

# ESG Basics: Peeling Back the Onion on ESG Due Diligence & Compliance Monitoring

*Why ESG Ratings Methodology Should Matter to Asset Owners...*

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*Do the investments in your Pension Plan accurately reflect the beliefs & values of your trustees/member beneficiaries?*

## TODAY'S PRESENTERS



**Ben Webster**

CEO & Co-Founder  
OWL ESG, Inc.



**Brian Greene**

Sr. Vice President  
Zeno AN Solutions



# Brian Greene



**Sr. Vice President**



- ✓ **More than two decades in Capital Markets & Trade Cost Analysis.**
- ✓ **Expert on how trading oversight and regulatory focus impacts the asset owner community and their fiduciary responsibilities.**
- ✓ **Skilled in equity, fixed income, foreign exchange trading oversight, transition management and assisting pension plans in reducing costs as well as improving their bottom-line performance.**

# Ben Webster



CEO & Co-Founder

 owl analytics

- ✓ +20 years experience in Financial Services Industry
- ✓ Experience in asset management, advisory, capital markets, hedge funds as well as private equity with significant expertise in ETFs, indexing and ESG investing.
- ✓ Frequent speaker regarding the use of ESG data in the investment process and proud proponent of how ESG-based investing makes the world a better place for future generations.

# What is ESG?

Environmental, Social, and Governance (ESG) is a term to describe data and metrics about how companies affect the environment, treat their stakeholders, and govern themselves for long term sustainability.

## Environment

Concern for Nature

- Climate change, carbon emissions, waste management
- Air and water pollution, water scarcity
- Biodiversity, deforestation, resource depletion
- Energy efficiency, renewable energy, energy waste

## Social

Consideration for  
People & Communities

- Customer satisfaction, community relations, charity
- Data protection, data privacy, data practices
- Board & management diversity, diversity policies
- Employee training, work conditions, human rights track record

## Governance

Ethical standards for  
running a company

- Board composition & independence, audit committee structure
- Bribery, corruption, and whistleblower policies
- Executive compensation & incentives, ESG tied compensation
- Lobbying, political contributions

# ESG is mainstream....

Environmental, Social, and Governance is a term to describe data and metrics about how companies manage the environment, treat their stakeholders, and govern themselves for long term sustainability. Sustainable investing is no longer an outlier embraced by a small segment of the financial community – it is undeniably mainstream, cutting across the global asset management landscape.

