HIGH MEADOWS INSTITUTE

ESG in a Post COVID-19 World

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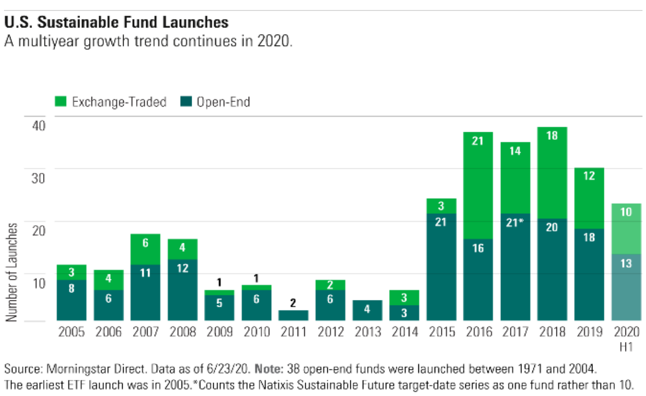
ESG perspective on the Wirecard scandal

Could ESG scores have predicted the scandal? **Moral Money** analyzed Wirecard's ESG scores and found that the company received an average score by several data providers that missed the red flag. Consequently, some ESG ETFs held Wirecard stock. An outlier is DWS's ESG fund, which saw the red flag in April and sold its stake in Wirecard. [July 1st] **Truevalue Labs** pushed the analysis further and looked at the history of Wirecard's ESG scores. They noticed a steady decline in ESG scores following negative news. They also mentioned that several data providers did not see the red flags because they "rely on self-reported data as a key ingredient in ratings." Truevalue Labs concluded that timely data, dynamic materiality and ESG controversies can provide early signals to investors and for credit risk analysis. [June 29th]

ESG investment constraints for employer-sponsored retirement plans: US increasingly out of step on ESG

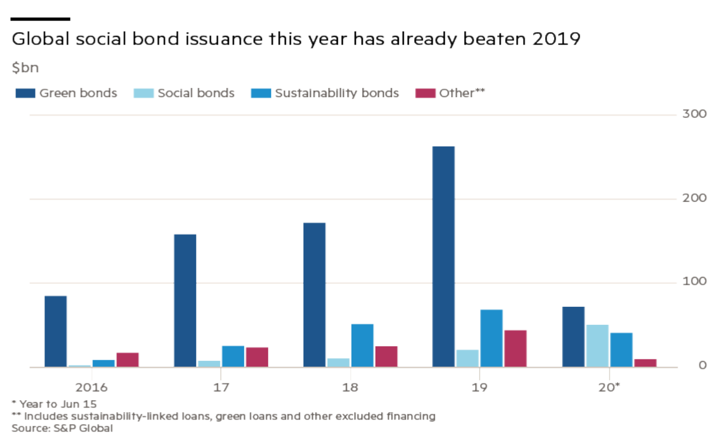
As the evidence in the following section shows, ESG funds continue not only doing well, but doing better and even outperforming non-ESG funds. Yet, the **Department of Labor** proposed a new rule that would limit certain retirement plan fiduciaries' ability to invest in ESG considerate funds, as they would have to prove that these ESG investments are expected to generate a return at least as high as similar non-ESG investment options, which would increase the burden for fiduciaries. This requirement is odd considering the recent market-beating investment performance of ESG funds. In **Responsible Investor**, two US sustainable bodies say that it limits access to ESG investment, and the rule is "a clear step in the wrong direction." [June 25th] An article in **Forbes** also further analyzes the issue and encourages investors, academics and others to speak up against and comment on this proposed rule. [June 25th]

ESG investment market going strong



2020 might be on course to be a record-breaking year for the ESG investment market despite the pandemic, as the high interest for ESG funds and companies continues. The outperformance of most of the ESG funds is likely to have triggered this market reaction. After a record level of flows to ESG funds in the first quarter, **Morningstar** now forecasts a record number of new ESG funds in 2020. In the first half of 2020, 23 new funds were launched, and 20 funds are in registration at the SEC. [June 24th]

