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Responsible Investment, Now More Than Ever

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STANDISH
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For investors concerned about changes in the earth's climate, changes in the political climate in Washington may appear to be compounding the risks posed by carbon emissions.

The U.S. government has historically been less willing than its counterparts in other developed countries to mandate emissions reductions and promote renewable energy, but the leadership of the world's second-largest carbon emitter now appears to be tacking decisively away from even modest initiatives to confront climate change. Indeed, the recent executive order rolling back power plant emission rules confirms what had been a widely expected shift in federal priorities.

But while politicians may de-emphasize climate concerns, long-term-focused U.S. investors cannot simply look away from climate-related risk and other environmental, social and governance (ESG) factors that have real and increasingly measurable impacts on portfolios as well as on the planet. Regardless of whether government leads or lags on these issues, the opportunities for investors to align their portfolios with their ESG concerns — whether to better manage risk or to advance specific objectives — continue to expand. We believe that investors and the private sector are both obliged to and capable of building momentum behind emissions reductions, renewable energy and other climate-friendly initiatives.

Not long ago, investors who considered non-market factors in their investment decisions could only practice exclusionary screening to keep disfavored firms or sectors out of their portfolios. Now, they have access to a rapidly expanding universe of data to better understand the sources and nature of non-market risks and a growing number of investment managers who integrate ESG awareness into their decision-making processes.

CLIMATE-FRIENDLY INITIATIVES

Fixed income markets will be the source of financing for the majority of climate-friendly initiatives. Here, the increasing interest in ESG factors is being met with increasing disclosure by corporate bond issuers about their exposures, goals and policies relating to those sources of potential risk. According to the Governance and Accountability Institute, 81% of S&P 500 companies now publish a corporate sustainability report, up from fewer than 20% in 2011. Meanwhile, organizations including Ceres, the Sustainability Accounting Standards Board and the Carbon Disclosure Project are encouraging companies to increase disclosure and are advocating for the standardization of the information that is disclosed. Also helping to increase the amount and quality of ESG-related information are data aggregators and rating services such as MSCI, Sustainalytics and oekom research, which cover an increasingly vast universe of bond issuers.

ESG RISK SCORE

While increased data and transparency provide tools for managers to better understand ESG risk, the way in which the data is put to work matters even more. Identifying data that could materially affect the market's perception of an issuer's creditworthiness within the investment horizon is critically important. With this goal in mind, Standish has developed the Standish ESG risk score system, which provides absolute assessments of ESG risk that can be compared across issuers and sectors.

To be sure, government has not completely quit the battle for a lower-carbon future. Individual states continue to mandate increases in renewable energy production and state standards will likely remain in place regardless of the direction of federal policy. Trump administration officials, such as Secretary of Energy Rick Perry, may also prove to be stronger allies than some observers expect. While Perry championed oil and gas production as governor of Texas, he also pushed legislation that helped turn the state into the country's largest wind power producer.

MATURATION OF ESG-AWARE INVESTMENT

While Washington's lack of interest in the ESG concerns that underlie responsible investment is disappointing to those who would prefer a European-style top-down regulatory push, the maturation of ESG-aware investment gives investors greater opportunity to drive outcomes rather than waiting for government to do it. American exceptionalism means the U.S. is unique among developed markets, sometimes in ways that appeal and sometimes in ways that appall. It means that while the U.S. political establishment may not fall in line with the approaches taken by other countries to foster responsible investment, the U.S. private sector can still play an active role in advancing environmental, social and governance objectives. The data is there, the facts are material and the need is real.

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