PATHSTONE IMPACT

Sustainable Investing Highlights

July 2019

Is Generation Z Pulling Strings to Heighten Focus on Sustainable Investing?

It comes as no surprise that those within the generation Z demographics are leading the fight for climate justice and are embracing sustainable investment. This generation understands that they are inheriting the severe impact of climate risk, dilapidated biodiversity, and resource mismanagement that was caused by prior generations.[1]

A Financial Times opinion piece by Pauline Skypala cited a survey by First State Investments which "found that more than 80 percent of millennials are interested or very interested in sustainable and responsible investing (SRI), where fund managers take account of environmental, social and governance (ESG) criteria when picking stocks or tracking an index." The Z generation is nudging investment managers towards incorporating ESG criteria to lower portfolio risk by reducing portfolio exposure to the negative externalities tied to climate change.[2]

A ShareAction 2017 survey on SRI investing highlights the benefits of a sustainable and responsible investment approach. The study noted that European fund managers consider incorporating ESG criteria as good practice, with the need for improvement "with regards to voting and company engagement and disclosure thereof; impact measurement and transparency of fees."

Skypala also noted how Generation Z championed the divestment movement in 2013. Since 2013, philanthropies, religious organizations, pension boards, and educational institutions have adopted fossil fuel divestment, thus far, "more than 1,000 institutions with about $8 trillion in assets have divested to date." For instance, the School Strike 4 Climate movement, inspired by Greta Thunberg, a 16-year-old elementary school girl from Sweden, continues to keep up the pressure on fund managers to try harder, and pay closer attention to climate change risk, especially if they are interested in doing business with Generation Z.

*Throughout this report, we cite icons that represent the 17 UN Sustainable Development Goals (SDGs). Many companies and investment firms have adopted the UN SDGs as guideposts for impact investing. For more information refer to page 20 of this report.

Climate Risk

- **Pope Francis asks - How Much Time Do We Have on Climate Change?**

Pope Francis and the Vatican issued a dire warning that time is running out on climate change. A Bloomberg news article by John Follain reported that the Pope delivered the Vatican's view on climate change to a gathering of oil and gas CEOs at the "Energy Transition and Care for Our Common Home" conference. The Pope emphasized that, "deliberations must go beyond mere exploration of what can be done and concentrate on what needs to be done from today onward.[3]

The communication emphasizes the existential threat of climate change, which calls for desperate measures. We must recognize that "we do not have the luxury of waiting for others to step forward or of prioritizing short-term economic benefits. The climate crisis requires our decisive action, here and now."[4]

Investment executives of BP, Exxon, ConocoPhillips, Sinopec, Eni, Total, Repsol, Equinor ConocoPhillips, and Chevron were among the representatives of 31 energy companies in attendance, with each attendee agreeing that "reliable and economically meaningful carbon pricing regimes …[are needed]…to significantly advance the energy transition while minimizing the costs to vulnerable communities and supporting economic growth." The conference highlights the role of private sector participants and religious leaders in addressing the challenges of climate change.[5]

2019 Basel Convention Offers a Brighter Future for a Cleaner Ocean

The United Nations member states have reached a legally binding agreement to amend the 1992 Basel Convention. The goal of the agreement is to reduce the amount of plastics washed into the ocean across the globe. Plastic waste remains a threat to ocean life, with an accompanying adverse impact to life on land, economies, and human health. The "Single-use Plastics: A roadmap for Sustainability, 2018" report states, "It is estimated that one to 5 trillion plastic bags are consumed worldwide each year. Five trillion is almost 10 million plastic bags per minute,"[6] with approximately 13 million plastic bags ending up in the ocean every year. This landmark agreement signals a brighter future for a cleaner ocean. According to Reuter's correspondent Tom Miles, the binding decision would "make global trade in plastic waste more transparent and better regulated, while also ensuring that its management is safer for human health and the environment."

Rolph Payet, the executive secretary at U.N. Environment for the Basel, Rotterdam & Stockholm Conventions, praised the landmark agreement, stating, "Pollution from plastic waste, acknowledged as a significant environmental problem of global concern, has reached epidemic proportions with an estimated 100 million tonnes of plastic now found in the oceans, 80-90% of which comes from land-based sources."[7]

Green Infrastructure Enhances Community Resilience

The severe threat of climate change continues to shape public policy discourse. Lower income and impoverished communities are the most vulnerable to the impact of climate change, and yet these communities lack the resources to build green infrastructure that would boost their resilience.[8] Green Infrastructure such as the storm water management project in the Hudson Valley of New York,[9] rain gardens (bioretention), bioswales, rainwater harvesting, urban tree canopy, vegetated roof, permeable pavements, and constructed wetland are examples of green infrastructure with potential to reduce the severity of climate change.

