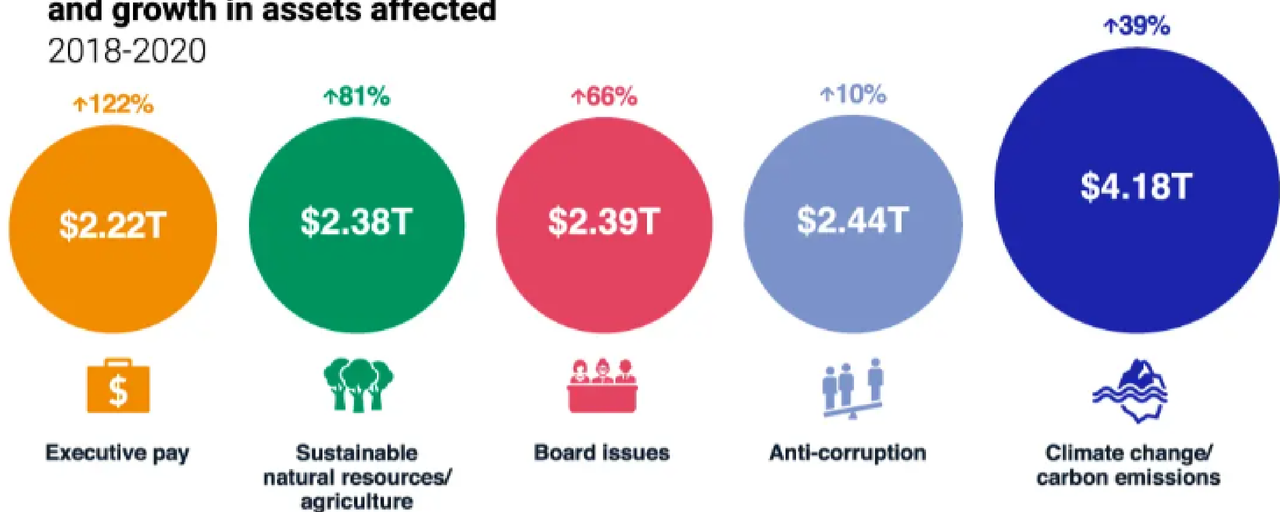
[1] It is important to note that this figure does combine the assets of both asset owners and asset managers and so does incorporate some double counting.

Is this a short-term fad or long-term fundamental change in investment management practices?

Is this growing prominence of ESG investing due to people jumping on the new 'bandwagon' within investments, or is it rather a result of a shift in mindset? There are arguments on both sides. While there is some element of 'fad' underpinning the current trends, we believe it will turn out to be the 'new normal' in investment practices in the same way that risk-adjusted optimisation is standard practice in portfolio construction.

What is the evidence for ESG becoming part of normal investment practice?

Figure 4:



Source: https://wpguynews.com/fact-check-the-truth-behind-five-esg-myths/

While there has been growth in the interest of ESG factors within the investment process, it is not limited to interest only – there is actual growth in such investments, as indicated in figure 4.

There has also been a movement within meetings with external analysts and shareholders, where discussions with management have focused on ESG matters. These are two separate avenues for investment managers to influence behaviour.

From the perspective of external investment analysts, two recent examples include Sasol and Nedbank. Sasol was pressed at a broad analyst meeting to put a climate impact-management policy in place. The company subsequently delivered on this, but not in a completely satisfactory way – and the pressure continues to be applied on the management team in these meetings. The Nedbank example was more positive in terms of outcomes. The chairman was particularly proactive on ESG-related issues and informed investment analysts of all policies completed and that were to be engaged on in future. He was the first to inform analysts that they would not be investing in new coal or carbon-related projects in the future.

From the perspective of shareholder meeting voting, the Standard Bank and BHP Billiton examples stand out. There were demands from shareholders at the most recent annual general meeting (AGM) that Standard Bank publish climate policies and institute systems to measure carbon intensity in all their loans and investments. The first system proposed by management was passed, but the second one failed on the basis that it was impractical from a cost/benefit analysis. In terms of BHP Billiton, the company was pressured to resign from the membership of all industry associations involved with lobbying that is inconsistent with the goals of the Paris Agreement. While rejected by the shareholders as being impractical, it highlights how votes at AGMs are increasingly being used to hold management to account for ESG-related issues.

According to Deloitte Centre for Financial Services, by the year 2025, about 50% of AUM in the United States will be ESG-mandated funds. The company has a view that investment managers will launch a record number of new ESG funds to meet this target and the increasing demand for these funds.

ESG-mandated assets could make up half of all managed assets in the United States by 2025

■ ESG-mandated ■ non-ESG-mandated

Share of ESG assets in overall professionally managed assets in the United States

Source: https://www2.deloitte.com/us/en/insights/industry/financial-services/esg-investing-performance.html

What are some of the potential barriers to ESG becoming part of normal investment practices?

A study by EDHEC Business School's Scientific Beta analysed the returns of equity strategies focused on ESG goals. The study revealed no outperformance when these returns were adjusted for risk. This challenges the claims made of a positive outperformance by industry participants. The study further added that ESG investing didn't provide significant downside risk protection either, despite the risk enhancements this investment approach is supposed to provide.

Another view provided by the Evidence Based Investor is that, irrespective of the principles and good intentions in place for investors, ESG is susceptible to marketing opportunism. These funds are at risk of being overpriced as many fund providers may claim that a fund may be the first of its kind with no competing funds for the investor to choose from. Investors should be aware of the problem of 'greenwashing' and how to spot and avoid it.

Another academic perspective noted that ESG-based funds had outperformed relative to their non-ESG counterparts. However, upon closer inspection, it was noted that these funds were heavily invested in tech companies and it was difficult to attribute the outperformance to what most would consider being 'proper' ESG factors. It is also made the point that positive liquidity and money flows into these investments would lead to positive relative returns due to the positive effect of these flows on the companies' prices – something that had nothing to do with their underlying investment characteristics.

Conclusion

Ultimately, ESG investing has an inherent focus on sustainability and overall positive effect on the world we live in and is expected to be a source of return in the future. If the hype behind the growth of ESG-based investing is based on capturing the most upside, then there is reason to believe it might be a short-term fad. However, the growth in ESG generally looks like it is due to a change of investors' mindsets, as the negative implications of ignoring these factors continues to grow.

At Momentum Investments, we take responsible investing seriously, and have several funds dedicated specifically to socially or environmentally responsible investing.

Our impact investment funds focus on three areas – alternative energy, social infrastructure, and diversified infrastructure. These investments are closely linked to very specific United Nations Sustainable Development Goals (SDGs), to which Momentum Investments subscribes. This is a level of commitment that we think is unique – not only in how we're investing, but in how we match these investments specifically with common, international goals for a better, more inclusive world.

This kind of strategic, goal-orientated investing means that our investors can hold us accountable. This makes for better decision making, and better-quality conversations with our clients.

Momentum Investments' approach to ESG

To get the most out of taking a proactive approach to ESG issues, it is crucial for a company to follow best practices for strengthening the company's ESG programme. At Momentum Investments, our approach to ESG contributes to the sustainability of our business by reducing our environmental effect through responsible use of renewable and non-renewable natural resources, which as a result, reduce our carbon footprint. We strengthen our social factor through our approach to employees' human rights, learning and development, safety, health and well-being, as well as employment. We can deliver our purpose by providing our clients with products and services that enable them to achieve their financial goals, while protecting their financial security, health and well-being, and creating economic value for all our stakeholders. Through the application of good governance practices, we have established an ethical culture, effective control and legitimacy, all of which contribute to the sustainability of our business and its good performance.

03

Greenwashing - What is it and how can you avoid it?

