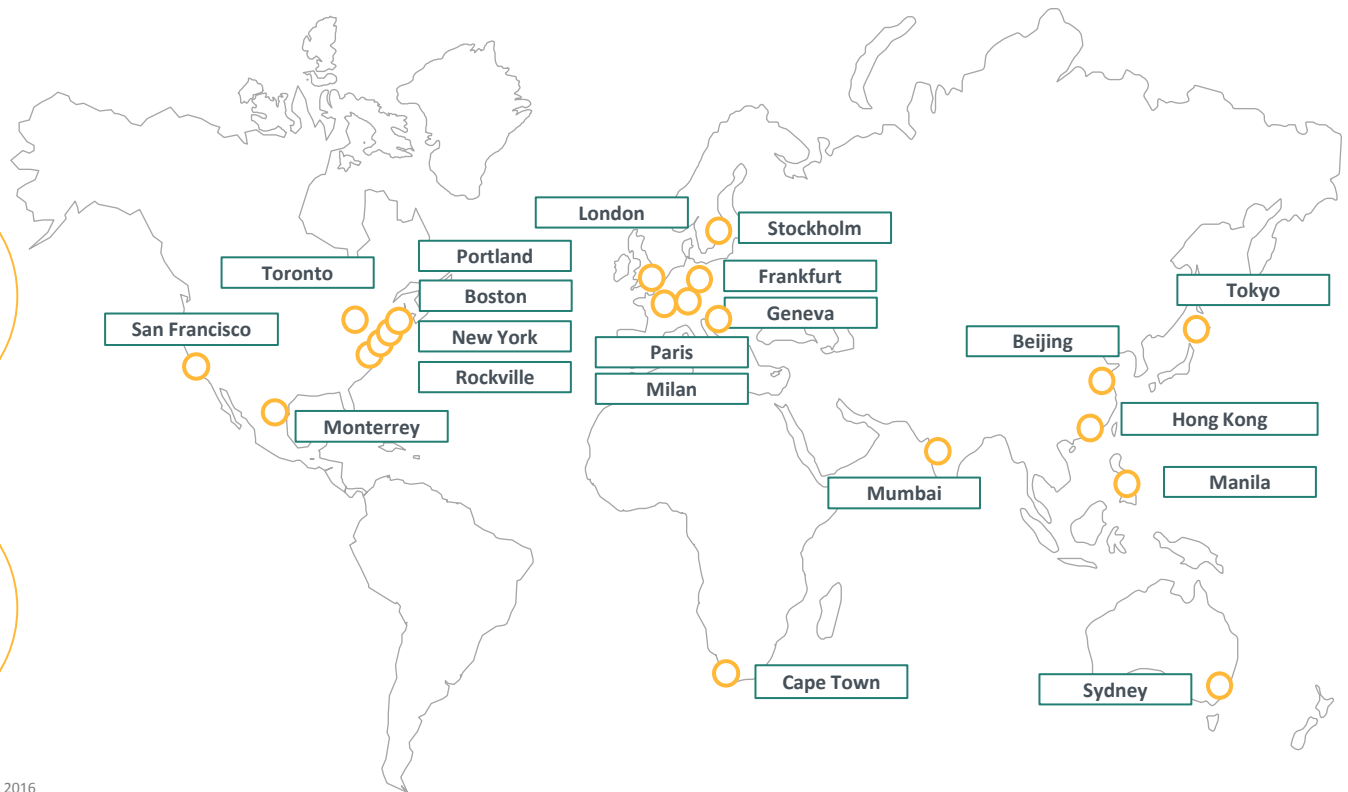


# ESG IN FINANCIAL MARKETS: WHY SHOULD WE CARE?

# INTRODUCING MSCI ESG RESEARCH

ESG RATINGS  
 MORE DATA  
 MORE CONTEXT  
 MORE INFORMED DECISIONS

- 155+**  
ESG analysts<sup>1</sup>
- 1000+**  
clients
- 47** of **50** <sup>TOP</sup>  
Global asset managers<sup>2</sup>
- 700+**  
ESG equity & fixed income indices use MSCI ESG Research ratings and data



<sup>1</sup> Source: MSCI ESG Research as of June 2016

<sup>2</sup> Based on P&I AUM data as of Dec 2015 and MSCI clients as of June 2016