Since the severity of the climate crisis has become more widespread, solutions have shifted from mitigation to adaption, and now resilience. Climate resilience takes into account how individuals, communities, or businesses address stress associated with the results of climate change: heatwaves, drought, flooding, and hurricanes, biodiversity loss, and wildfires.[10]

As the impact of climate change becomes severe, certain cities across the United States have begun to integrate green infrastructure strategies. Given that green infrastructure remains a viable way to boost resilience, workers cooperatives and social enterprises could also potentially benefit by seizing the opportunity to both boost employment and reduce investment risk at the same time.

A Democracy Collaborative report by Johanna Bozuwa investigated how worker cooperatives and social enterprises are taking advantage of green infrastructure to provide real jobs to communities. Green infrastructure has environmental, economic, and social net benefits to the communities most vulnerable to climate change.[11] According to Bozuwa, the "buildout of green infrastructure projects could create new opportunities for social enterprises, mission-driven nonprofits with a fee-for-service component, and worker cooperatives, and democratically owned-and-operated businesses, to thrive." The report helps shed light on how community wealth-building enterprises could thrive when resources are put into green infrastructure resilience initiatives.

How Prepared is the City of Boston for a Climate Change Apocalypse?

An opinion piece by Bloomberg's Prashant Gopal and Brian K. Sullivan makes it clear that the City of Boston might not survive the wrath of catastrophic climate change tied to rising sea level and storms. Gopal and Sullivan noted Boston would be "vulnerable to rising sea levels and the fierce storms known as nor'easters… [B]y the end of the century, Boston Harbor could be 2 to 4 feet higher [in sea level] than it is now." The ability of cities and businesses to adapt and be resilient in the face of climate change will directly depend on their innovation, research, and development.[12]

According to Gopal and Sullivan, the City of Boston has begun to employ the necessary resources needed to adapt. Similarly, developers "are elevating ground floors, putting electrical and other critical equipment on higher ones, and investing in saltwater-resistant materials and flood barriers to protect garages and other vulnerable areas of buildings. Boston is planning a series of sea walls, berms, and other structures that will act as a barricade against Mother Nature."

The underlying question remains – How prepared is the City of Boston for a climate change apocalypse? Although Boston is striving to build resilience around its vital infrastructure, the answer to the question will not be known until the end of this century.

LBGTQ Rights and Diversity in the Investment Industry

The momentum surrounding the growing need for environmental, social, and governance (ESG) portfolios is one to acknowledge, especially when viewing ESG through a LGBTQ lens. Since the Stonewall uprising in New York City 50 years ago, when the LGBTQ community rose to defend their rights, communities, businesses and laws have evolved to increasingly embrace diversity. At the same time, the investment community has evolved as well, with a number of fund companies creating investment opportunities that take into account the needs and concerns of members of the LGBTQ community and their allies.[13] A fast transforming world can create opportunities for those aligning investments with core values.

A CNBC opinion piece by financial planner Stuart Armstrong noted that the list of investment opportunities available to LGBTQ investors has been expanding "in part reflecting changing attitudes inside and out of the financial industry but also a growing awareness of the importance of constructing financial products that will appeal to the concerns of LGBTQ investors."

Armstrong also notes that investment managers can help clients gain exposure to holdings that address multiple social concerns, including LGBTQ concerns. Nevertheless, there is no single prescription for issues that affect the LGBTQ community, since all investors are different. Some investors that focus on LGBTQ issues might choose to invest in portfolios based on LGBTQ criteria, while others want to donate to causes that address LGBTQ issues such as human rights, diversity, inclusion, or health. LGBTQ investors are taking a variety of approaches, helping broaden diversity in the investment space.

Can the Gender Equality Fund help Break Glass Ceilings?

Women will lead 33 Fortune 500 companies in June of 2019, up from 24 a year earlier, according to a Fortune news article by Claire Zillman.[14] Despite significant progress, the numbers are far from parity. Women continue to have a difficult time breaking through corporate glass ceilings.