Prof. Evan Gilbert - Strategist
Paulina Mwenda (intern) and **Bafana Motshweni** (intern)

Due to the challenges of the availability of accurate and complete data in assessing the effect in the sustainable investing space, the practice of 'greenwashing' has grown. Greenwashing is the practice of giving the wrong impression, providing false information, or fabricating a story about how a company and its products, or an investment solution, are environmentally friendly or beneficial in an environmental, social or governance (ESG) context.

There is some concern that recent large inflows into ESG solutions may not be based on complete information and that, if results disappoint, or if practitioners are seen to be greenwashing, a backlash may result.

GREEN WASHING *and non-investment companies*

The terrachoice organisation has identified the following Most Common GREEN WASHING 'SINS'

Key trade-offs are hidden in the claims
(positive claims are made, but negative issues are ignored)

No independently verified proof of the claim is provided

Deliberate vagueness in the claims made
(eg 'all-natural')

False labels are used
(eg they use in-house certification standards)

Irrelevance of the claims made
(eg 'CFC-free' when that is already required by law)

Lying - the use of blatantly false claims
(eg Volkswagen's diesel engine emissions claims)

Some specific examples of corporate greenwashing include:

In December 2019, a complaint was lodged against BP for misleading the public with advertisement that focused on BP's low carbon energy products, when more than 96% of its annual spend is on oil and gas.

In 2018, Starbucks released a "straw-less lid" as part of their sustainability drive. However, this lid contained more plastic than the old lid and the straw combination.

Eni Diesel+ was said to save fuel and reduce air pollution, but is palm oil based. They received a fine of €5 million by Italy's advertising watchdog for its advertisement which was found to be misleading for overstating its degree of environmental friendliness.

In January 2021, Leon announced they would become the first UK restaurant chain to serve carbon-neutral burgers and fries at more than 60 locations by reducing and offsetting the emissions they produce. They pledged to neutralize emissions by purchasing carbon credits from three rainforest conservation and tree-planting schemes. Investigation found that the credits, which are generated by preventing hypothetical deforestation, were unlikely to represent real emission reductions at all.

Greenwashing in the Investment Management industry

The growth of interest in ESG-related investment strategies is an incentive to create an investment solution that 'looks green' rather than one that reflects a meaningful commitment to a strategy with meaningful implementation of relevant ESG dimensions.

The EDHEC Business School recently produced a report on detecting greenwashing in climate investing. Its argument is that most climate-related portfolios have investment strategies that are closet 'business as usual' due primarily to their unwillingness to deviate from the traditional market capitalisation benchmarks. Given this constraint, the effects of climate-related metrics on the overall portfolio weightings are vanishingly small. In addition, they show that the share-specific climate ratings are not consistently reflected in the portfolio's active positions (ie deviations from the benchmark weightings) over time. This is deemed to be inconsistent with consistent implementation of the ostensible climate mandate of the portfolio.

It is possible, however, that the more pragmatic explanation is possible – the climate mandate is not the only requirement of the portfolio – other share-specific factors can also affect the choice of weightings in the portfolio. This suggests that the effective extent of the greenwashing will be determined by the mandate of the portfolio, which includes the benchmark and tracking error limits (if any).

What can you do to avoid greenwashing?

Unfortunately, greenwashing is real. The following factors should be considered by investors when considering an investment in a specific company:

- ESG needs to be made very specific to the company's context and strategy. The company needs to explain which ESG issues it is tackling and why and how that ultimately affects its value chain.
- ESG should be integrated with all company activities, meaning it should be clearly part of the company's strategy, its risk considerations and the practice of its board's oversight duties.

From an investment perspective, investors should do the 'smell test' as highlighted by Karen Wallace, director of investor education at Morningstar. This means investors should simply read up on the portfolio they are looking to invest in. This will highlight what the objectives are and, more importantly, the companies invested in. The investor can therefore determine if

the portfolio is aligned with their own ESG objectives or criteria. The mandate and the benchmark of the portfolio need to be considered as well as other constraints, such as the extent the investment manager can deviate from the benchmark (ie its tracking error). Finally, if the portfolio is using any metrics for assessing its investment status on an ESG basis, these metrics should be certified by an independent third party.

Greenwashing and Momentum Investments

Momentum Investments actively integrates ESG and other RI-related considerations into the portfolio management of both our single and multi-asset class solutions.

We also review the Responsible Investing (RI) practices of all the external investment management companies used in our portfolio solutions on an annual basis. The specific methodology used, and findings made is available on the 'Rating our investment managers' report. In short, we actively seek to avoid greenwashing on behalf of our clients by assessing the extent to which the ESG and other RI-related investment practices of investment managers match their rhetoric.

We also support and welcome the development of a green finance taxonomy for South Africa. This is a catalogue that defines a minimum set of assets, projects and sectors that are eligible to be defined as 'green' in line with international best practices and national priorities. This initiative will also help curb greenwashing, and the disclosure practices will enable transparency and accountability among all market participants.

04

ESG and investment management practices in SA

Tatjana Raunich – Investment Manager Research Analyst
Jana van Rooijen – Responsible Investment Specialist

Investment professionals choose to adopt responsible investment principles as guidelines to make sure their business conduct leads to more sustainable, responsible and profitable investments. Investment managers need to understand the impact of environmental, social and governance (ESG) risks on their portfolios by incorporating ESG factors into their investment processes.

The ESG approach to responsible investing primarily focusses on the risks related to ESG factors, and guides the implementation of risk-mitigating approaches in the investment process. Formally incorporating ESG into the investment process ensures the improvement and continuity of responsible investing through time. It also assists in making the reporting of ESG systematic and repeatable. Comprehensive ESG reporting enhances transparency, which enables more efficient and effective decision making by investors.

While simple in theory, this can be challenging to implement in practice and requires a clear consideration of the relevant trade-offs.

‘Comprehensive ESG reporting enhances transparency, which enables more efficient and effective decision making by investors.’

South Africa has a relatively small investment universe of investment opportunities, be it the listed equity universe or the credit space. This has direct implications for the implementation of ESG-based investment practices. South African investment managers do not have the luxury of choice and therefore it is not always easy to simply exclude a share like British American Tobacco (BTI). The sale of tobacco products has clear social costs, but the company has also generated stable returns for shareholders in the long term and is considered to have attractive rand-hedge qualities. Exclusion can be seen as an opportunity cost from a fundamental research and portfolio construction perspective. ESG can therefore also be applied on a relative basis, where investment managers consider ESG scores relative to their sector and relative to the company’s own historical score. BTI has meaningfully improved its overall ESG score, according to some investment managers, and the company’s investment in new-generation products is seen to have reduced social risk. This is where engagement plays a very important role, because it assists in the improvement of responsible investment practices by the investment managers as well as the measurement and monitoring of those practices.

Another good example of this balancing act is Sasol – a dominant player in South Africa’s energy sector. Besides being a culprit of high greenhouse gas emissions, it was also seen to have poor governance, allowing the Lake Charles Chemical Project to run over budget (the cause of this attributed to ineffective leadership). Investment managers that see potential in this company have engaged with management on governance issues and this led to a change in leadership and the replacement of the joint CEOs, in addition to the changes that were made to general management. The effect of future carbon taxes is an environmental risk that will detract from future shareholder value and Sasol is in the process of addressing this risk. Corrective plans that are being instituted result mainly from engagement by investment managers in collaboration

with stakeholders. Where investment managers see steps are being implemented to reduce the risk of increasing carbon taxes, in combination with other risks, and where valuations still hold, they will still be willing to consider investing in Sasol while being consistent with their ESG perspective or mandate.