INDEPENDENT RESEARCH IN RESPONSIBLE INVESTMENT (IRRI) SURVEY AWARDS

1st IRRI SURVEY 2015 | 1st IRRI SURVEY 2016

EXTEL | SRI CONNECT

**MSCI ESG RESEARCH AWARDED FIRST PLACE IN 13 OUT OF 17 CATEGORIES, INCLUDING:**

Best firm for Socially Responsible Investing Research  
 Corporate Governance Research | Indexes | Data  
 Fixed Income Research | Emerging Markets Research



## Why ESG matters?

- What is driving investors' interest and how Asset Managers respond to that?
- ESG as a growth catalyst for asset managers to attract new mandates

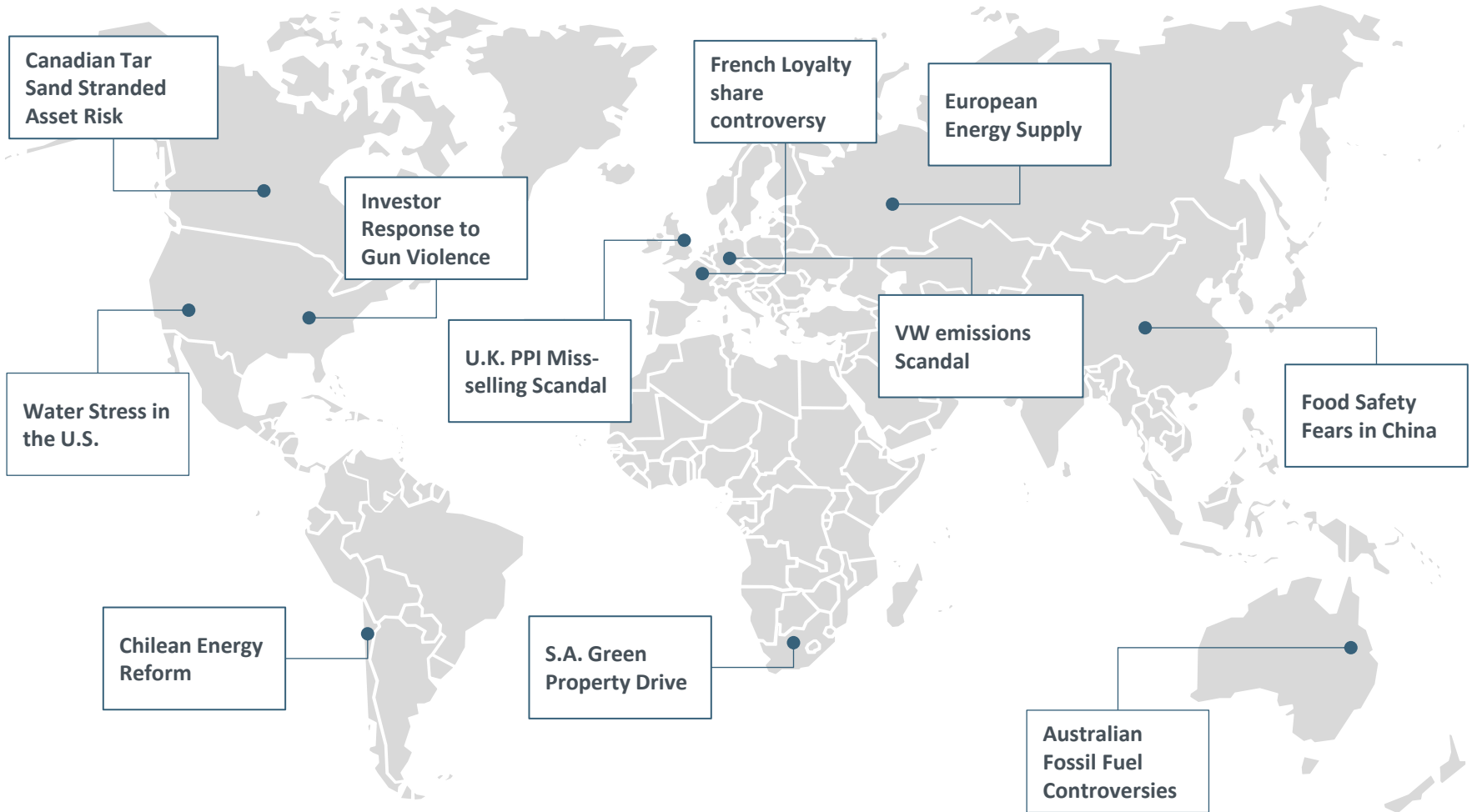
## How does ESG complement fundamental analysis?

