How ESG can lead to long-term value for all investors

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In March 2023, the Intergovernmental Panel on Climate Change (IPCC) cautioned in a report that a groundswell of aggressive actions on emissions is required to curb widespread instability. The IPCC's perspective is one more call to action for investors who want to mitigate environmental risks, an important component of Environmental, Social and Governance (ESG) investing, in their portfolios. **Bernard Walsh, Head of Pensions and Investments Bank of Ireland Life**, talks to **Barry O'Leary, Vice President and Client Relationship Manager at State Street Global Advisors (SSGA)**, about the importance of considering ESG criteria in investment decisions.

BARRY, can you tell us why SSGA believe that ESG matters for investors?

State Street's mission is to create better outcomes for the world's investors and the people they serve. We invest responsibly to enable economic prosperity and social progress. As a fiduciary, we have an obligation to put our clients' long-term interests first, and our fiduciary duty is our most important responsibility.

To be effective in fulfilling this obligation, we need to consider material ESG factors, or those that we believe can impact portfolio performance.

What are some of the ways that ESG can effect longterm value for investors?

There is a long list of ESG factors that could impact longterm investment performance. For example, with the "E", or **environmental** factors, a company's readiness to meet the regulatory, physical, and reputational challenges related to climate change can be important for risk and return. A company with a plan to reduce its emissions and meet targets for resource usage may be more resilient to energy shocks or more prepared for the global climate transition.

With the "S", diversity, including gender balance, is a **social** issue, and its importance is supported by studies that show diverse teams (such as company boards) generate better ideas and have stronger long-term performance.

Finally, with the "G", companies with weaker **governance** could be more likely to be flagged for executive compensation, corruption, or political contribution concerns.

We believe that considering ESG factors is predominantly about long-term value creation. Rather than seeing it simply as a standalone offering, we've found that the assessment of material ESG issues during the investment process enriches traditional research like analysing financial statements, industry trends, and company growth strategies.

Could you give us more insight into how ESG is addressed by SSGA?

ESG now represents a significant amount of the assets we manage. Out of the €3.4 trillion SSGA managed at the end of Q1 2023, **over €440 billion is managed in ESG strategies.**

Each investment team has dedicated ESG specialists. Additionally, we have a team of 20 experts focused exclusively on ESG research, strategy, and operations. These teams work closely with the individual investment teams on product development, and with clients to help them achieve their ESG objectives.

We also have a dedicated Asset Stewardship Team of 17 professionals who focus exclusively on engaging with companies on ESG issues that we believe can have a significant impact on clients' portfolios over the long-term. At SSGA, we use our voice and our vote to encourage portfolio companies to take material ESG issues like gender diversity and climate change seriously.

What are some of the more common ESG investment approaches?

Clients' risk tolerances and goals vary, and ESG investing can be performed in various ways, such as exclusionary screening, tilting, thematic investing, or integration. Some clients may wish to support solving social or environmental problems, or ensure that their investments reflect their core beliefs. Others may aim to mitigate risks in portfolios from the global decarbonization pathway, the stricter ESG regulatory landscape, the reputational challenges that can amass in portfolios, or other risks. ESG strategies, therefore, are not one-size-fits-all.

However, in our view, as long-term holders of the companies in which we invest on behalf of our clients, divestment is not always an adequate option for investors. Rather, we believe that in many instances, engaging with companies to optimise their operations and disclosures can be an impactful strategy for mitigating risks posed to clients' investments, as well as capturing potential opportunities that may exist. We refer to this as Asset Stewardship (see below for more).

Could you expand on the various ESG investment options for passive investors?

Yes. Let's look at Bank of Ireland Life's **PRIME Funds (PRIME)**. It predominantly uses passive building blocks, and ESG is incorporated in three distinct ways.

- First, **Exclusions**. Two common exclusions - which are applicable to the vast majority of the equity exposure of **PRIME** - are controversial weapons and violators of the UN Global Compact.

- Second, **Tilting** is an ESG technique that is often used in addition to exclusions. For instance, MSCI, the index provider, rates Meta (the parent company of Facebook) as an ESG laggard, and its ESG rating has deteriorated since 2019. Corporate behaviour and privacy and data security were two of the key areas in this assessment. This has resulted in Meta's weighting being reduced. The recent fine issued by Ireland's Data Protection Commission, on behalf of the EU, of €1.2 billion is a clear example of how poor corporate behaviour and governance pose real financial risks.
- Finally, **Asset Stewardship**, is a critical ESG tool. As one of the world's largest asset managers, we engage with companies' boards of directors and senior management teams on key ESG issues. One of the most impactful uses of our influence has been our calls for gender diversity among board members at our portfolio companies. Since March 2017, 1,027 of the 2,146 companies we identified with all-male boards have responded to our call to improve gender diversity, as part of the SSGA Fearless Girl campaign, by adding at least one female director, and every company in the S&P 500 now has at least one woman on the board[1].

When specifically addressing the climate challenge, our preferred approach is to use Asset Stewardship to influence our portfolio companies' strategic direction. For instance, Exxon had been lagging its peers in relation to addressing climate-related transition risk and investing in renewable energy. We leveraged SSGA's significant voting power, in conjunction with other longterm investors, to appoint three new external directors that had either expertise in climate transition strategies, renewable energy, or both, to join Exxon's board. These were shareholder nominations, not candidates that the Exxon board had proposed. Had SSGA and other companies simply divested, this outcome may not have been achieved.

Finally Barry, what are the three things you think are important for people to know about ESG?

First and foremost, Bernard, I think we need to stop seeing ESG and returns as a trade-off and instead see ESG as an investment tool.

Secondly, implementing ESG does not mean you need to take on additional active risk. We have many indexed products that integrate ESG. Index funds perform very well and are cost-effective; you can still maintain these advantages and integrate ESG.

Thirdly, scale and expertise are important to implement ESG effectively. We managed our first ESG mandate in 1985 and have invested heavily to build a strong capability to offer clients quality and cost-effective ESG options.

[1] Source: SSGA, S&P. As at 31 December 2022.

	What is it?	Where is it used?
Exclusions	Exclusions based on specific companies, sectors or countries based on ESG factors or risks.	▸ Developed and Emerging Market Equities ▸ Emerging Market Debt ▸ Short Dated Corporate Bonds ▸ Corporate Bonds
Tilting	Increasing or decreasing weights based on ESG scores.	▸ Developed Market Equities ▸ Short Dated Corporate Bonds Emerging ▸ Market Debt
Asset Stewardship	Active ownership, board engagement on key ESG issues.	▸ Equities

To find out more about how ESG is applied to Bank of Ireland Life's **PRIME Funds**, visit **Fund Centre** and **Sustainable Investing Hub** or talk to the Advisor in your local Bank Of Ireland branch.

Warning: If you invest in these funds, you may lose some or all of the money you invest.
Warning: The value of your investment may go down as well as up.
Warning: These funds may be affected by changes in currency exchange rates.

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