The impact investing approach

Impact investing is a distinct sub-set of ESG-based investing. Here investments are made into businesses whose purpose and objectives have an intentional positive effect on the environment and communities. These types of businesses explicitly aim to have a direct and measurable effect on society and the environment. However, these investments also need to be financially viable, as impact investing aims to combine intentional impact and adequate financial returns on capital. They aim to 'do well by doing good'.

The impact investing approach allows the investment industry to move towards integrating sustainability directly into their underlying investments. Impact investing is more predisposed to funding from private equity investors. This is because of the nature of private equity, which is characterised by direct funding of long-term projects with the ability to draw on needed specialist knowledge. Investment managers in South Africa have refined impact investment objectives to be consistent with the goals of National Treasury in terms of structural reforms. This is helping make impact investing more relevant for the South African investor, and there has been an increase in investment products that reflect government initiatives through this approach.

The Risk Mitigation Independent Power Producer Procurement Program (RMIPPP) is an example of a programme implemented by government, which focuses on the expeditious procurement of energy into the national grid, addressing the South African electricity power supply crisis, and also reducing the use of costly diesel generators. This programme also serves to reinforce government's intention to meet international obligations of reducing carbon emissions by decarbonising the energy system through advancing technologies that emit less carbon dioxide. A report from the desk of President Cyril Ramaphosa (September 2020) confirms intentions for additional energy to be procured from diverse sources, such as solar power, wind and gas. The above supports government's Integrated Resource Plan released in 2019 (which updates the national energy forecast and provides a roadmap for our energy sector for the next decade). In June 2021, President Ramaphosa announced the draft amendment to Schedule 2 of the Electricity Regulation Act, effectively raising the self-generation capacity threshold below which power plants are absolved from having to acquire generation licenses (from 10 to 100 megawatt). This encourages a broader range of supply options, which includes renewable energy sources. This is a direct boost for impact investment portfolios focusing in this area.

ESG scores and analysis

ESG can be integrated across all asset classes, by incorporating it into valuation models or portfolio construction. The investment manager can use a set of criteria, qualitative and quantitative, to score companies individually in terms of ESG risks. Quantitative and qualitative risks can be determined for each company by scoring them on the individual components of ESG, commonly using ESG score cards.

Third-party service providers can also be used for ESG analysis. This improves objectivity and is beneficial to investment managers when used to complement their own analysis.

To assist in the comparison of ESG scores across industries, ESG components can be weighted based on the industry or sector characteristics by identifying the materiality of ESG factors affecting specific sectors. For example, the governance factor is regarded as having a more direct effect on risk for the banking sector. If a factor weighting is applied in an ESG methodology, then, in this example, it is likely that the governance factor will carry a higher weighting in the overall ESG score relative to the remaining two components. The weighting is then applied to the governance score of the bank, similarly for E and S weightings, to arrive at a total ESG score. In assessing the E score, the physical effect of climate change on a bank's assets and the challenges faced by banks in transitioning to a low-carbon economy must be considered. Banks also need to move to financing sustainable companies and investments and, in doing so, need to take social implications into account alongside profitability. Investment managers need to examine how banks engage with their regulatory authorities to address risks and whether they are being proactive in identifying solutions.

The above discussion highlights the subjectivity inherent in the implementation of ESG into an investment approach. Not only are ESG risks many and diverse, they are also not always easily quantifiable, which makes measurement a challenge.

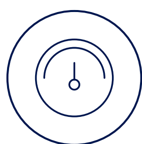
However, just as any type of analysis performed on companies by different investment managers will have varying results and degrees of subjectivity, so too will ESG analysis.

These multiple ESG factors are intertwined, influencing one another and hence affecting a business in its entirety. An investment process, where ESG is not integrated but a separate step (where conclusions are drawn independently from company analysis), can lead to the erosion of the benefits of ESG analysis, because an investment manager is less likely to adjust investment decisions based on information that wasn't part of the company analysis from the outset.

Do South African investment managers walk the talk?

We perform an annual responsible investment rating assessment of investment managers to allow us to better understand how far along these investment managers are on their responsible investment journey. The scope of responsible investment practices is wide, and we therefore assess the investment companies' overall responsible investment framework and the level of transparency confirming their actions. In addition, as supporters of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, it is in our interest to encourage investment managers to adopt a climate change focus for a sustainable and Just Transition future. A summary of the key findings of the survey are presented below. The full report is available on our responsible investing page at momentum.co.za.

The responsible investment rating complements the appointment, monitoring and reviewing process of the investment managers.



Organisational culture

This indicator guides us in understanding the responsible investment culture within the investment management company. Company values should inform their policies and lead to fair and transparent information for their stakeholders.

Resources

This indicator gives insight into the level of oversight and accountability assigned to management and investment staff to make sure responsible investment practices are upheld within their organisation. To assess the level of ESG expertise or function that can interpret how ESG risks translate into investment decision making and outcomes, which determines the level of quality of ESG integration.

ESG integration

This indicator helps us understand to what extent investment managers integrate ESG across their assets under management. The key point is the extent of ESG integration rather than the type or form being implemented.

Active ownership

This indicator provides insight into the extent to which the investment manager contributes to a well-balanced economy for investors. It is used to assess to what degree the fiduciary's formal rights are used to influence the activity and behaviour of invested companies.

How should the responsible investment rating be interpreted?

5 **The investment manager is a market leader when it comes to responsible investment practices.**

4 **The investment manager has demonstrated above-average application of responsible investment practices.**

3 **Responsible investment practices are inherent in the investment manager's investment culture.**

2 **The investment manager is in the process of embedding responsible investment practices within its organisation and processes.**

1 **The investment manager has not demonstrated enough responsible investment practices within the organisation and processes.**

Comparison of averages across sub-indicators

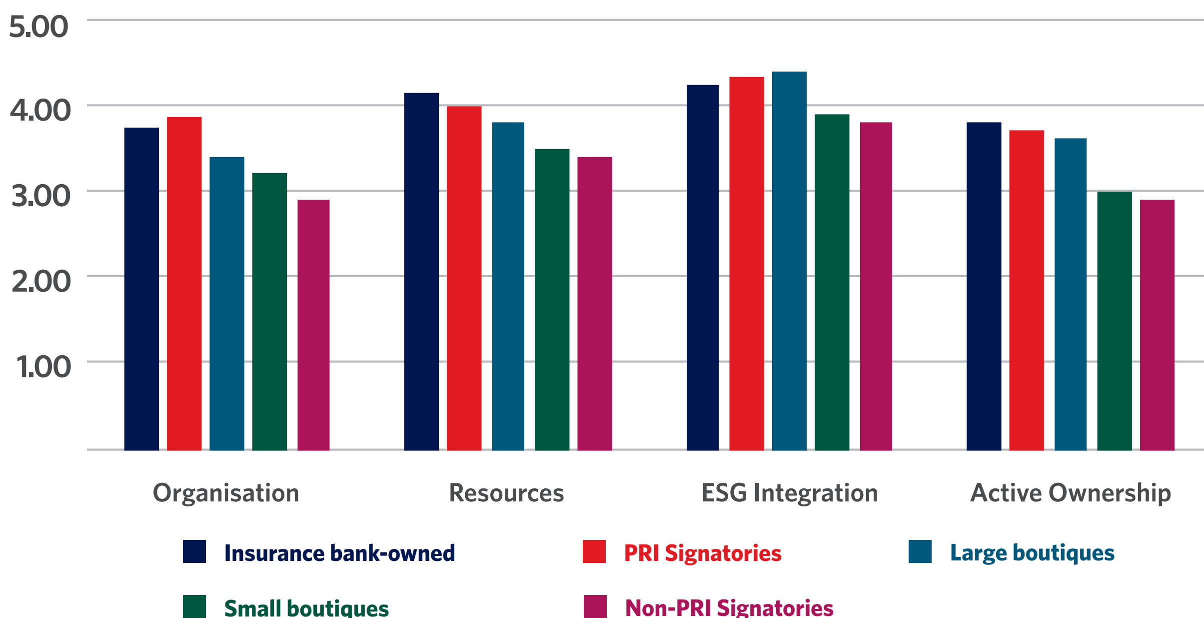


Figure 1. Comparison of average scores across sub-indicators

Our 2020 survey sample

The insurance/bank-owned group is the best-performing group across the organisation and resource dimensions, but the large boutiques group is the best-performing group from an ESG Integration perspective. Not surprisingly, the UN PRI signatories consistently outperform the non-signatories across all the dimensions.

