It’s Time for ESSG

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If you needed proof that ESG wasn’t going away, it’s the huge strides that have been taken in the space even against the backdrop of Covid-19 lockdowns and cancelled or curtailed annual general meetings (‘AGMs’).

Equity owners and activists have come together to drive a revolution in stewardship that has seen a number of headline-grabbing resolutions passed. In the UK, Barclays bowed to pressure on climate targets, while in Japan, Mizuho was taken to task for its coal investments in the first ever such resolution in the country.

US oil giant Chevron was told by shareholders in May that it needed to disclose how much it spent on lobbying, as well as how the firm intended to comply with Paris Accord goals. The motion passed, with 53% of shareholders in favour – impressive for a resolution which management was set firmly against.

Exxon managed to have a similar resolution struck from the bill of its May AGM, but you get the feeling it’s a matter of time before they too face the fact that climate change has been established definitively as the primary source of engagement between shareholders and companies.

We expect the 2021 AGM season to be dominated by more resolutions of this kind, as momentum in ESG continues to grow, with the possibility that social issues such as labour rights and worker protections are elevated alongside climate goals as a result of the focus on employee welfare during the Covid-19 crisis.

Collaborative engagement between equity investors has transformed the face of stewardship in recent years. Where once ethical investors were largely voiceless and fragmented, organisations like the PRI, ShareAction and Client Earth have provided a point of coalition, enabling many diverse investor groups to speak with a more powerful and collective voice when it comes to sustainability and other ESG-related issues.

The challenge now is to deepen and extend this engagement, so that it takes in all aspects of the investment universe, not just long-only equities. Indeed, the Financial Reporting Council, in the UK Stewardship Code 2020, advances the notion of stewardship beyond equities to other asset classes like fixed income, real assets and more.

At Man Group, we supported the recent Barclays resolution and continue actively to drive engagement on ESG issues at the more than 1,500 management meetings we have each year.

However, while traditional long-only funds have an established track record of successfully compelling change through shareholder revolt and resolution, only a fraction of Man Group’s business is long-only.

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The practicalities and expectations for other investment strategies are generally far less clearly defined when it comes to ESG, and our fellow hedge funds are still able to claim that considerations around sustainability and responsibility ought not to apply to their operations (as illustrated in a recent AIMA and KPMG study, which showed that 85% of hedge funds had made little or no effort to incorporate ESG into their strategies).

Hedge funds generally take their exposure to equities in synthetic form because of the lower transaction costs and therefore forgo their voting rights.

When it comes to credit, long-short equities, EM and, particularly, quantitative investing, the template for stewardship remains ill-defined in the asset management industry more broadly.

We have addressed this by adopting a top-down approach to stewardship, so that initiatives undertaken at the firm level filter down to individual investment engines.

We have sought to create feedback loops between senior management and individual portfolio managers so that there is a consistent and coherent approach to achieving ESG targets, and so that different elements of the business, which may hold different parts of a company's capital structure, approach engagement in a joined-up fashion.

This feedback loop means that best practice at a fund level is centralised and then adopted firm-wide, while all funds are held to these enhanced standards. It's a model that we believe puts stewardship firmly at the centre of our investment philosophy and permeates throughout the firm's investment strategies.

Indeed, often when we speak about ESG internally, we add an extra 'S', so that stewardship, rather than just being a subset of the 'G' of governance, takes its place on the ESG podium. This elevation is a recognition of the fact that while shorting, divestment and exclusion lists all have their place in any integrated ESG strategy, it is genuine stewardship – dialogue, voting and shareholder resolutions – that really makes a difference when it comes to changing behaviour and changing the world.

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Stewardship means using the seat you have at the table to force management teams to focus on the issues that matter.

Pivoting our understanding of responsible investment so that ESG becomes ESSG highlights some of the circularities in traditional ESG thinking. ESG funds place their money in firms that already score highly when it comes to ethical metrics (or are already on positive trajectories when it comes to ESG scores).

Stewardship is more ambitious and transformational in its goals. It seeks both to push those firms that are performing well in the space further and faster in their ESG targets and, particularly, to drive radical change at firms who are laggards in the space.

It is the self-realising process that enables management teams and boards to be the agents of change, or they will be voted out and replaced with those who understand that inaction on ESG is no longer an option.

Perhaps we don't expect the investment world to adopt our new moniker wholesale, but we do hope that our fellow hedge fund managers will begin to hear the whisper of a second S behind the S for Social in ESG, one that reminds them of the importance of driving genuine change in the companies in which they invest.

And we hope that soon we will see other multi-strategy managers, hedge fund managers, and firms from across the investment spectrum adopt the same top-down approach to their stewardship initiatives, so that the whole asset management industry moves forward together to face the environmental, social and governance challenges of the coming years.

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Robert ('Rob') Furdak is Chief Investment Officer for Environmental, Social and Corporate Governance ('ESG') of Man Group. He is responsible for overseeing all aspects of Responsible Investing across Man Group's five investment engines. Rob serves as the chairman of the Man Group Responsible Investment Committee and is a member of the Man Group Executive Committee. He also serves on the United Nations supported Principles for responsible Investment (PRI) Macroeconomic Risk Advisory Committee.Rob was previously the Co-Chief Investment Officer at Man Numeric and Chairman of Man Numeric's Investment Committee. In that position, Rob led the ESG initiatives and oversaw all aspects of the investment process. Rob joined Man Numeric in 1997 as Director of International Strategies and designed and launched Numeric's first non-US strategies. Before joining Man Numeric, Rob was a Principal in the Active International Group at State Street Global Advisors. During his eight years there, Rob performed global quantitative research and was the principal architect of State Street's active emerging markets investment process. Previously, Rob worked at Harvard Management Company.Rob holds a Bachelor's Degree in Finance from the University of Michigan and an MBA in Finance from the University of Chicago. He is also a CFA charterholder.

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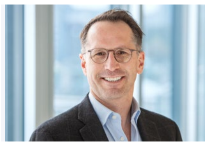

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