## Standardized Reporting

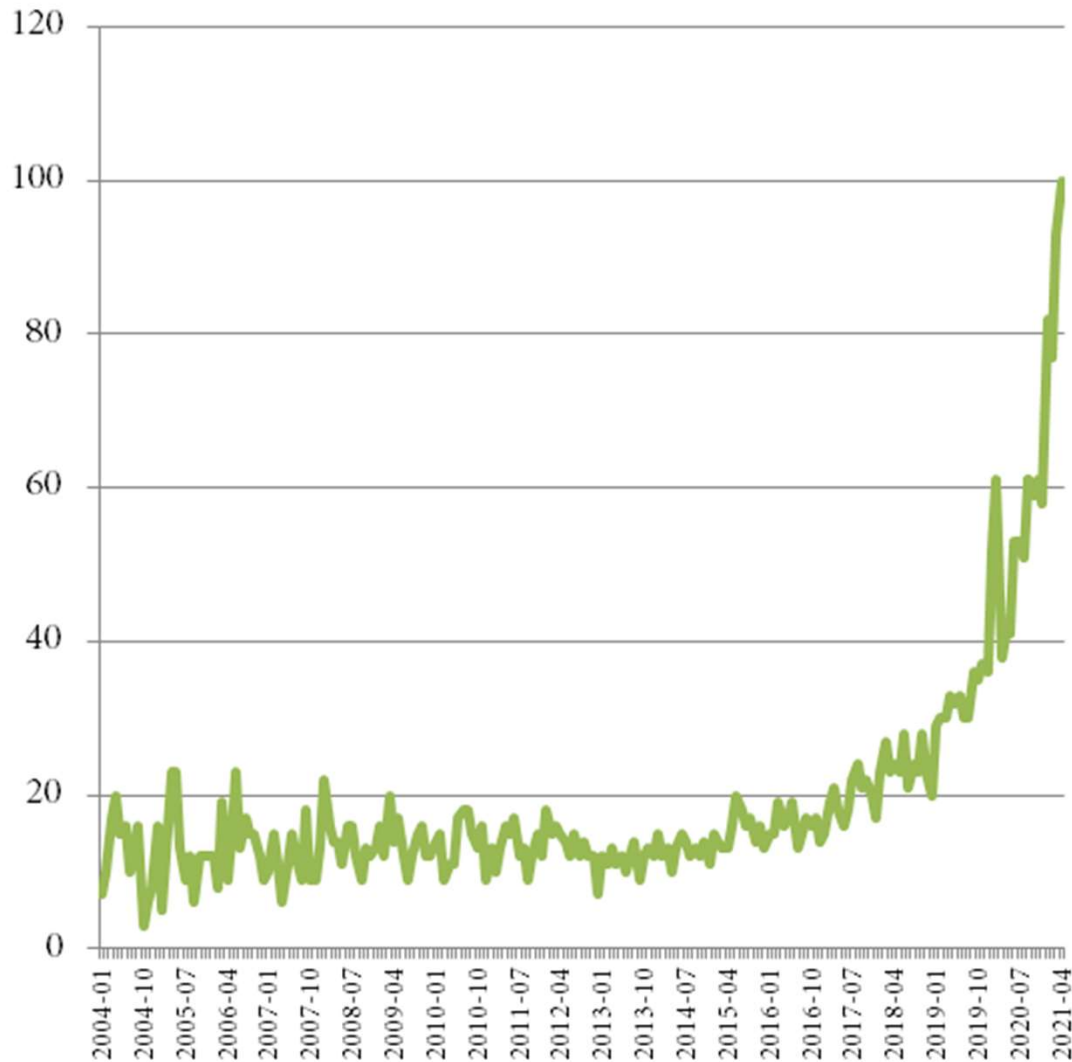
The world of ESG data can be described as *subjective, non-standard, unreported, and unregulated*. Attempts to standardize and mandate reporting over time, and to define materiality with respect to company sustainability practices have met with little success. Thus, extreme inconsistency is the norm.