Are there signs of progress?

2019 compared to 2020 average ratings

Comparing the two annual responsible investment rating assessments of 2019 and 2020, it shows that the number of investment managers rated below a level three rating decreased from 29% to 11%. The ratings have improved across the respective indicators (see figure 2).

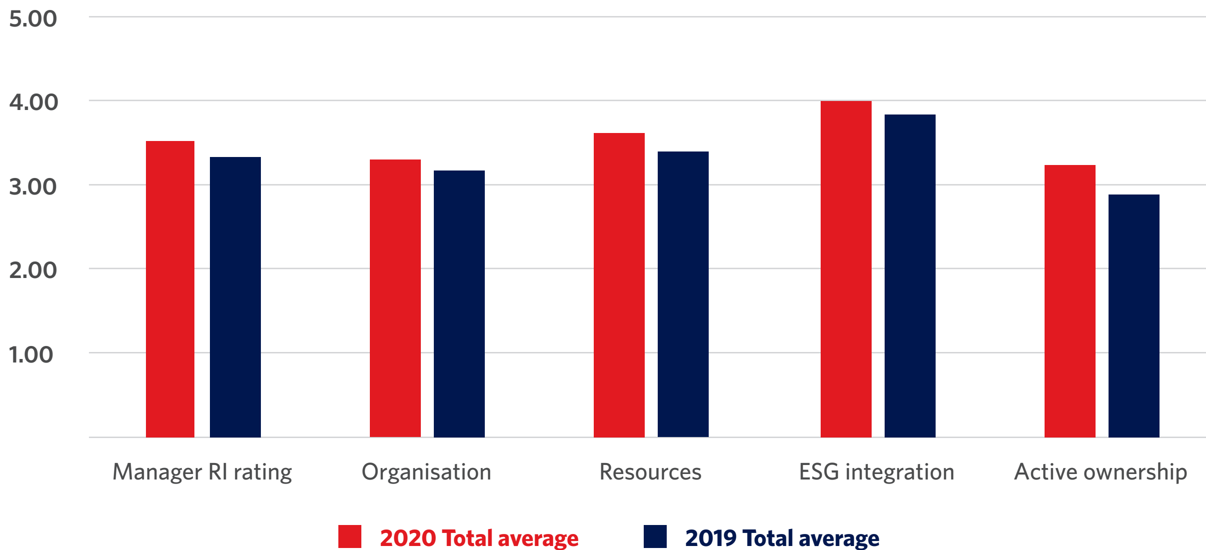


Figure 2. Comparison of average scores between 2019 and 2020

The active ownership indicator's average rating was below a three in 2019, which has improved to a rating of 3.3. This improvement was due to more investment managers disclosing their proxy voting activities on their websites and making their engagement registers available to investors. In 2019, 44% of investment managers made their engagement registers available in comparison to the 63% of investment managers, which now maintain an engagement register and publish or at least make it available on request to investors. Reporting on these stewardship duties gives us as investors insight into the important ESG issues that were addressed with the investee companies and enhances the quality of ESG reporting and accountability to our clients.

Conclusion

At Momentum Investments, integrating ESG into investment management practices is a key part of our fiduciary responsibility to our clients. It matters to society and to the risk-adjusted returns of our investment portfolios. When mindfully and judiciously applied, they will support flourishing investment management businesses, satisfied stakeholders and sustainable operating environments.

05

ESG in fixed income: Our perspective

Thami Lesito – Fixed Income Portfolio Manager

With environmental, social and governance (ESG) factors now more broadly incorporated into investment decision making, fixed income investors are faced with the challenge of how best to implement these across such a diverse asset class.

While it is true that ESG can easily be integrated in the listed corporate credit market, the same cannot be said for structured credit, high yielding credit, distressed credit or emerging market sovereign debt. Some fixed income investors have taken the view that, where ESG is too difficult to incorporate in investment decision making, it can be ignored; we disagree. Our fixed income team believes ESG metrics can help identify risk factors and enable us to avoid the 'potholes', namely defaults.

The fixed income team of Momentum Investments has developed a framework that is quantitative and qualitative to assess ESG metrics across the diverse spectrum of debt instruments. Our framework has the goal of uncovering hidden strengths and vulnerabilities of issuers. Some of these vulnerabilities and strengths may not be easily uncovered if one only looked at traditional credit metrics.

Our framework first looks at qualitative factors, especially those that relate to the governance (G) factor. Several defaults that have occurred in the past few years have been because of governance failures. We believe this factor needs to be given significant attention so that, as investors, we can not only avoid 'potholes' but also use our power to work with issuers to make sure that sound governance, necessary for sustainability, is present. Our framework depends on our ability to have regular engagements with management of the various issuers, boards of state-owned enterprises and National Treasury. Without this ability, some of the qualitative factors we assess would not be visible to us and would make ESG integration in our investment process near impossible. We see this access as one of the strengths of being a sizeable fixed income house.

> 'As an investment manager of a large pool of retirement fund investments, we also believe it is our legal duty to consider ESG factors in our investment approach.'

Environmental (E) factors are increasingly becoming more important. With global warming fast approaching the point of no return, we believe we need to use our power as lenders to the corporates, some of the biggest emitters of greenhouse gasses, to reach carbon neutrality over time in a sustainable way.

Our fixed income team, as a significant lender in the debt capital markets, has been working with issuers and debt arrangers on sustainability-linked debt that specifically target the 'E' factor. We have participated in a few issuances that penalise issuers if pre-specified environmental factors are not reached. For example, we recently participated in the Rand Water SOC Sustainability Linked Bonds, whose objective is to link the coupons we receive to Rand Water's commitment to doing its part of

implementing and achieving the United Nation's seventh sustainable development goal (affordable and clean energy), sixth goal (clean water and sanitation) and fifth goal (gender equality). The bonds are linked to specific targets Rand Water needs to meet by 2023 and 2025. If these targets are met, there is a benefit to the company, ie reduced coupon payments. As investors, we are happy to receive reduced coupons because of the sustainability metrics that will be met. Further, to show how seriously we take environmental sustainability, we have also taken a decision that we will not fund any new coal-fired power stations.

As investors on behalf of our clients, we take responsibility to make sure we provide our clients with the best risk-adjusted returns. We also have a duty to make sure we allocate our clients' money to investments that guarantee a sustainable future. With the recent unrest we experienced in South Africa in July 2021, it has become even more pressing to work at speed with National Treasury so debt instruments that can address social (S) factors are made available to the market. Our view has always been that, in addition to funding the sovereign through government bonds, we need other investments that can have a direct and measurable effect on people's lives. Social impact bonds that address various social needs, where we as investors provide funding for an intervention that is responsible for the social services delivery, is what South Africa needs. Through various forums of the Association of Savings and Investment South Africa (ASISA), we are involved in discussions to help set these social impact bonds up and make sure the investments are appropriate for the client mandates we manage. We are also assessing other issuers, such as The Urban Housing Foundation, which provide affordable housing. Addressing social factors is important for the sustainability of South Africa.

