

ESG: From Evolution to Revolution

Disruptive Forces in Investing

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Anu Rajakumar: Environmental, social, and governance, or ESG factors, are a significant consideration for investors today. And here at Neuberger Berman we're deeply committed to thoughtfully integrating ESG across our broad investment platform. As ESG investing prominence grows governing bodies around the world are building regulatory frameworks to promote transparency and safeguard investors. Nevertheless, there are plenty of skeptics. Investors may worry that they will compromise potential returns for the sake of ESG. But at Neuberger Berman we reject that notion. And my guests today are here to explain why. My name is Anu Rajakumar, and joining me from London are Sarah Peasey, head of European ESG Investing, and Jeroen Brand, Portfolio Manager for the Global Sustainable Equity Strategy, joining me from The Hague. Sarah, Jeroen, thank you so much for joining me today.

Sarah Peasey: Thanks, Anu. It's a pleasure to be here.

Jeroen Brand: Thanks for having us, Anu.

Anu Rajakumar: So, as I've mentioned ESG has grown tremendously over the last few years. But let's step back for a second and talk about how the concept of ESG investing got started, and how it evolved to where it is today.

Sarah Peasey: Yeah, absolutely, Anu. I'll, I'll take it from here. So, I guess using the idea of history and, and ESG in the same sentence I think will come as a surprise to a lot of people given the prevalence that we've seen of ESG, and what more so in recent years.

And it feels like a relatively new phenomena to hit financial markets. But I guess the reality is it, it really isn't. I think ESG has broadly always impacted how, how we invest and, and manage capital. Particularly when you come at it from, from a G perspective, so the G of, of ES and G investing. To actually invest in a well-governed company with say like a very stable management team is ultimately fundamental to the long term uh, sustainability of, of any capital that we manage.

So conceptually ESG as a tool is, is not new. However, what has changed of, of course is the labeling of, of product. And I'm sure many listeners would have come across SRI investing, or, or avoidance screens in the past. And these were all very early manifestations of ESG. And Neuberger Berman themselves in fact, we, we actually applied avoidance screens all the way dating back to, to the early 1940s.

But assets and ESG product today have absolutely soared. So, I think today we're standing at about 35 trillion. And, and that accounts for nearly a third of, of all the assets that, that are managed professionally from a bank and an investment fund perspective.¹ So it's enormous. Um, an, and the increase in product can be highly correlated to the prominence in, in a lot of these big global challenges that I'm sure we're going to be discussing today around climate change, and net zero, and the UN Sustainable Development Goals even. But if we just look at climate alone there is something like 800 purely climate orientated equity funds globally now, which is an absolutely staggering number. So, you can understand why this had led to greater regulatory scrutiny. And, and I think it's fair to say that the regulation is, is never necessarily an initiator of change. But it's often a tailwind when it comes to historical shifts or even like events that impact the financial sector. And this is exactly what we're seeing now through the likes of the Sustainable Financial Disclosure Regulation in Europe or SFDR as a lot, a lot of people more commonly term it.

Anu Rajakumar: Yep, perfect. Thank you very much. That's, that's very helpful, good overview. You mentioned, Sarah, you know, "Greater regulatory scrutiny," you mentioned, "SFDR," one of the European mandates coming through.

¹ Source: Global Sustainable Investment Review 2020, all assets reported as of December 31, 2020, except for Japan which reports as of March 31, 2020

And as I mentioned the opening, a number of governing bodies around the world are really trying to figure out the right frameworks for ESG practices. So maybe if you could expand upon that Sarah, tell us a little bit more about these regulations, and what adjustments you think could come of these changes to policy?