A 2018 report by *2020 Women on Board* confirms that women held 17.7% of the board seats of companies in the Russell 3000 index in 2018, an increase from 16.0% in 2017. In 2018, the percentage of women in the largest companies as represented by the Russell 1000 index was 25.3%, while the percentage of women in the smaller companies as represented by the Russell 2000 index was only 13.0%, reflecting that smaller companies are less diverse."[15]

It remains a challenge for many companies and investment managers to improve their gender balance and reduce gender pay disparity. The Fidelity Women's Leadership Fund (FWOMX) is a newly launched mutual fund that is tailored towards addressing diversity and inclusion disparities within corporate offices. Gender equality funds seek to help investors deploy their assets into well managed companies that are addressing the glass ceilings problem, and are advancing women's leadership and development.[16]

Gender Equality Funds are increasingly relevant on Wall Street as the #MeToo movement[17] and the United Nations push for gender inclusion and equality.[18] At least one study suggests that such funds may be rewarded for their focus. A 2015 study from MSCI shows "companies with strong female leadership generated a Return on Equity of 10.1% per year versus 7.4% for those without (on an equal-weighted basis)."[19] The same study by MSCI showed "companies lacking board diversity tend to suffer more governance-related controversies than average."[20] Although the percentage of female CEO's and board members continues to very low, investment funds that specifically address these glass ceilings might be a push in the right direction.

A Push for Exxon to Separate Board Chair and CEO Positions

Investors continue to pressure companies on how they conduct their business, demanding more effective structures that can lead to fewer conflicts and better decisions. In order to push ExxonMobil to improve its governance, the New York State Common Retirement Fund (NYSCRF) and the Church Commissioners for England will support a shareholder proposal requiring the ExxonMobil "board chair to be an independent member of the board,"[21] effectively separating the roles of Chief Executive Officer and Board Chair.

The New York State Comptroller, Thomas P. DiNapoli, and Edward Mason, Head of Responsible Investment for Church Commissioners for England (CCE), announced their support in a joint statement. NYSCRF and CCE are both signatories to Climate Action 100+ (CA100+), "an investor initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change."[22]

According to DiNapoli, "When the CEO serves as board chair, it not only presents an inherent conflict of roles, but also a warning sign of bad corporate governance as it raises serious questions that the board may be merely a rubber stamp instead of providing genuine oversight."[23] In their move to compel Exxon to improve its governance structure, NYSCRF and CCE join other "benevolent bullies" in the CA100+ that are using a carrot and stick approach to push for positive change.

Proxy Voting: An Indicator of Companies' Commitment to the ESG

Investment funds that are "sustainable" or "socially responsible" may invest in companies that perform well when measured along environmental, social, and governance criteria, but they may be missing out on the opportunity to influence company management, speak out about controversies, and demand change when societal trends require more responsive leadership. These funds may only be using half of their toolkit, since their shareholder voice can push for change, and demand greater accountability from a company's board and its senior management.

A recent article by Calvert AVP and Shareholder Engagement Assistant Manager, Shirley Peoples, described how an investment company's proxy voting records could serve as an indicator of the firm's commitment to the ESG.[24] For instance, a 2017 Barron's article, "Fund Sustainability Ratings Tell Half the Story", highlighted an investment firm that managed a socially responsible fund with a good ESG rating. However, rather than support shareholders' proposals for greater "climate change risk disclosures, board diversity, and gender pay gaps,"[25] the firm voted alongside management—resisting the proposed changes.

According to Peoples, "Environmental issues have long been a focus of Calvert's corporate engagement agenda. Calvert has engaged with companies in areas like climate change, greenhouse gas emissions, water conservation and development of renewable energy sources, among others. In the most recent 2018 proxy season, on proposals related to climate change, Calvert voted for the proposal 100% of the time. Each was contrary to management's recommendation. A vote not aligned with management is significant since corporations typically seek to maintain the operational status quo."

In a Poker Game of Proxy Voting, Mark Zuckerberg Holds All the Aces

A modern-day Don Quixote recently tried tilting at a governance windmill. Shareholders, led by the organization SumOfUs, recently demanded a change in Facebook's "dual-class voting structure," an initiative that was doomed to failure from the outset. Mark Zuckerberg, the founder and chairman of Facebook, holds all the aces in this card game. His control is a direct result of the very dual-class voting structure that SumOfUs is seeking to eliminate. A Bloomberg news article by Kurt Wagner and Paula Dwyer described how "Zuckerberg has monopoly voting power. He controls 88% of these more powerful shares, which gives him nearly 58% of Facebook's voting power."[26] Although the initiative has raised awareness of the issue, it will not change the class structure unless SumOfUs can either convince Zuckerberg to do so out of the goodness of his heart, or convince him to sell his shares. External pressure will not be able to change the Facebook leadership structure, or Zuckerberg's control, as long as the main shareholder continues to hold all the aces.