ESG integration in investment decision making will help investors use their influence to ensure sustainability. ESG integration in South African fixed income investing is no longer a luxury but a must-have. As an investment manager of a large pool of retirement fund investments, we at Momentum Investments also believe it is our legal duty to consider ESG factors in our investment approach. Regulation 28 states that investment managers have to "... give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social or governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment."

We believe we are living this intent and building a competitive advantage in this space through the innovative efforts highlighted here.

06

ESG integration - A property perspective

Pelo Manyeneng - Head of Listed Property

Environmental, social and governance (ESG) investing encompasses many aspects about allocating capital that were historically (deliberately or subconsciously) overlooked. In some cases, investors often (wrongly) viewed ESG investing as something falling within the purview of 'greenies' or some other 'extreme' ethical position.

We have often seen in financial markets, globally and locally, that, if left unchecked, ESG-related issues have tended to lead to severe negative financial implications for shareholders, the environment and the well-functioning of society, in the short and long term.

ESG integration is, admittedly, a somewhat complex process in practice that cannot be a tick-box exercise. For ESG integration to be comprehensive, it should entail a thorough, dynamic assessment of the steps that companies are taking on matters such as energy conservation, carbon footprint, water usage, fair employment practices, inequality, corporate integrity and accountability, among others. Most of these factors, if looked at from an activist investment approach, often require time, deep and knowledgeable resources on the subject as well as the existence of proper systems to track effective changes in behaviour.

Although we are proud of our achievements, the reality is that the industry at large (be it owners of capital, investment managers or corporates) still has some way to go in terms of having a comprehensive ESG integration process that informs day-to-day decision-making. For investment managers, the challenge remains accessing relevant ESG data and translating that into information that can be used in valuing companies and ranking investment opportunities in a less subjective way. The good news, however, is that efforts from all stakeholders are all pointing in the right direction.

'ESG integration is, admittedly, a somewhat complex process in practice that cannot be a tick-box exercise.'

While we are doing our part in driving the awareness of how we incorporate ESG in our investment processes, listed property companies (and many corporates at large) have increasingly become aware of the role they also need to play in society. For example, listed property companies have increasingly sought to reduce their carbon footprint by installing photovoltaic (PV) solar systems on roofs of their buildings and have started incorporating ESG reporting in their integrated reporting.

Redefine's 2020 ESG report notes that the company has invested about R250 million in solar PV installations and has increased its solar PV generation capacity to 25 913 kilowatt. This initiative has contributed to reducing the company's carbon emissions by 33 607 tonnes of carbon dioxide equivalent during 2020. According to the company, this reduction in carbon emission is equivalent to eliminating the typical emissions of 7 260 passenger cars.

Given our constrained investable universe within the listed property space, eliminating companies that do not report widely on their ESG practices is often difficult. As such, we approach ESG integration with an active corporate engagement role in mind. We focus on driving the company to adopt or improve aspects of ESG and we assess each investment opportunity based on its best efforts.

How do we integrate ESG into our processes?

We have introduced an ESG rating methodology within our listed property team, working with our wider Momentum Investments' responsible investment team. The findings we obtain from our weekly ESG integration process are not only captured but are used to guide our engagements with individual companies.

Issues we engage on range from unclear remuneration practices to matters such as lack of transparency in reporting of earnings. We also exercise our rights by voting against company decisions that are not in the best interest of our clients. Our efforts are also placed on examining how companies reduce costs through green energy sources and their approach to electricity and water initiatives, as well as assessing continuity of skill and talent as well as diversity at board level.

Examples of how we have engaged with companies on ESG matters in the property space

On director independence, our approach is that after non-executive directors have served on the audit committee of the board for more than nine years and more than twelve years on the board of directors, their independence credentials should come under more scrutiny, as the familiarity between the directors and company management would have grown substantially. A company might declare a board member still independent after an extended length of service, but a continual refreshment of boards is the best way, in our view, to make sure there will always be board members who can question the way the company is run with new and independent eyes. This will make sure there is a better level of peace of mind for shareholders that the board has not become a club of like-minded individuals.

There was an instance where two independent non-executive directors had more than 15 years as board members. We shared our view with the company and the company CEO expressed an opinion. The CEO of the company maintained that he needed the individuals as independent non-executive board members. It has always been our view that, if a company requires the service of a non-executive director for scarce or unique knowledge, insights and experience then these non-executive directors should be appointed as non-independent non-executive directors to garner positive votes for re-election. In the end, the company still listed the two directors as independent, now going on 17 years of service. We continue to vote against their appointment as independent non-executive directors.

Using the same company, we can highlight why one negative governance-related issue can be offset by taking positive steps to protect the environment and contribute to addressing inequality. We engaged with the same company on their environmental and social initiatives. Our discussions were focused on the company's environmental sustainability plans that have been in place since 2015, which centred on the company's electricity and water initiatives. The plan focused on reducing its tenants' environmental footprint by using green energy sources, reducing consumption and optimising utility usage. To bolster this skill set, the company appointed an engineer to drive the initiatives and provide sound metrics of its progress on these matters. This is positive, as it brings experience into the process. Our discussions with the company also centred on the work done by their academy, which seeks to empower young, black professionals with skills to develop their careers in property development and investment in South Africa.

At Momentum Investments we believe a focus on ESG contributes to society, the environment and shareholder returns. ESG integration is an essential part of our responsibility, and we will continue to exercise our responsibility as investors and look to build on our current efforts. Therefore, we are proud of the efforts we have made on integrating responsible investment practices in our portfolios and the role we play in being good custodians of the investments we manage.

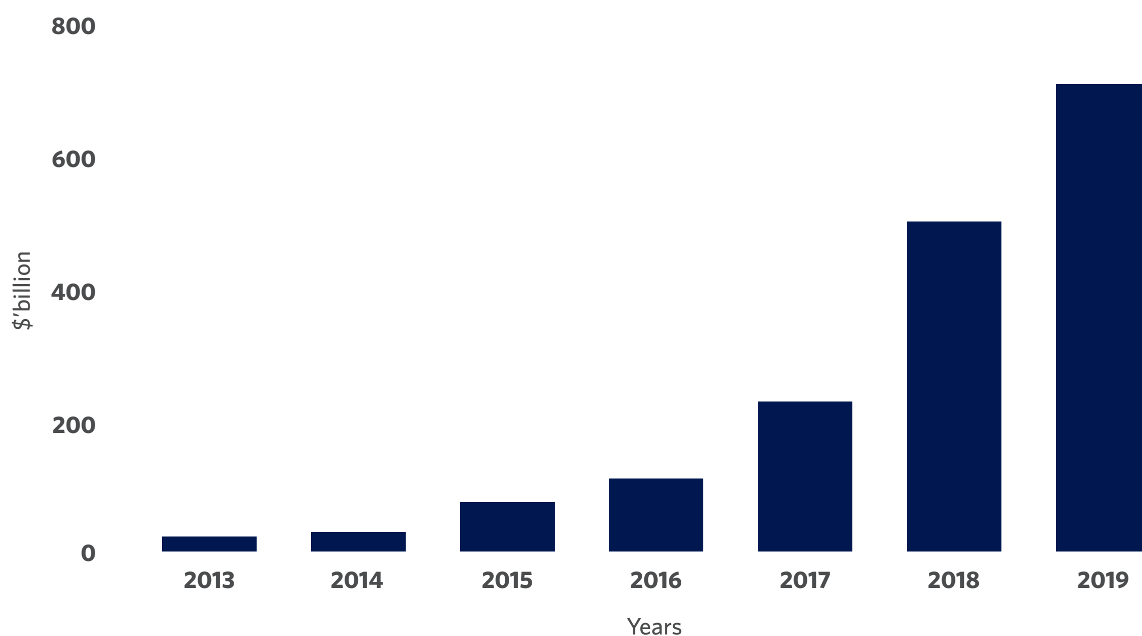
07

Investing for impact

Motlatsi Mutlanyane - Head of Alternative Investments
Egon Soontiëns - NWU BMI Student*

Impact investing is happening. A review of investment flows shows there has been significant growth in the commitment and application of impact investments to current global challenges. The Global Impact Investment Network's (GIIN)[1] 2020 GIIN annual survey report estimates the market size of impact investment to be $715 billion (see figure 1).

