Benefits and Pensions Monitor Meetings & Events WEBINAR

BMO Exchange Traded Funds

Working Together to Define Sustainable/RI/ESG Investment

BMO Exchange Traded Funds webinar dives into the evolving landscape of ESG implementation in asset management

Panelists Danna Broadworth, Responsible Investment Client Strategy Manager of BMO Global Asset Management and Catie Chipman, ESG Consultant – Client Coverage, Americas of MSCI, alongside moderator Mark Webster, Director, Institutional at BMO Exchange Traded Funds; discuss the journey of sustainable investment from its nascent stages in the 1920s, driven by ethical beliefs, to the current sophisticated framework integrating ESG as a crucial component of fiduciary risk management.

The discussion underscored the complexity inherent in sustainable investing. Asset owners now face the challenging task of aligning investment strategies while meeting required rates of return for beneficiaries, regulatory landscapes, and long-term systemic risks. This intricate scenario calls for a multi-dimensional approach and input from external experts, balancing fiduciary responsibilities with broader environmental and social considerations.

The role of asset owners and asset managers

Central to the conversation was the collaboration between asset owners and their asset managers in steering investments towards sustainable outcomes. The emphasis was on understanding and navigating ESG risks not just for immediate financial gain to identify long-term systemic health. This approach underscores the expansion from single materiality to dynamic and sesqui materiality, encompassing societal and environmental impacts on capital markets.

Chipman's insights provided a practical angle, discussing how asset owners could set ESG considerations into their investment processes. She highlighted the importance of defining clear ESG objectives, codifying these into investment policies, and ensuring effective communication and education to stakeholders regarding these strategies.

Materiality in ESG: A multifaceted approach

The panelists also delved into the complexities of materiality in sustainable investing, highlighting its crucial role in determining what is included in company disclosures and how it shapes regulatory debates. Materiality, as Broadworth maintains, is not a static concept but a spectrum that varies from single materiality, focusing on the impact of ESG risks on enterprise value, to dynamic and double materiality, which consider broader impacts on the environment, society, and systemic risks.

Broadworth highlights:

- **Single Materiality:** Focuses on how ESG risks affect a company's bottom line. This perspective is primarily of interest to investors at the portfolio level.
- **Dynamic Materiality:** Recognizes that ESG risks and opportunities are ever-changing and need a forward-looking approach.
- **Double Materiality:** Examines both the impact on enterprise value and the broader implications for the environment and society.

Broadworth introduced an additional concept, "sesqui materiality," which considers both the impact on enterprise value and the management of systemic risks, which is essential for long-term value generation.

> "Our stewardship strategy involves initiating dialogue with companies to encourage better ESG practices."
> -Danna Broadworth

The discussion emphasized the significant influence of universal owners, such as pensions and asset managers, who own a part of everything in the economy. Their concern for systemic risks and externalities, if unaddressed, could have a pronounced influence, highlighting the necessity for a comprehensive approach to ESG materiality.

To illustrate the varying approaches to materiality, Broadworth used the example of a pipeline company's operations and their impact on indigenous reconciliation. Each materiality lens offers a different perspective on what the company should report, from the direct impact on the bottom line (single materiality) to broader societal and environmental impacts (double materiality) and systemic risks (sesqui materiality).

Chipman further elaborated on the practical application of these materiality concepts in ESG ratings. She underscored the importance of assessing each company according to the most relevant criteria to its sub-industry, a granular approach to identify the most significant risks and opportunities from an ESG perspective, ensuring companies are measured on those aspects which are most pertinent to an industry subsector. The goal is to provide precise context and insights into how companies are managing these risks and leveraging opportunities.

Implementation and stewardship

The panelists highlighted the increasing complexity and depth of incorporating ESG into investment strategies. Asset owners and their managers are now considering from the outset, during the due diligence phase of selecting external managers. This process is not a simple yes-or-no question but requires a comprehensive understanding of how ESG factors are woven into investment strategies.

Chipman says, "Around the world, there are numerous examples of investment strategies and environmental, social, and governance (ESG) frameworks, each with its unique characteristics. This diversity is a key strength, as it allows for various approaches to be highlighted. Some asset owners may focus more on climate policies, with goals oriented towards a low carbon transition. Others might adopt an index approach where there are explicit exclusions on controversial business practices, while adhering to broad benchmark sector and country weights.

"The beauty lies in the fact that there is no single correct way to approach ESG investing. Investors globally have adopted different strategies. Regardless of the approach, what is evident is the systematic adoption of ESG considerations at the planning and policy level, reflecting a broad and evolving commitment to sustainable investing practices."

In discussing stewardship Broadworth, described it as a crucial element of responsible investment strategy. She outlined their four-pillar stewardship strategy: company engagements, proxy voting, industry collaborations, and policy advocacy. These pillars aim to drive financial, environmental, and social value creation. Examples of successful engagements with various companies were shared, showcasing tangible improvements in their ESG practices.

Broadworth says, "Our stewardship strategy involves initiating dialogue with companies to encourage better ESG practices. Our engagement takes various forms, including in-person and virtual meetings, as well as communication through letters and emails. We adopt a mix of one-on-one and collaborative engagements, choosing the most effective format and style to make a meaningful impact.

"The second pillar of our strategy is proxy voting. We consistently exercise our shareholder rights to vote, guided by a custom voting policy. This approach ensures that we actively participate in shaping the ESG practices of the companies we invest in." BPM

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