Barriers to Diversity and Inclusion

Investors continue to be concerned with diversity and inclusion when viewing their investment portfolio along environmental, social, and governance (ESG) metrics. Global trade and cultural discourse are making it increasingly essential for individuals, corporations and nonprofit organizations to interact and interface with each other regardless of culture, beliefs, and backgrounds.[27]

Successful adaptation to this diverse world offers the benefits of a higher financial return, attracting and retaining top talent, heightened creativity and productivity, and improved cultural insights. A 2015 study conducted by McKinsey & Company confirmed that, "companies in the top quartile for gender diversity were 15% more likely to have financial returns that were above their national industry median, and the companies in the top quartile for racial/ethnic diversity were 35% more likely to have financial returns above their national industry median." [28]

Companies, especially in the technology sector, still find it challenging to increase their diversity, even when the benefits of diversity are not disputable. A Bloomberg interview by Scarlet Fu with Liz Fong-Jones noted how the lack of diversity in the technology industry results in a tremendous opportunity cost of lost talent, and how the industry could address its lack of diversity. According to Fong-Jones, "the technology industry has not done well to increase its diversity across the board," especially in the inclusion of employees in companies' structural decisions, and should rethink how their actions are harming employee success and creating barriers for hiring talent.[29]

Shareholders have recently focused on forced arbitration as a key impediment to shifting a tech company's culture away from a pervasive "Bro" culture, a culture that may turn a blind eye to sexual harassment. By ending forced arbitration, investors may gain greater insight into a company's exposure to bad actors.[30] Increased transparency could hold management accountable, encourage action to reduce litigation risk, result in a more sustainable work environment, and foster a culture that is better able to attract and retain top talent.

Investors Call for Disabilities Inclusivity in Corporate Hiring Process

Disability is often perceived by hiring managers as a barrier to work performance, reducing the ability of disabled individuals to adapt to a company's fast-paced environment and culture. A Bloomberg news article by Andrea Vittorio noted that institutional investors and pension funds with over $1 trillion in assets are calling on companies to hire talented individuals with disabilities to increase their inclusion and diversity initiatives.[31]

Tobias Read, Oregon State Treasurer, noted that "companies that embrace disability inclusion in the workplace benefit from increased innovation as well as profitability." Although it might be a hurdle for companies to break barriers associated with hiring individuals with disabilities, there is evidence that it might be well worth the effort. A study by Accenture found that companies that "offered the most inclusive working environment for disabled employees achieved an average of 28% higher revenue, 30% greater economic profit margins, and twice the net income of their industry peers between 2015 and 2018."[32]

Is there a correlation between Higher Drug Prices and Executive Pay?

As environmental, social, and governance (ESG) criteria becomes mainstream, shareholders are not only concerned with how their investment portfolio aligns within their values, but also how individual companies are conducting their business. Within the healthcare sector, investors are addressing the issue of lack of transparency regarding executive pay increases, as well as the rise in cost of prescription drugs.

A Proxypreview opinion piece by Cathy Rowan described how pharmaceutical companies have relied on drug price increases to drive growth. For example, price increases for Pfizer's nerve pain medication Lyrica drove 90% of the more than $1 billion in sales growth Pfizer recorded for the drug between 2014 and 2017. Investors are looking into whether there is a correlation between these product price hikes and executive pay increases.[33]

According to Rowan, hiking prices of prescription drugs to drive business growth and executive pay increases is "unsustainable," and ultimately hurts public health. In addition, the practice may boost the legal and financial risk of pharma companies that are overly reliant on price hikes to generate revenue growth.

EU Releases Guidelines on Sustainable Finance

The European Commission has released guidelines known as the Sustainable Finance Action Plan (SFAP), with the goal of helping companies and their managers report on how their business activities are directly or indirectly contributing to climate change problems and solutions. According to the Commission, SFAP "guidelines are part of the Commission's ongoing efforts to ensure that the financial sector–private capital–can play a critical role in transitioning to a climate-neutral economy and in funding investments at the scale required."[34]

The Commission also highlighted three important reports on sustainable finance, which focus on areas that are essential to understand climate change dynamics. The reports outline tools that can help businesses and individuals better adapt and build resilience to the impact of climate change. The three areas are:

1) classification system – or taxonomy – for environmentally-sustainable economic activities;
2) EU Green Bond Standard; and
3) EU climate benchmarks and benchmarks' ESG disclosures.

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UN Sustainable Development Goals (SDGs)

We cite the 17 UN Sustainable Development Goals (SDGs) throughout these investment highlights. Many companies and investment firms have adopted the UN SDGs as guideposts for impact investing.

The UN provides the following perspective on the SDGs:

The 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, provides a shared blueprint for peace and prosperity for people and the planet, now and into the future. At its heart are the 17 Sustainable Development Goals (SDGs), which are an urgent call for action by all countries - developed and developing - in a global partnership. They recognize that ending poverty and other deprivations must go hand-in-hand with strategies that improve health and education, reduce inequality, and spur economic growth – all while tackling climate change and working to preserve our oceans and forests..

https://sustainabledevelopment.un.org/?menu=1300

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