Figure 1: Impact Investment market has grown at a 27% compound annual growth rate (CAGR) from $25.4 billion to $715 billion between 2013 and 2019



Source: Adapted from ForexToStocks – Impact Investing, SRI and & ESG investing: Market Trends, Data & Stats 2020

Governments and philanthropists cannot continue to solve the social and environmental challenges on their own. Hence, institutional investors are expected to adopt the new investment norm of positively influencing the society and environment they invest in to ensure sustainable development.

The Global Steering Group for Impact Investment (GSG)[2] defines an impact-orientated investment as an investment where risk, return and impact are maximised by positioning measurable social and environmental goals alongside financial goals. The GSG argues that well-executed investments benefit not only the owners of the investments but also the society and the environment in which they are made. It believes these societal and environmental effects should be expressly stated and should be the driving force behind any organisation. It also believes these effects be integrated into all investment decisions of investment managers.

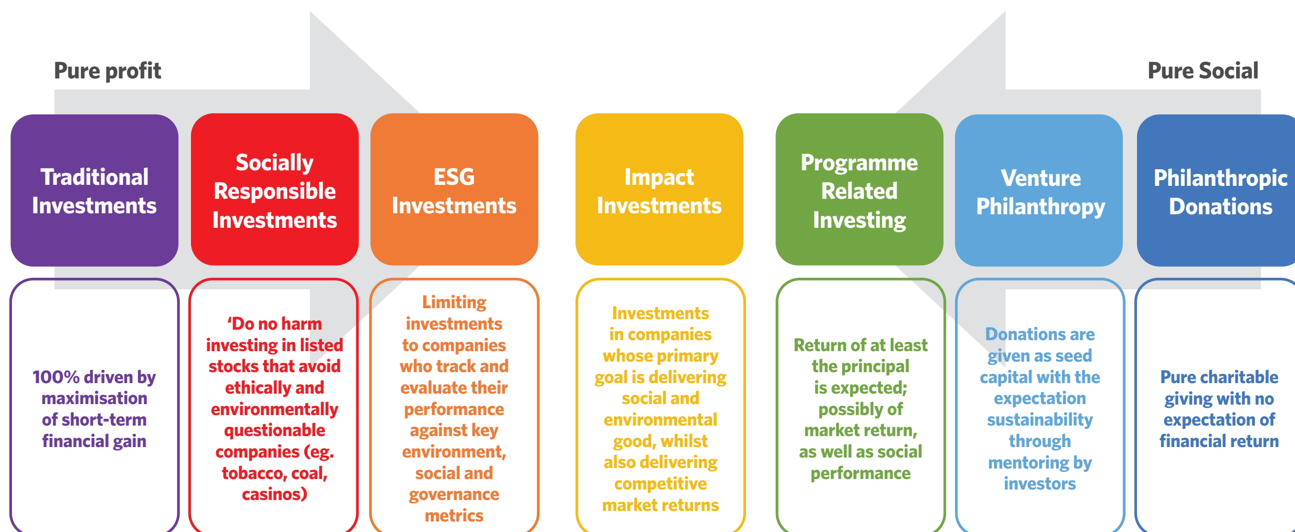
** Egon Soontiëns is a student in the Centre for Business Mathematics and Informatics at North West University and this article is based in part on a research project that he is doing under the supervision of Mr Robert Maxwell.*

[1] The Global Impact Investment Network (GIIN) is a leading international advocate for impact investing, working to expand its reach and effectiveness. Go to https://thegiin.org/ for more information.

[2] The Global Steering Group for Impact Investment (GSG) aims to stimulate impact investment to benefit people and the planet. GSG was created to replace the Social Impact Investment Taskforce in 2015. Go to https://gsgii.org/ for more information.

Impact investing's capacity to improve lives and to benefit the environment is proven. Properly managed impact investment can offer the best of financial returns and create a positive effect. To place impact investing in context and to differentiate it from other investment approaches, figure 2 shows the investment spectrum with impact investment in the centre.

Figure 2: Investment Spectrum



Source adapted from Centre for Development Impact: Innovation and learning in the evaluation of impact - Impact Investments: a literature review (2015)

It is essential to emphasise that impact investing includes profit as one of its main objectives. Hence, impact investment does not trade off financial return for social or environmental effect, but instead aims to identify investment opportunities that combine them. In other words, there is an explicit commitment to social and environmental impact goals while earning a market rate of return. Another key defining characteristic of impact investment is its expressly stated intentionality. Impact investment has, by design, an intentional impact on either the society, the environment or both. This key characteristic distinguishes impact investment from all other investment types classified on the investment spectrum. When viewed this way, impact investment is a universal term, as it can be applied to all investment types and asset classes.

A common starting point for implementing impact investing in practice is the United Nations' sustainable development goals (SDGs). The member states of the United Nations adopted the 17 SDGs with 169 targets (see figure 3) in 2015 as part of the 2030 Agenda for Sustainable Development. These goals form part of an extensive globally coordinated action plan to end poverty and reduce inequality, while also protecting the planet, tackling climate change and spurring economic growth. The goals recognise that social and environmental issues affect everyone and thus apply to every country, irrespective of their 'developed' or 'developing' economic status.

Figure 3: United Nations Sustainable Development Goals

Source: https://www.un.org

Sustainable development embodies the idea of doing well by doing good. By incorporating social and environmental targets into their investment strategies, investors can align their impact objectives to the SDGs and track their contribution towards achieving these goals. Using metrics that reflect their effect on specific SDGs, investors can address how they are contributing to a sustainable and equitable future.

Momentum Investments has adopted six of the SDGs and we're aligning our impact strategies with the goals to drive results. These are SDGs 3, 4, 7, 8, 9 and 13. The Momentum Impact portfolios have incorporated sustainable investing principles and guidance throughout their investment cycles to make the achievement of the goals an intentional objective. That is, the principles have been integrated into deal origination, due diligence and investment selection for the three impact portfolios – the Momentum Alternative Energy Fund, the Momentum Social Infrastructure Fund and the Momentum Diversified Infrastructure Fund.

The Momentum Alternative Energy Fund is invested in sustainable energy companies, which focus on renewable energy, energy efficiency and storage technology. The priority SDGs for the portfolio are 7 (Affordable and Clean Energy) and 13 (Climate Action). The Momentum Social Infrastructure Fund is invested in businesses involved in providing student housing in the higher education sector, quality affordable housing and non-urban shopping centres. The portfolio aligns with SDG 4 (Quality Education) and 9 (Industry, Innovation, and Infrastructure). Finally, the Momentum Diversified Infrastructure Fund is invested in core economic infrastructure including toll roads, telecommunications as well as water and wastewater infrastructure. This portfolio specifically targets SDG 8 (Decent Work and Economic Growth) and 9 (Industry Innovation and Infrastructure).

Potential investments are identified and added to the pipeline based on investment criteria that include impact targets. First, it is important that the purpose of the target company (or project) is to address a critical problem relating to the environment or a societal challenge. For example, the investment in student housing is through a company that focuses exclusively on addressing the 250 000-bed shortage for students.

Second, investments must show a direct link to at least one of the six SDGs. Finally, the impact generated by the investment must be substantive and measurable. In addition to these, the investment case must also hold, i.e., it must meet the risk-and-return requirements expected for the exposure. Moreover, the investment committee that deliberates on the recommended investments also reviews each proposal's ESG report.

