

# Challenges in Valuing ESG-Related Risks and Opportunities: *Reflections of a Fund Manager*



HBOS plc



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# Agenda



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# Insight Investment - Overview



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- **Asset management business of HBOS plc, a leading UK financial services company**
  
- **£79.2 billion in funds under management (as at 31 March 2005)**
  
- **A leading shareholder activist in the UK**
  
- **Member of UNEP Finance Initiative since October 2004**
  - Responsible Investment Initiative
  - Asset Management Working Group

# Responsible Investment Defined



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*“Investment where social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investment, and the responsible use of rights (such as voting rights) attaching to investments”*

Mansley, M. 2000. Socially Responsible Investment: A Guide for Pension Funds and Institutional Investors. Monitor Press.

# Responsible Investment – Key Concepts



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## ■ Enlightened Shareholder Value

*Investors have a financial interest in taking account of environmental, social, and governance (ESG) issues that could have material impacts on companies' earnings and/or share price.*

## ■ Responsible Ownership

*Investors have a financial interest in using the rights associated with share ownership to engage with companies to support good corporate governance and corporate responsibility practice, as well as challenge poor practice.*

# Integrating ESG Issues



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## ■ Investment Analysis

1. Consider the potential effects of ESG issues on investment value drivers, such as:

- Regulation Risk
- Legal Liability
- Brand Value Risk
- Intangible Value Risk
- Human Capital Risk
- Competitive Advantage

2. Exploit market inefficiencies

## ■ Engagement / Activism

- **Registration, Evaluation and Authorisation of Chemicals (REACH) – EU’s Proposed New Chemicals Regulation**
  - Lack of research / analysis by brokers
  - Insight conducted in-house research / analysis
  - Detailed understanding of company positioning re: Reach is important when forming an overall view of the company
  - Risks as well as opportunities

# Case Studies (cont.)



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## ■ Climate Change

- Significant broker research / analysis re: GHG trading in the near term (2005-07)
- Less re: 2008-12 (Kyoto) – period during which more likely to be material
- Risks as well as opportunities
- Insight is currently engaging with companies to:
  - Better understand potential materiality
  - Encourage the development of strategies for the future

# Observations re: Challenges of ESG Integration



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- **Currently material ESG issues are already being taken into account**
- **Broker research is focused on short-term, easily quantifiable issues**
- **However, many ESG issues are longer-term in nature, intangible – so difficult to value**
- **There may be investment opportunities**
- **Need more research on and analysis of mid- to longer-term ESG issues**

# UNEP FI – Asset Management Working Group (AMWG)



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- **Explores the association between environmental, social and corporate governance considerations and investment decision making.**
- **Consists of 13 asset managers with combined mandates of 1.7 trillion USD:**

ABN AMRO Asset Management (Brazil)

Acuity Investment Management

BNP Paribas Asset Management

Calvert Group

Citigroup Asset Management

Groupama Asset Management

Hermes Pensions

HSBC Asset Management

Insight Investment

Morley Fund Management

Nikko Asset Management

RCM (UK) (Allianz Dresdner)

Sanpaolo IMI Asset Management

# AMWG's Materiality Series



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- **2004 - MAT1 - “The Materiality of Environmental, Social and Corporate Governance Issue to Equity Pricing”**
  
- **2005 AMWG Work Programme: MAT2**
  - Financial Services, Automobile, Aero Defence, Food and Beverage, Chemicals, Pharmaceuticals, and Basic Materials (Forestry, Iron and Steel, Other Extractives)

We would point out:

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