## ESG Ratings

Knowing the unreliable nature of ESG data, research firms have created ESG rating systems. ESG ratings are an attempt by these research firms to provide investors and other members of the financial community a means to compare the current sustainability business practices of companies.

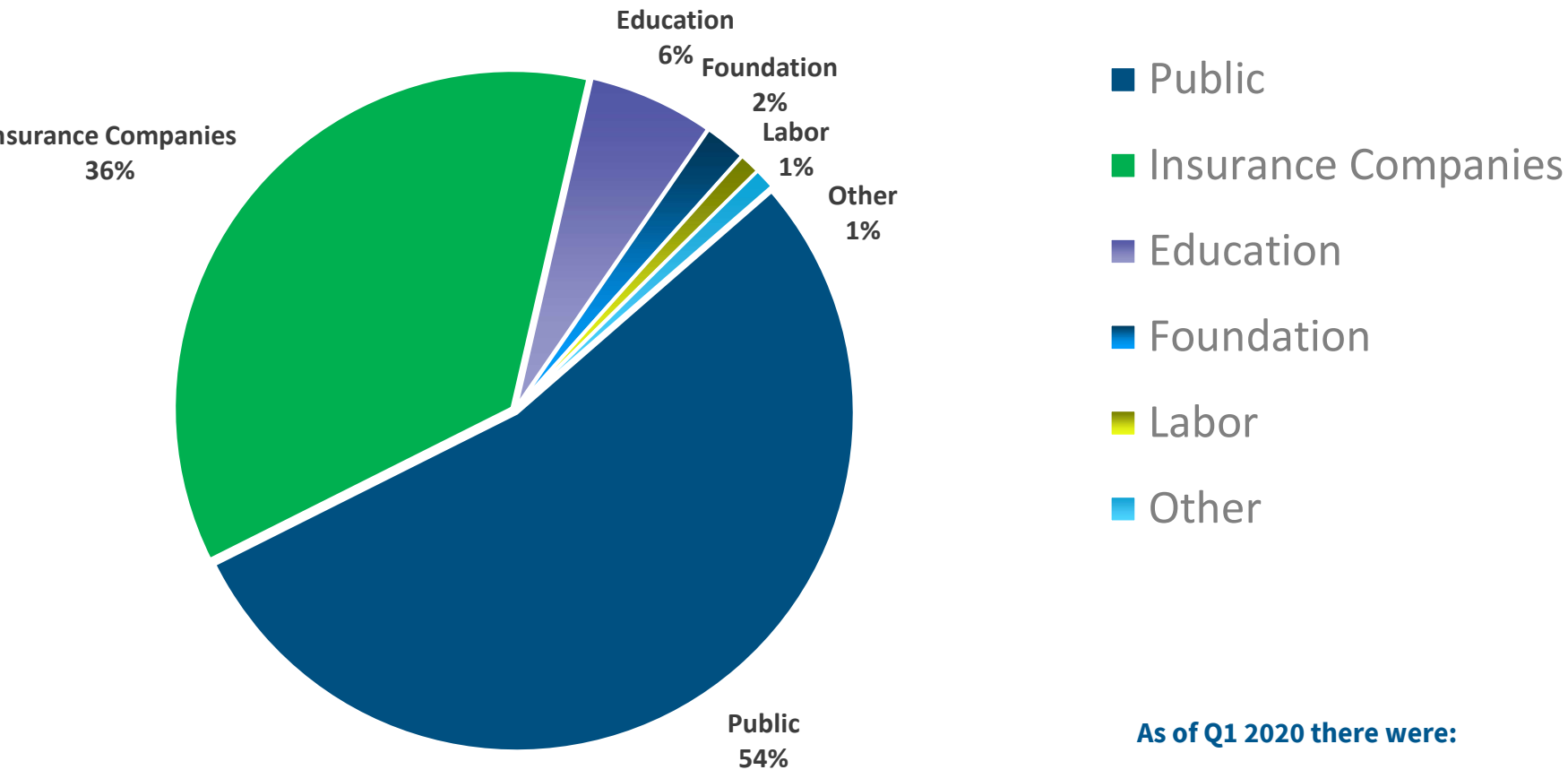
# ESG Grows in Internet Searches beginning in 2019 only to skyrocket in 2020