- **Governance:** what are the advantages of an effective board oversight in capital markets?
- **Brexit:** identifying outliers combining Equity Research and ESG Analysis
- **Regulatory scrutiny:** how to predict fines?

# WHY ESG MATTERS?

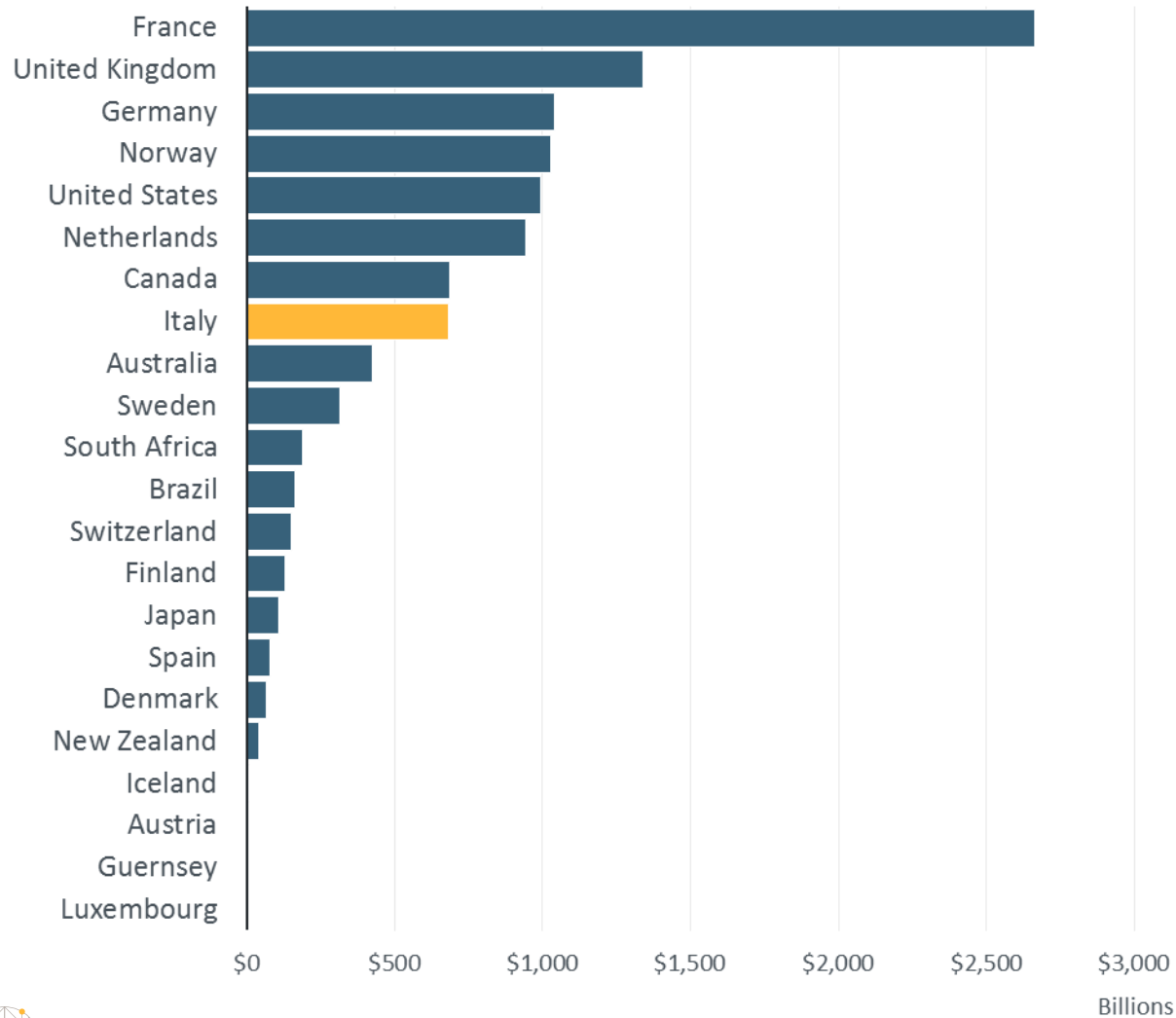
Macro trends: Understand what is driving ESG integration and how Asset Managers respond to this growing demand

