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JOIM CONFERENCE SERIES
THE PROMISE AND CHALLENGES OF ESG
MAY 17-19, 2021/VIRTUAL CONFERENCE

Co-Sponsored with Stanford Graduate School of Business

CONFERENCE SUMMARIES

This conference focused on the investment implications of ESG including leading research findings of the importance of ESG analysis. The current methods of analysis and up to date understanding of the role of ESG in the investment process was explored. This conference included both the academic and practitioner research in this area with a view of identifying current best practice. This event was co-sponsored with Stanford Graduate School of Business, BlackRock and Invesco.

Masataka Miyazono, Government Pension Investment Fund (GPIF)
Keynote Speaker
GPIF and its ESG investing

translated by Jeffrey Bohn, Swiss RE

Brad Cornell, Anderson School of Management
ESG: Conceptual Questions

Discussant: Kathleen Houssels

In the last decade, companies have come under pressure to be socially conscious and environmentally responsible, with the pressure coming sometimes from politicians, regulators, and interest groups, and sometimes from investors. The argument that corporate managers should replace their singular focus on shareholders with a broader vision, where they also serve other stakeholders, including customers, employees, and society, has found a receptive audience with corporate CEOs and institutional investors. The pitch that companies should focus on "doing good" is sweetened with the promise that it will also be good for their bottom line and for shareholders. All of this enthusiasm has pushed aside some significant issues that have not been adequately addressed, including some raised by Milton Friedman more than fifty years ago.

Lisa Goldberg, Aperio/University of California Berkeley
The Inherent complexity of ESG investing

Discussant: Lloyd Han, PIMCO

Many investors have shifted their asset allocations to account for Environmental, Social, and Governance (ESG) issues. While we welcome this shift from an ethical perspective, the financial and non-financial benefits of ESG investing as well as best practices for portfolio construction are subjects of heated debate. We look at aspects of the debate through a series of practical examples. First, we illustrate the tradeoff between risk control and unwanted exposures in energy and "vice" stock exclusions, which have exhibited inconsistent performance at a ten-year horizon. Next, we show how recent underperformance of a gender lens portfolio has been confounded by technology stocks. Finally, we explore how ESG score disparities lead to important differences in portfolios constructed with these scores. In aggregate, our examples point to the inherent complexity of ESG investing, which will benefit from better data, transparency, customization, and an acknowledgement that doing good does not necessarily lead to doing well. An important theme throughout this paper is that everything should be made as simple as possible, but no simpler. This work is in collaboration with Jeff Bohn and Simge Ulucam.

Ben Meng, Eight Sequoias LLC
The Inflection Point for Sustainable Investing

Discussant: Cel Kulasekaran, Windham Capital Management

The COVID-19 pandemic has accelerated a few investment trends. For example, we have seen a drastic rise in self-claimed ESG funds during the pandemic. What are the drivers behind such a rise? Extreme weather events? Civil society? Generational shift? Government interference? Investors' demand? And more importantly, does the rise indicate that we are at an inflection point of ESG investing? This presentation attempts to address this question by three steps: (1) identify and assess each of the drivers of demand for ESG investing (2) identify and assess each of the enablers of ESG investing and (3) put the demand and supply sides together—what does the gap mean and are we at the inflection point of ESG investing? The presentation concludes with some concrete recommendations to bridge the gap between the supply and demand sides of ESG investing such as investment grade ESG data, appropriate policy supports and global collaboration.

Jay Raol, Invesco
The Influence of ESG on Fixed Income Portfolio Manager Behavior

Discussant: Shaojun Zhang, Vanguard

Environmental, Social and Governance (ESG) signals have gained increased attention with investors especially in equities. Existing work has looked extensively at the impact on the risk and return profile of ESG portfolios, their impact on asset pricing and interactions with existing factors. While there is strong momentum towards ESG adoption, several studies have noted the different ESG data sources and methodologies can create uncertainty in ESG measurement. However, both adoption and analysis of ESG in corporate bonds has lagged behind equities. We explore the impact of ESG on corporate bond returns and characteristics. We find similar results to previous studies that observe a strong correlation between ESG exposure and corporate default risk. In order to better understand how potential uncertainty in ESG data and the correlation of ESG to corporate default risk effects portfolio construction, we look at the portfolio exposures and characteristics of the largest fixed income ESG managers. Among several interesting observations, we note that most managers largely agree on which companies have low ESG exposure. ESG exposures reduce the credit beta of a portfolio to traditional fixed income benchmarks as proxied by passive managers. Active managers tend to overweight lower rated, longer dated bonds with higher ESG score to offset the bias. This behavior by individual managers has broad implications for investors in their own portfolio construction.

Roberto Rigobon, MIT Sloan School of Management
ESG Confusion and Stock Returns: Tackling the Problem of Noise

Discussant: Wendy Harrington, Nuveen

The Aggregate Confusion Project has shown that the discrepancy in ESG Ratings comes from to sources: aggregation of data using different procedures, and the measurement errors. In a recent paper, we investigate what happens to the estimates of materiality when the ESG signals are noisy. We propose an instrumental variable approach to correct for the noise, and estimate the noise signal ratio for each rating agency. We apply the analysis to four levels of aggregation ESG, E, S, and G. We find that on average the coefficients are biased downward by more than 60 percent. Therefore, if anything, materiality is more important than previously found. We also propose a heuristic to combine the ratings from the different raters.

Laura Starks, McCombs School of Business University of Texas
Climate Risk and Climate Risk Disclosure: Views of Institutional Investors

Discussant: Will Kinlaw, State Street Associates

Institutional investors view climate risk from diverse perspectives as shown by the different ways in which they incorporate risks into their investment processes and engage their portfolio firms' management on the topic. However, the majority believe the risk to be financially material and that disclosure of climate risk to be at least as important as traditional financial disclosure. Some institutional investors have begun to adapt their portfolios to mitigate perceived climate risk.

Panel Discussion

Paul Pfleiderer, Stanford Graduate School of Business
Amit Seru, Stanford Graduate School of Business
Anne Simpson, CalPERS