ESG: (United States)



Source: Google Trends  
Keyword: "ESG"  
Market: United States

# Institutional Investor ESG Assets, by Investor Type



Foundation: The Forum for  
and Responsible Investment

## As of Q1 2020 there were:

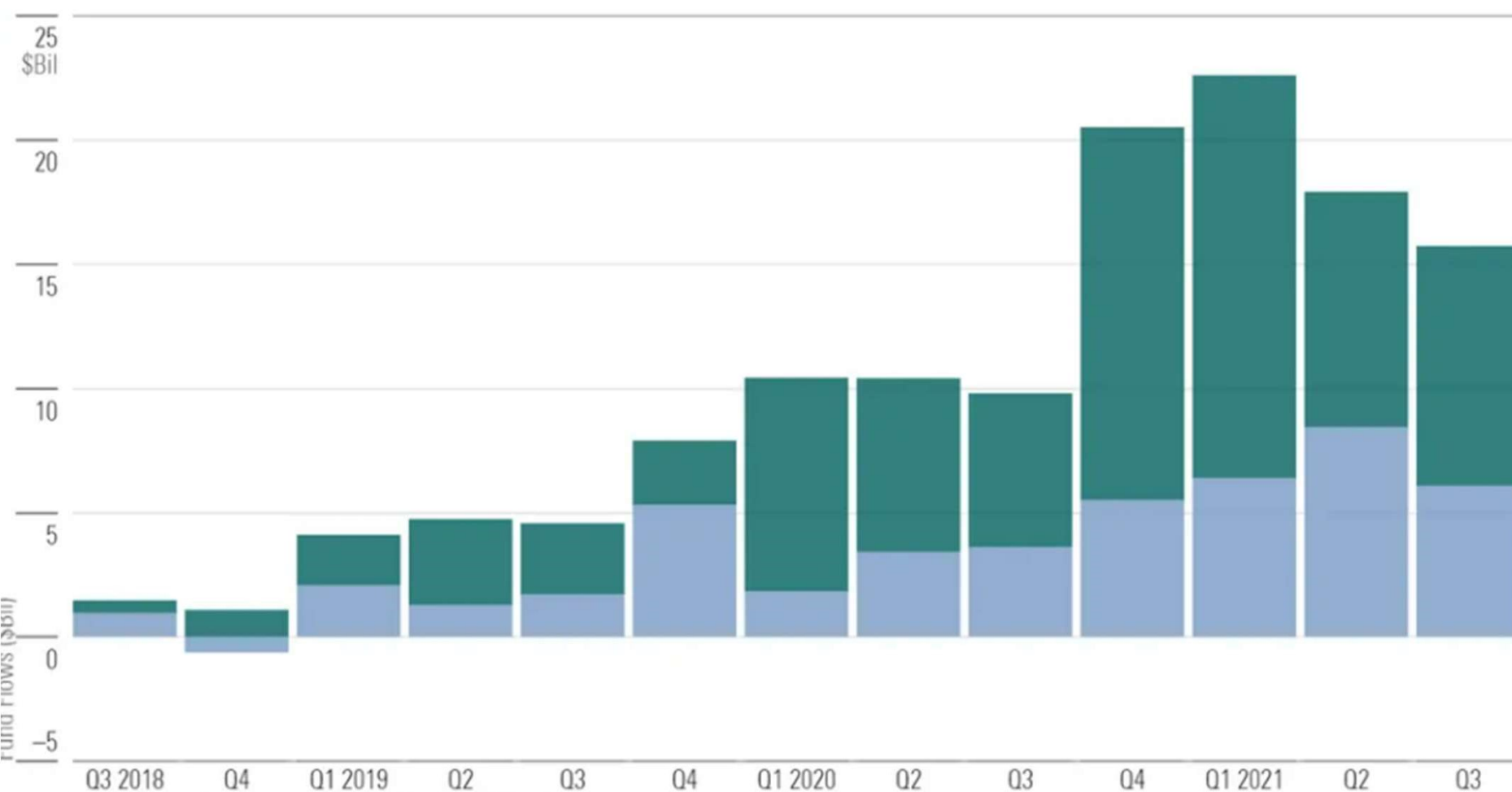
- 180+ US public pension funds with ESG-related policies
- ~500 US asset owners that utilize ESG in some fashion
- ~400 US investment managers that utilize ESG in some fashion
- 700+ “sustainable investment” ETFs and mutual fund vehicles