Sarah Peasey: Yeah, so look, if we just focus on SFDR for the moment, this actually started to really gather momentum back in 2018. And the EU first laid out the sustainable finance plan. And this had three pillars. The first one was to reorientate capital to, towards sustainable investments. The second was to manage financial risks uh, associated with, with climate change, so the likes of, of stranded assets. And the third was to foster greater transparency and long-term investment. Now, there has been various pieces of legislation that's, that's dropped off of each of those buckets over the years since. But by far, the biggest has been SFDR and possibly it, it's one of the biggest pieces of regulation that we've actually seen in the financial sector more broadly since the introduction of, of MiFID II. So, so SFDR sits in this last bucket as, as I mentioned uh, around transparency. But there are another two components that we do have to mention that, that sit alongside SFDR. And that is um, around corporate sustainability disclosure, and also the EU taxonomy, which many listeners um, may have heard of. But how is this affecting us I guess is the most important question. And look, the purpose of SFDR is this idea of greater transparency. Um, and what is going to come out of that is, is, is more reporting uh, for, for one. But also, this idea of, of product labeling, and it, it's currently only affected products in the EU, ex the UK. But products are being accredited with uh, a designation. And this can range from an article six, an article eight or an article nine.

And article six being a fund, which isn't promoting ESG, and so couldn't be necessarily considered sustainable. Then you've got article eight, where it incorporates a more binding element of ESG into the decision-making process, and that's where a lot of product is now sitting within the EU. And then you have article nine. And this is where there is an actual explicit sustainability objective being built in. And asset managers more broadly did release sort of their designations earlier this year. And as many listeners have probably seen, it did provoke quite a lot of media scrutiny. And there were accusations of green washing that had been branded about. And I think that was inevitable in many cases because this ultimately was the first attempt by any regulator globally to, to even put a label on sustainability. And we haven't even seen yet what the SEC in, in the US is, is planning to do. So, there are going to be bumps in the road. Um, but I, I don't think we can lose sight of the purpose of SFDR. And, and as I mentioned at the start this was to foster greater transparency and consistency to, to support end investors' decision making.

Anu Rajakumar: Yeah, terrific. Thank you very much. You know, Sarah you touched on some important topics here. The, the regulation, you know, this is about transparency, better reporting, avoiding green washing, et cetera. Jeroen, maybe to turn it over to you now, you're a portfolio manager on the Global Sustainable Equity Strategy at Neuberger Berman. Your team has been investing with this ESG lens for a long time. What have you done over the years to change or accommodate this growing interest and focus on ESG? What are some insights from your position as a portfolio manager?

Jeroen Brand: Yeah, well as you said we have been doing this for, for quite a number of years. Our strategies have been around for the better part of 20 years. And I think our approach throughout the years has been roughly the same. If you have a very strong competitive position today, but you're not able to change uh, also to societal demands then ultimately, it's going to impact your competitive position. So, it's always been core to what we do. Um, but of course there has been involvement in terms of the data that we have available at our fingertips. In the past, it was more about just exclusions or, or uh, ESG scores based on policies. But in recent years, you see that those scores are also taking into account company exposures, and how they manage those exposures. And from that perspective the data has already more come to how we look at the world.

So from that perspective, it's becoming more aligned. In terms of transparency, what the regulation is all about, reporting and transparency, I think it's also quite helpful that a cornerstone of our investment process is company engagement. So even if the data might not be available, just by engaging with companies throughout time and see how they develop in terms of how they manage their company, that already gives you a lot of insights in whether they really mean it and really want to be sustainable.

Anu Rajakumar: You know, Jeroen, you mentioned engagement and we've spoken a few times about the need to avoid green washing. Would love it if you could just share an example of an engagement that your team has done, and maybe some of the outcomes of that engagement.

Jeroen Brand: Sure yeah, green washing is indeed if you label a product differently from what you're actually doing. Or if you want a certain sustainability label and, suddenly, you change the way you operate. And indeed, engagement is a key aspect just to find out how sustainable a company is indeed operating.

A recent example is for instance that we spoke to uh, a salmon farming company from the Faroe Islands called Bakkafrost, which is a medium sized company. So they didn't have a lot of resources to do a lot of reporting on ESG and sustainability. But by engaging with the company, we did know that they were operating in a very sustainable fashion. And of course that's also crucial to their business model given that you're growing a natural product. But we also stimulated them to start reporting more on it. Since we engaged, the company did start issuing an ESG annual report, and they also hired people to specifically facilitate the reporting on ESG aspects.