An investment that meets the investment criteria but not the ESG requirement may still be included if the ESG issues can be resolved through active engagement with the management team of the investee companies.

By using appropriate indicators, data on impact metrics are collected regularly, and investee companies are monitored to track progress towards their social or environmental objectives. While the impact measurement and monitoring methodology is evolving and may not capture all of an investment's impact, it captures enough of the impact to track progress toward the SDGs being measured.

We believe that impact investing is the responsible thing to do and a fundamental part of our commitment to delivering sustainable outcomes to clients. The improvement of society and the environment is vital if clients enjoy the financial returns delivered by their investments, and we will continue to direct our actions to achieve these outcomes.

ROBECO
The Investment Engineers

08

Sustainability integration in core equity portfolios

Robeco

- **Various dimensions of sustainability integration are available to investors**
- **Financial and sustainability objectives can be combined at different tracking error levels**
- **Customized sustainable solutions go above and beyond passive indices**

Integrating dimensions of sustainability in equity portfolios is a popular theme among investors in this asset class. In this white paper we describe the various ways investors can integrate sustainability in core equity portfolios. We illustrate these possibilities by highlighting the integration of sustainability themes in the Robeco Core Quant Equities strategies.

A quant approach to investing

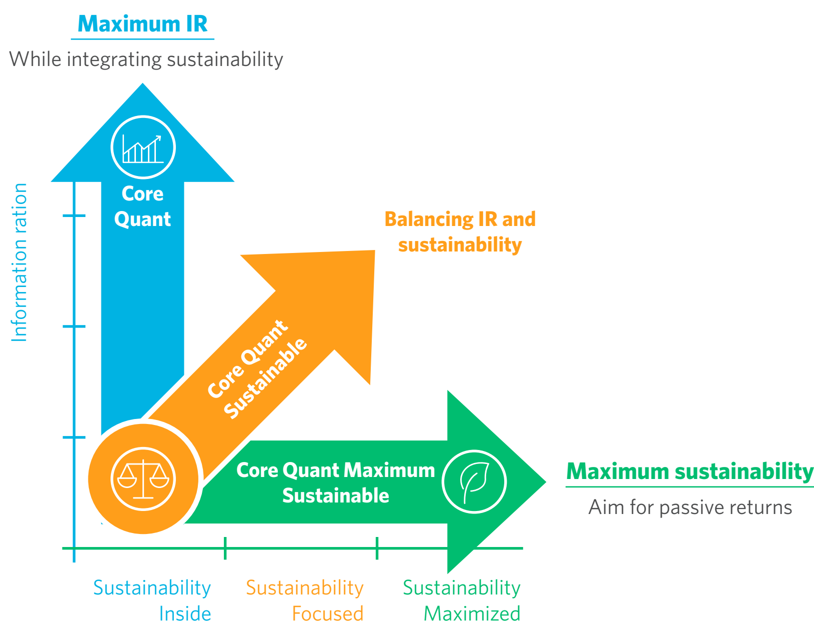
Around 30 years ago Robeco developed a stock selection model that was able to identify out- and underperforming stocks by assessing their stock specific characteristics (e.g. value, quality and momentum).

Since 2004 we have been successfully using this stock selection model as an input for the Core Quant strategies that aim to maximize the excess return versus a benchmark with a controlled relative risk budget (tracking error). A proprietary portfolio construction model is used to allocate a higher (lower) weight to stocks that are positioned on top (bottom) of the stock selection list. Nowadays close to EUR 30 bln. is managed in Core Quant Equities strategies.

As shown in Figure 1, the information ratio (IR) focused Core Quant strategies are available to investors at various levels of tracking error: Semi-passive (tracking error 0.5%, expected IR of 1.0), Enhanced Indexing (tracking error 1%, expected IR of 1.0) and Active (tracking error 3%, expected IR of 0.8). These strategies, shown in the first column, integrate various dimensions of sustainability in the investment processes, ranging from excluding controversial companies to the integration of ESG scores in the stock selection model and portfolio construction. Finally, we act as active owners (on behalf of our clients) by pursuing voting and engagement activities on companies that are part of the eligible investment universe and portfolio.

Robeco Asset Management is Momentum Investments' global partner. This article reflects their perspective on including ESG factors into global equity portfolios. We use these funds in our Global Equity building block and so our clients have exposure to the approach outlined in this article.

Figure 1: Overview of Core Quant Equities strategies in developed and emerging markets



Source: Robeco

For investors that aim to balance financial and sustainable goals, we manage the Core Quant Sustainable strategies since 2013. These strategies target explicit sustainability objectives next to maximizing the IR. Finally, for those investors that solely aim for a maximized sustainable portfolio, we are able to manage Core Quant Maximum Sustainable strategies that aim for benchmark like returns while integrating multiple client-specific dimensions of sustainability.

Negative screening: Exclusions

Excluding controversial companies from the eligible investment universe is often the first step for sustainable investors. Companies may be excluded based on the ethical values of investors. Although investors often share common values (e.g. excluding producers of controversial weapons), the range of possible exclusion varies among religious background (Catholic or Islamic values) and business activities (exclusion of tobacco and alcohol stocks by insurance companies) of investors.

Theoretically, excluding controversial stocks from an investment universe lowers the breadth of any investment strategy. Nevertheless, even at a modest level of tracking error (1%) the Core Quant Sustainable Global Developed Enhanced Indexing strategy is able to target an IR of 0.5 while excluding various controversial companies from the investment universe and applying full sustainability integration. An overview of the various exclusions that apply for both the Core Quant and Core Quant Sustainable strategies is shown in Figure 2.

In order to assess which companies need to be excluded from the investment universe all Robeco funds use information provided by RobecoSAM. For clients invested in mandates or dedicated funds we can integrate client-specific exclusion lists or design a customized exclusion policy based on RobecoSAM information and/or information from other suppliers of ESG data (e.g. Sustainalytics). Apart from excluding companies from well-known investment universes (e.g. MSCI World Index), the Core Quant strategies can also enhance customized indices (that have excluded controversial stocks as part of the index design) by pursuing sustainable and/or return goals.

Figure 2: Overview of exclusion criteria for Core Quant Equities funds

Exclusion criteria	Sub area for exclusion	Company revenue threshold	Core Quant	Core Quant Sustainable Enhanced Indexing	Core Quant Sustainable Active
Controversial Weapons	Land mines, Cluster munitions, Chemical-, Biological-, Depleted Uranium & Nuclear weapons	0%	✓	✓	✓
Palm Oil	Production without RSPO certification	*	✓	✓	✓
Tobacco	Production and key Parts	0%	✓	✓	✓
Nuclear	Power generation	30%		✓	✓
Military Contracting	Weapon systems, Tailor-made components	5%		✓	✓
Firearms	Production	0%		✓	✓
Thermal Coal	Mining/power generation	10%/20%		✓	✓
Global Compact Breaches	Human rights, Labor conditions, Corruption, Environmental damage	0%		✓	✓
Alcohol	Production or sales	5%			✓
Gambling	Production	5%			✓
Adult Entertainment	Production, services, print	5%			✓

*Source: Robeco. *Exclusion of palm oil producers is based on the percentage of land (ha) for palm oil cultivation certified according to the RSPO standard.*

Positive integration: Higher ESG scores

In addition to negative screening investors may also pursue positive integration by targeting investments in companies that exhibit above average ESG scores. In order to improve the ESG score of a portfolio versus the ESG score of the benchmark, investors first need to assess the ESG scores of all index constituents and other stocks eligible for investment.