# The Number of New Sustainable/ESG Funds Hits an All-Time Record

J.S. Sustainable Fund Flows

Passive Active

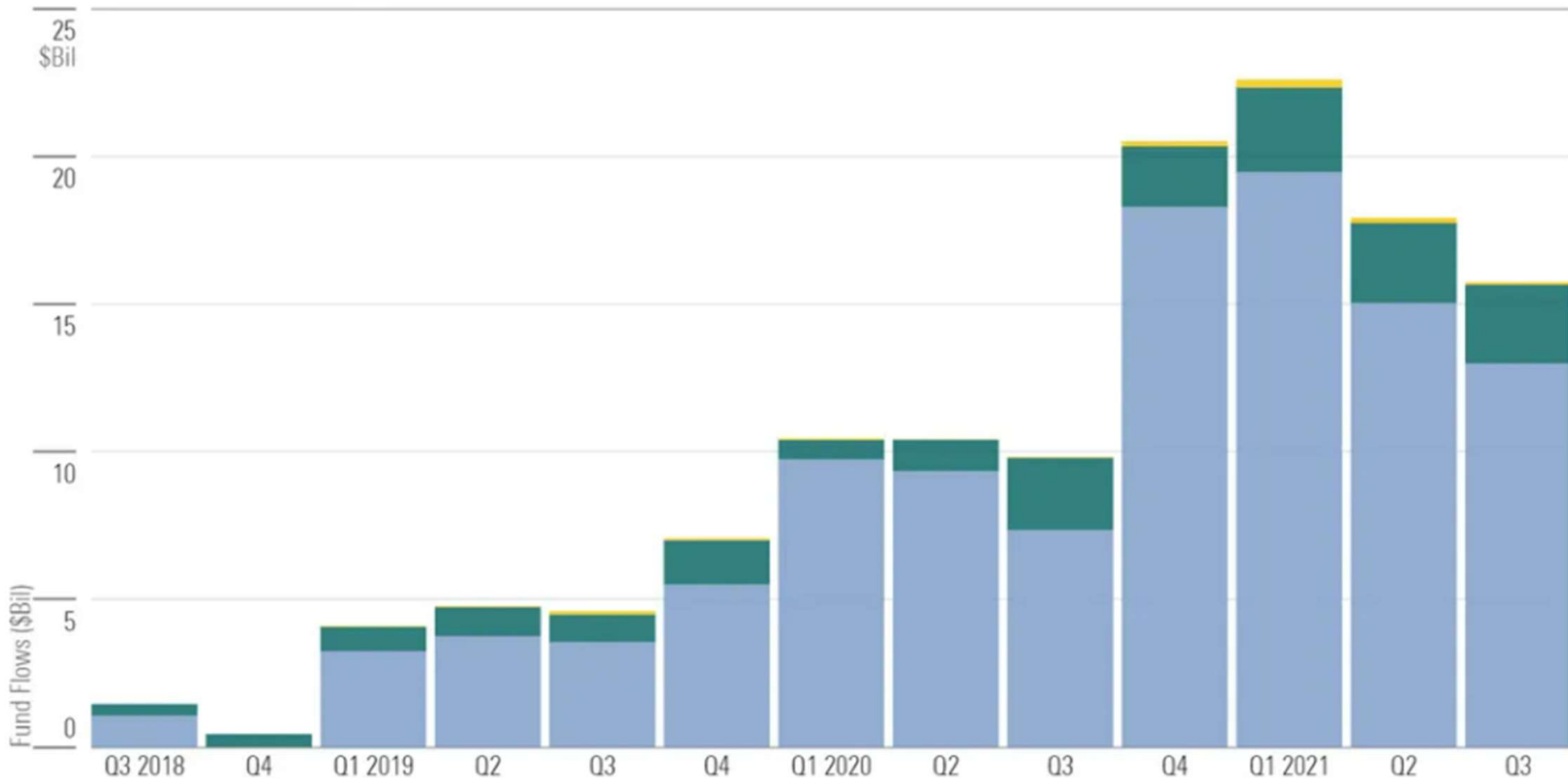


Source: Morningstar Direct. Data as of September 30, 2021.

# Assets in U.S. ESG Funds have stayed on a steady growth trajectory...

U.S. Sustainable Fund Flows by Asset Class

Allocation Fixed Income Equity



Source: Morningstar Direct. Data as of September 30, 2021.

# ESG Has Become Too Big To Ignore

## ESG IS NO LONGER NICHE

ESG investing could exceed *one-third of total assets under management* (projected to reach \$140 trillion globally by 2025)

Europe currently accounts for half of global ESG assets, but the U.S. is expanding rapidly and may dominate as early as 2022

## EUROPE'S ESG GOLD RUSH HAS SPREAD GLOBALLY

Growth in Europe's ESG funds, now \$1.1 trillion (10% of total European fund assets) shows what to expect globally

New ESG funds launched between January and September 2020, reflecting strong client demand and an unprecedented level of product development