Sarah Peasey: So, if, if I could just add to that in recognition of the crucial role that, that engagement actually does play, last year we, we launched our, our NB Votes Initiative. And through the initiative we actually publish our vote intentions in advance of select shareholder meetings. And we think it is really important to give companies the sight ahead of our vote as to what our concerns are with regards to specific votes. And allowing us to share our analysis uh, and expectations on a variety of matters is, is, is ultimately what, what we wanted to do, and, and, and vitally important. So very much we recognize the importance of engagement to our clients in really seeking to get this additional layer of granularity. And see where engagement ultimately is adding value with their investments.

Anu Rajakumar: Fantastic, well thank you very much for that Sarah. As we start to wrap up here, would love to get your final thoughts on what you think the outlook is for achieving the goals that have been set out for these regulations? You know, is this feasible, achievable? What work needs to be done, and do you think the investors globally are really on the right track?

Sarah Peasey: Yeah, so I guess, if I just focus on, on Net Zero by 2030 um, in this instance and uh, of course achieving this goal is, is hugely aspirational. And it's going to require substantial changes uh, across the global economy, which ultimately uh, filters down to, to investment solutions that we manage. And this will be a challenge from an investment perspective because there is no historical precedent for, for climate change. And the modeling that we are working with is, is definitely going to be sensitive to, to assumptions that, that are going to change in, in the near future. But look, of course where we are today and where we will be in, in five years' time will look very different.

And arguably the, the abrupt shutdown that we saw of the global economy over COVID gave us an insight into what a disorderly transition could really look like. And, and we saw the price of oil plummet. And the world was ultimately grounded. But it's going to be a very long journey, and there are going to be some real hard yards ahead. But the recent introduction of, of SFDR, and the imminent roll out of the taxonomy in, in my opinion I think will only galvanize how we're able to, to quantify climate risks. And further allow investors to properly discern how they want to allocate capital. But undoubtedly the asset management industry has such a pivotal role to play, and a huge responsibility really to get this right. And one for me, I personally feel very privileged to ultimately be a part of.

Anu Rajakumar: Jeroen, what about you? What, what are your thoughts on the ESG investment landscape going forward?

Jeroen Brand: Well, I think um, as I described our, our approach has been roughly aligned with, with where the uh, regulations are moving to. And I think the big challenge will be more on the data side. Um, there is lots of targets being set, and reporting requirements will, will come. But ultimately, it's dependent on the data availability. I think we can be confident given our quality focus that our holdings will, will stick up pretty well uh, once get to the reporting phase. But having the data available will be key there.

Anu Rajakumar: Terrific, thank you. Now I do have a bonus question for both of you. How do you incorporate sustainability into your own daily life?

Sarah Peasey: Great question, and actually it was, it was something I did recently look at cause, I've obviously recently joined Neuberger Berman. So, I was consolidating all of my pension assets. And it was an opportunity to actually see what I was really invested into. And I did take the opportunity to reallocate to, to some sustainable funds. So yes, it's something that I've definitely been looking at from a financial perspective. But more personally, my husband gets frustrated with me on a daily basis when I'm taking things out of different bins and putting them in other bins just to make sure the recycling is, is all in the right place. So yeah, look I try to walk the walk and talk the talk. But look no, nobody is perfect, right? And I, I don't want to pretend to be.

Anu Rajakumar: That's great, I know I'm the same way with making sure everything is in the right bag. So, I'm on the same page with you on that one. What about you, Jeroen?

Jeroen Brand: Yeah, well in the Netherlands we are also quite fanatic about separating garbage. But on top of that, I had the privilege of starting to drive an electric car pretty early on. So I have been through all the range anxiety with just being able to drive 100

kilometers and being really conscious about where you go and when you go there. And still drive an electric car, which has a much wider range now – nowadays. So that was my contribution I would think.

Anu Rajakumar: That is terrific. Thank you very much uh, for sharing uh, some stories there, and uh, and really just for all of your comments on what was a, a really terrific conversation. I do hope that our listeners takeaway a better understanding of where ESG investing has come from, and, and what direction it's heading in. Sarah, Jeroen, thank you very much for joining me today.

Sarah Peasey: Thanks, Anu.

Jeroen Brand: Thanks, Anu.

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