Our preferred supplier of this data is RobecoSAM, as sustainability scores of companies are calculated by using both public as company assessed data, while controlling for known transparency biases in these data.

If preferred by clients, the strategies also allow for the use of data from other ESG data providers (e.g. Sustainalytics, MSCI). Once captured, these scores can be used when constructing the portfolios in order to improve the ESG score of the portfolio versus the benchmark (Core Quant strategies), or increase the relative score by at least 20% (Core Quant Sustainable strategies) or even higher for the Core Quant Maximum Sustainable strategies. The depth and scope of the RobecoSAM data also allows for a relative portfolio improvement of only one or two aspects of the ESG score (e.g. Environmental score only).

Coping with climate change: Decarbonising the portfolio

Since the Paris agreement of 2015, many institutional investors on various continents have expressed their intention to lower the carbon footprint of their portfolios as a means to prevent further climate change[1]. All Core Quant strategies address carbon footprints in different magnitudes. A first step towards decarbonization is assessing the carbon footprints of the value factor that is part of our stock selection models. Investors targeting value stocks may find themselves being exposed to companies with carbon footprints that exceed benchmark values. This is partially due to its structural tilt towards asset-heavy companies and sectors such as energy, utilities and materials[2]. To prevent such elevated carbon exposures, all Core Quant strategies use enhanced and decarbonized value factors that allow investors to capture the full value premium with a reduced exposure to carbon risk. In addition to decarbonizing the value factor, the strategies also actively reduce waste, water and energy consumption footprints.

Further decarbonization of the portfolio is achieved by the Core Quant Sustainable strategies. These strategies target at least a 20% lower carbon footprint as well as a 20% lower footprint on waste, water and energy consumption in addition to an extensive exclusion list and a 20% higher ESG-score. For investors in segregated accounts or mandates we are able to fully customize the type of environmental footprint reductions and their respective magnitude to client-specific levels. The Core Quant Sustainable strategies aim for information ratios of at least 0.3 (at tracking error levels of 0.5% and 0.75%) up to 0.7 (tracking error 3%), thus delivering positive excess returns while integrating various sustainability dimensions. For investors that purely focus on achieving sustainability objectives and aim for market-like returns, the Core Quant Maximum Sustainable strategies might be a perfect fit. These strategies allow for a 50% carbon footprint reduction, even at tracking error levels of 0.5%, while offering several other benefits above and beyond most popular ESG Indices[3].

[1] *The Paris Agreement is an agreement within the United Nations Framework Convention on Climate Change, dealing with greenhouse-gas-emissions mitigation, adaptation, and finance, signed in 2016. The agreement's language was negotiated by representatives of 196 state parties at the 21st Conference of the Parties of the UNFCCC in Le Bourget, near Paris, France, and adopted by consensus on 12 December 2015*

[2] *Decarbonizing the Value factor, Laurens Swinkels, Kristina Ūsaitė, Weili Zhou and Machiel Zwanenburg, Robeco white paper, October 2019*

[3] *Above and Beyond ESG Indices, Jan de Koning, Robeco white paper, November 2019.*

UN SDG Investing

For sustainable investors, 2015 was an important year. Not only decarbonization was put on the agenda in this year, the UN also presented a collection of 17 sustainable development goals that act, according to the UN, as 'a blueprint to achieve a better and more sustainable future for all'[4]. The result: a growing number of investors is exploring the possibilities of integrating all or some of the SDGs in their investment portfolio. As a leader in sustainable investing, we are equipped to accommodate the needs of these investors by either tilting equities portfolios away from companies with a negative impact on SDGs or enhancing the return and/or sustainability characteristics of a customized index that integrates the impact on SDGs in the weighting of constituents.

Active engagement on portfolio holdings

Investors can improve the sustainability profile of portfolios by excluding stocks, integrating ESG and SDG scores and lowering environmental footprint. However, despite the good intentions of investors implementing these measures in their portfolio, it may not result in a change of the behavior of the underlying corporations.

Actively engaging with companies and voting in favor or against board proposals enables investors to put the pursuit of better ESG practices on the agenda of corporates. Therefore, active engagement is the default choice for all Core Quant strategies. We not only pursue this dialogue for the sake of doing so, we actually 'walk the talk' by reflecting our engagement activities in portfolio positioning and ultimately exclude companies that refuse to listen. This active integration of engagement in the investment process stands in sharp contrast with the non-existent integration of engagement by passively managed ESG indices[5]. As Robeco encourages good governance and sustainable corporate practices, which contribute to long-term shareholder value creation, proxy voting is part of our active ownership approach. We believe this will increase long-term shareholder value while also encouraging responsible corporate behavior.

Customised sustainability integration

As highlighted in this whitepaper, various dimensions of sustainability can be integrated in portfolios. The number of dimensions and the magnitude of the integration depends on the overall objective of the portfolio (excess return, balanced or maximum sustainability integration) and the level of tracking error.

To illustrate the various possibilities of sustainability integration, Figure 3 highlights in blue the available UCITS funds and the corresponding dimensions and magnitudes of sustainability integration. The plethora of choices that are available to the sustainable investor highlight the need for a customized approach that meets the specific demands of institutional investors. Therefore Figure 3 also highlights the potential dimensions of integration at each level of tracking error and portfolio goal for strategies that are solely available as segregated accounts or mandates.

Figure 3: Dimensions of sustainability integration for Core Quant Strategies

	Core Quant Sustainable Investing - Inside *Goal: Maximum IR while integrating sustainability*	**Core Quant Sustainable** Sustainable Investing - Focused *Goal: Balancing IR and sustainability objectives*	**Core Quant Maximum Sustainable** Sustainable Investing - Maximized *Goal: Maximum sustainability integration*
Semi-passive	Tracking error = 0.5% - IR: 1.0 Basic exclusions ESG score > benchmark Decarbonized value	Tracking error = 0.5% (DM) 0.75% (EM) - IR: 0.3 Customized exclusions ESG score +20% > benchmark 20% lower carbon, waste, water & energy	Tracking error = 0.5% (DM) 0.75% (EM) - IR: 0 Limited exclusions ESG score max +20% > benchmark **or** Max 50% lower carbon
Enhanced Indexing	Tracking error = 1% (DM) 1.2% (EM) - IR: 1.0 Basic exclusions ESG score > benchmark Decarbonized value	TE = 1% (DE) 1.5% (EM) - IR: 0.5 (DM) 0.7 (EM) Advanced exclusions ESG score +30% (DM) +20% (EM) > benchmark 20% lower carbon, waste, water & energy	Tracking error = 1% (DM) 1.5% (EM) - IR: 0 Customized exclusions ESG score max +30% > benchmark **and** Max 50% lower carbon
Active	Tracking error = 3% - IR: 0.8 Basic exclusions ESG score > benchmark Decarbonized value	Tracking error = 3% - IR: 0.7 Advanced exclusions ESG score +20% > benchmark 20% lower carbon, waste, water & energy	Tracking error = 3% - IR: 0 Customized exclusions ESG score +50% > benchmark **and** Max 50% lower carbon

Source: Robeco.

[4] *"About the Sustainable Development Goals". United Nations Sustainable Development. Retrieved 9 November 2019.*

[5] *Above and Beyond ESG Indices, Jan de Koning, Robeco white paper, November 2019.*

Conclusion: Future proof sustainable solutions

Sustainability integration in equity portfolios is on the rise, resulting in a wide array of choices that can be made by passive and active investors. In this whitepaper we have described the various dimensions of sustainable investing that are integrated in the Core Quant Equities strategies. In addition, we can meet the demands of institutional investors that aim to pursue a bespoke and personalized sustainability agenda in their investment portfolios, by designing a client-specific and futureproof mandate. Detailed and extensive reporting on the various aspects of sustainability integration is provided by client-specific reports.

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