## ESG ETFs SET FOR \$1 TRILLION ORGANIC GROWTH

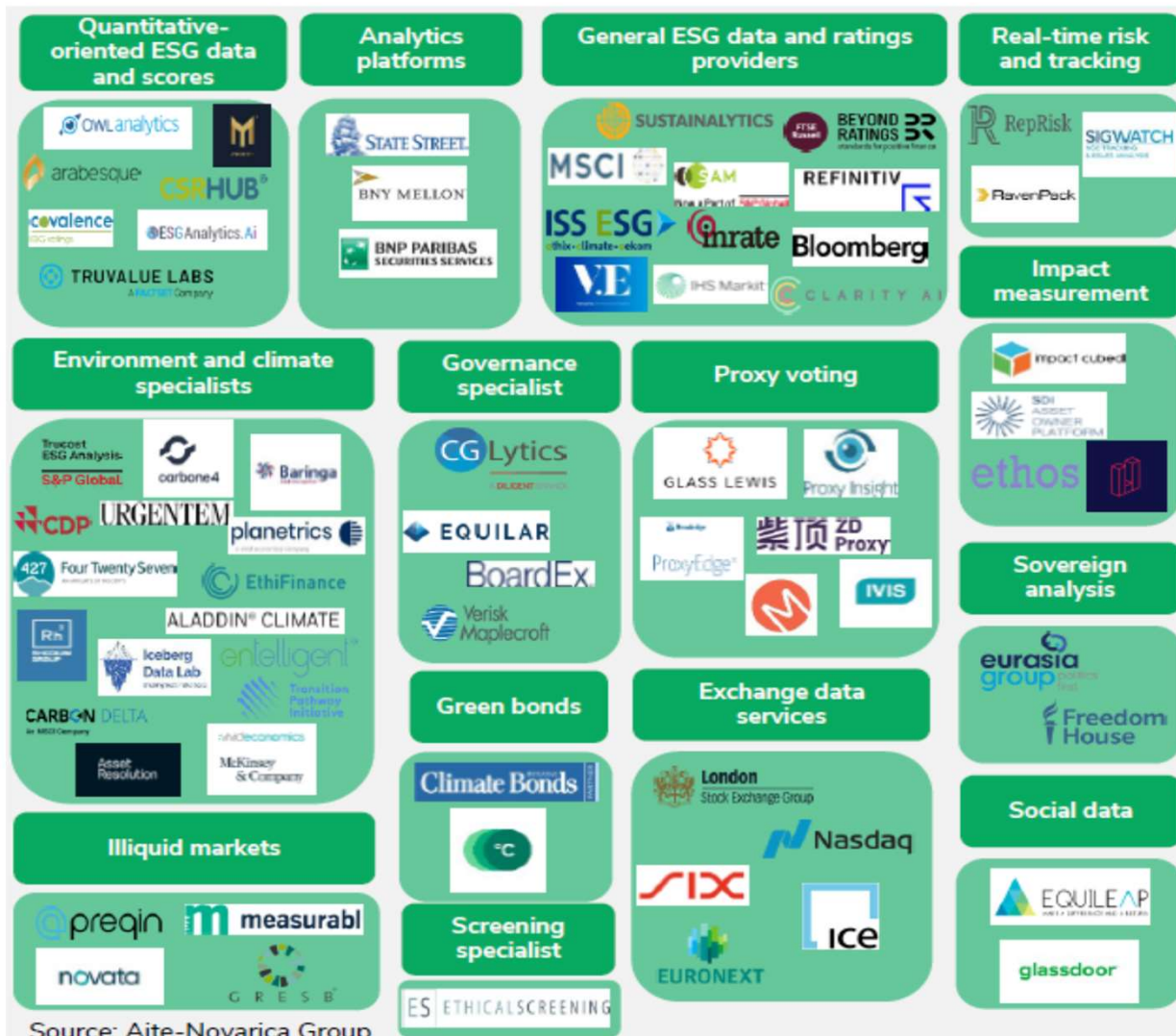
- Cumulative inflows to ESG ETFs should surpass \$135 billion in 2021
- Growth trends show that *as much as \$1 trillion could flow into ESG ETFs globally* over the next five years

## U.S. ESG FUNDS ARE GROWING RAPIDLY

- The value of ESG ETF assets was projected to exceed \$190 billion by year-end 2020, capturing almost 13% of total ETF asset growth globally
- Europe has dominated in ESG ETFs up to now, but the largest share of ESG ETF investing is now directed into the U.S. market
- U.S. ESG ETFs increased by 318% in the first nine months of 2020, capturing 90% of "smart-beta" flows

# The ESG Market is complex, yet simple: Approach it by applying 'K.I.S.S.'

FIGURE 10: ESG VENDOR LANDSCAPE



# You Haven't Seen Complex Until You've Seen ESG Data...

There are thousands of potential ESG data points that a company can report upon. Attempts to standardize and mandate reporting, including defining materiality with respect to company sustainability, practices have met with little success. Thus, extreme inconsistency is the norm.

## LESS REGULATED

ESG reporting is not regulated in most markets and even in markets with regulation, standards are not nearly as strict as for financial reporting.

## NOT STANDARDIZED

ESG reporting is all over the place, with many companies changing the ESG issues they report on and how they report on them from year to year.

## SELF-REPORTED

Most ESG data is self-reported with the lack of regulation resulting in companies only reporting on data favorable to them or framing reporting in a favorable manner.

## LIMITED HISTORY

ESG reporting is relatively new making it difficult to gather enough data on each company from which useful insights and intelligence can be generated.