The issuance of social bonds is following a very similar path to ESG funds. Also in the first half of 2020, $50bn of social bonds were already sold, which is more than twice the amount sold in 2019. Nevertheless, the social bonds market is not as mature as the one for green bonds, which opens the door to "social washing," as noted by analysts in **FT**. Indeed, they report that the proceeds of COVID-19 social bonds issuance are too vague in some cases, due to a low level of clarity and compliance with guidelines compared to green bonds. [June 30th]

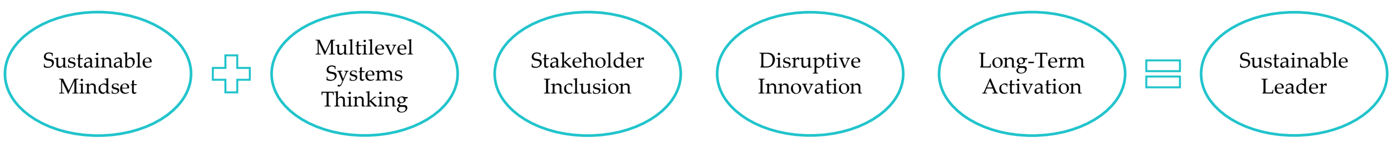


Good governance? Good performance!

It does not come as a surprise that well-governed firms outperform their counterparts, yet the latest evidence is striking. JUST Capital found that acting ethically at the leadership level, following laws and regulations, avoiding corruption, following a code of conduct, fostering board diversity and generating returns for investors indeed pays off. According to their analysis, those companies with the highest scores for shareholder issues performed much stronger during the past year. Compared to companies within the sample's lowest quintile, the results present a significant difference of around 3%. [June 25th]

The leadership role of boards has been amplified lately, and will evolve as we learn lessons from this crisis and slowly steer our way out of it. In collaboration with **Forbes**, the **World Economic Forum** presented a *six-point leadership agenda* for boards to understand how they can translate the principles of stakeholder capitalism into practice, remain competitive and become fit for future challenges. The outlined priorities are: #**1**: Align strategy and capital allocation with drivers of long-term value creation, #**2**: Internalize material ESG factors in addition to material data stewardship factors in enterprise risk management, #**3**: Strengthen preparedness and resilience to crises and systemic shocks, #**4**: Engage the firm in cooperative efforts to strengthen its operating environment, #**5**: Prepare the company's mainstream reporting in an integrated manner, #**6**: Adapt the Board's organization, composition and engagement to these imperatives. [June 24th]

Achieving a sustainable future essentially requires that sustainability is embedded in leadership expectations and culture. However, an analysis by **Russell Reynolds Associates** and **the United National Global Compact** found that this is currently not the case. Yet, what sets apart sustainable leaders, what makes them different? The authors analyzed 55 sustainability pioneers (including Paul Polman, Vice Chair of the UNGC Board & Former CEO of Unilever and Fiona Reynolds, CEO, Principles for Responsible Investment*)* and found four differentiating leadership attributes, besides these individuals' belief in corporate purpose*:*



Investors can look out for these traits when evaluating how well company leaders are positioned for navigating the future. [June 16th]

More "E" on directors' and investors' plates

The pressure on directors demonstrating their commitment and progress in fighting environmental issues is growing. **Responsible Investor** reports that failing on environmental risks could result in being voted against by investment giant **BlackRock**. Michelle Edkins, Global Head of BlackRock's Investment Stewardship team, announced that the firm will assess a director's efforts on managing forest destruction in the supply chain alongside its actions on other environmental issues such as climate change. According to Edkins, this will not only benefit the planet, but also long-term investors. [June 30th] The announcement by BlackRock was made in a webinar hosted by **Ceres**, a sustainability advocacy group, that issued the recent publication "*Investor Guide on Deforestation and Climate Change*." [June 30th]

The pandemic not only reinforced the interest for ESG, but also defied ESG skeptics who thought that sustainability targets would disappear in a crisis. **FT** looked back on some events during the crisis that show the opposite and demonstrate that corporate purpose might emerge as the winner. Indeed, several companies strengthened their ESG commitments and took actions to protect employees as well. It also mentions the leading role of several top legal officers driving ESG strategy. [June 26th]

This briefing note was developed in collaboration with KKS Advisors.