# Problems with ESG Ratings

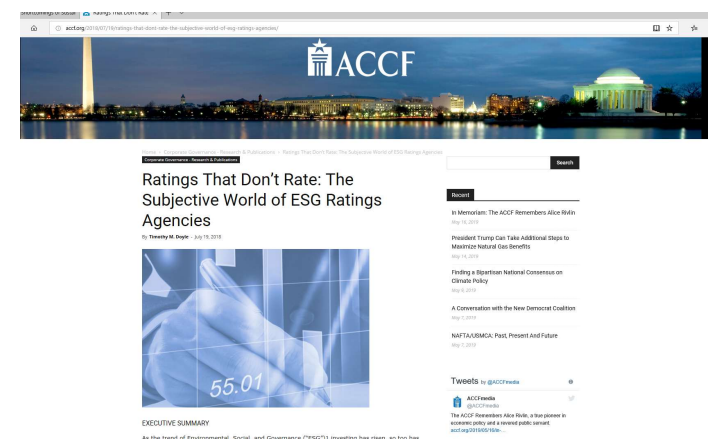
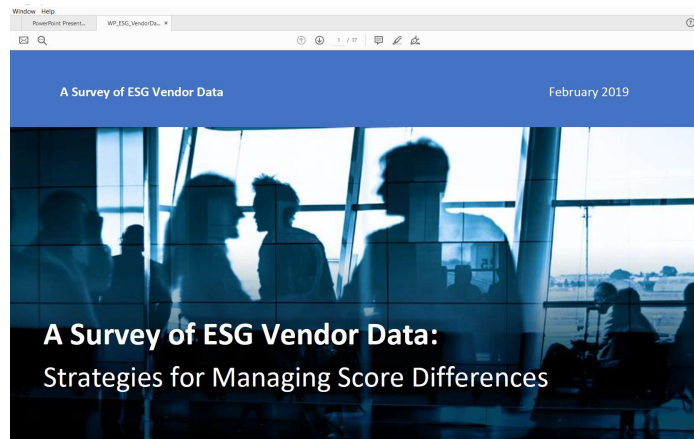
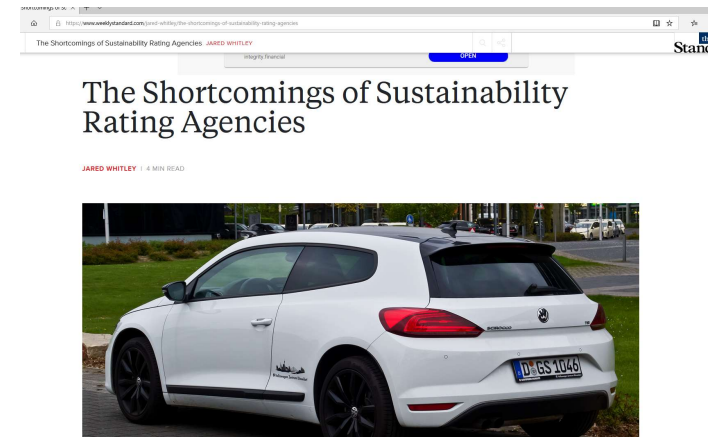
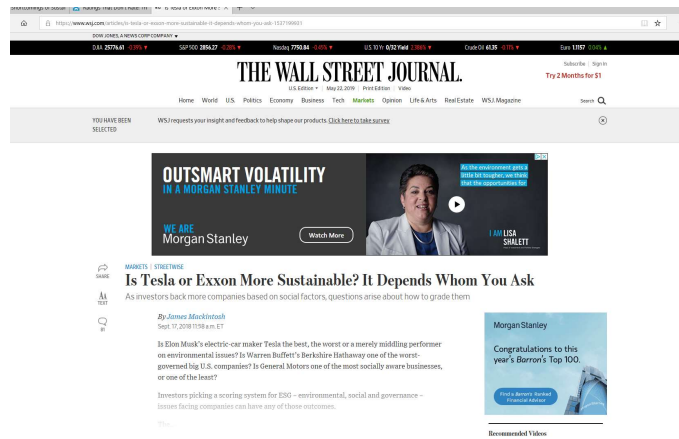
## RATINGS ARE SUBJECTIVE

Like for bond ratings, which tend to be 50%+ correlated, ESG ratings tend to have low correlation with each other. On average there is approximately a 40%-50% correlation between the ESG ratings of any two ratings firms

## CRITICAL RAMIFICATIONS

The companies can score high with one ESG vendor, low with others, or anywhere in between.

This means that the results of any investment strategy or portfolio can be greatly affected by excluding, including, giving greater or lesser weight to, or any other portfolio construction technique that relies on ESG ratings.



THANK YOU

Q & A

Additional questions?

Ben Webster  
OWL ESG, Inc.

Email: [bwebster@owlshares.com](mailto:bwebster@owlshares.com)



Brian Greene

Zeno Abel-Noser Solutions

Email: [bgreene@abelnoser.com](mailto:bgreene@abelnoser.com)