# ESG RISKS – THE WORLD IS CHANGING

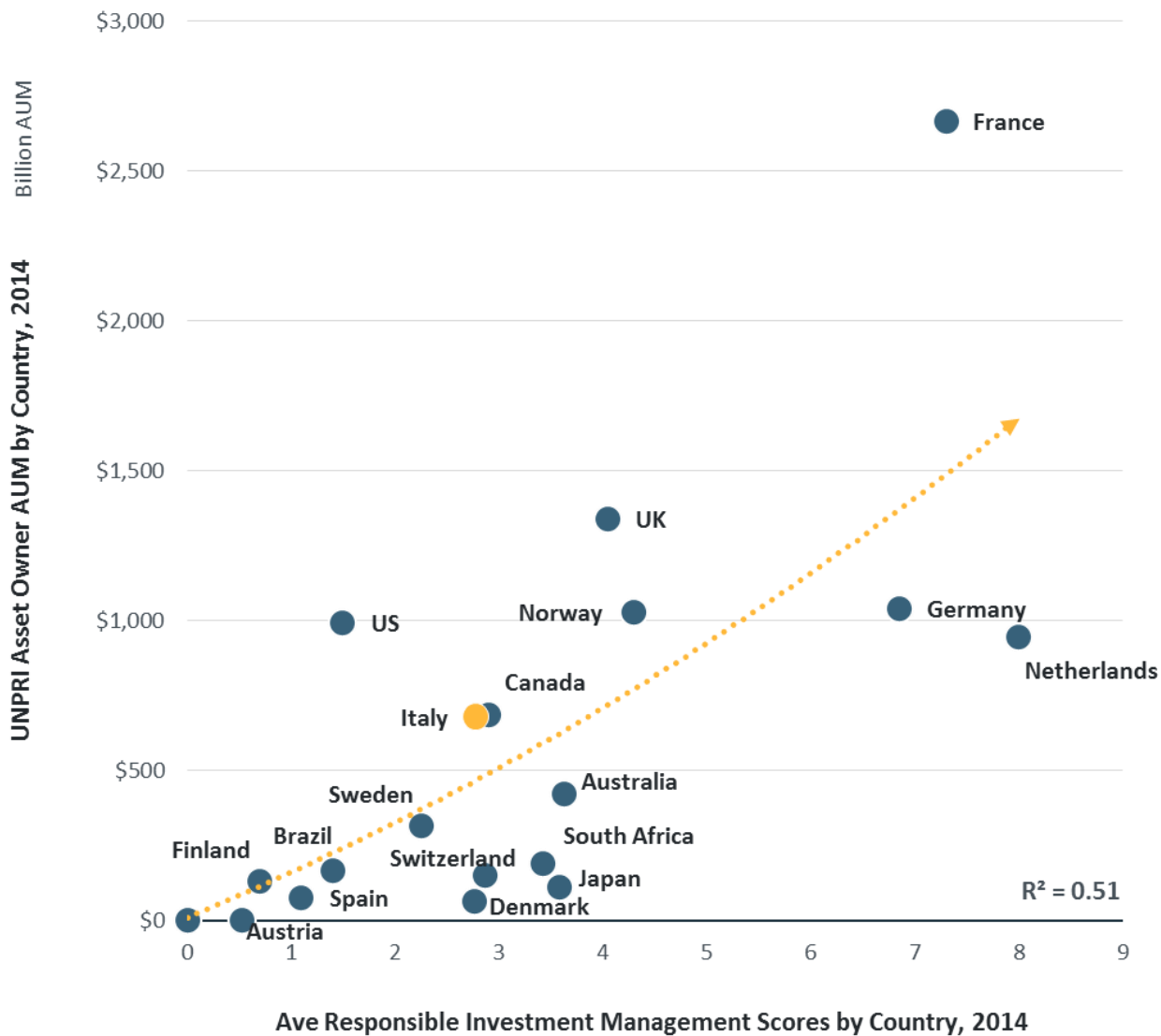


# WHAT IS DRIVING INTEREST IN ESG

## UNPRI Asset Owner Signatories AUM, 2014

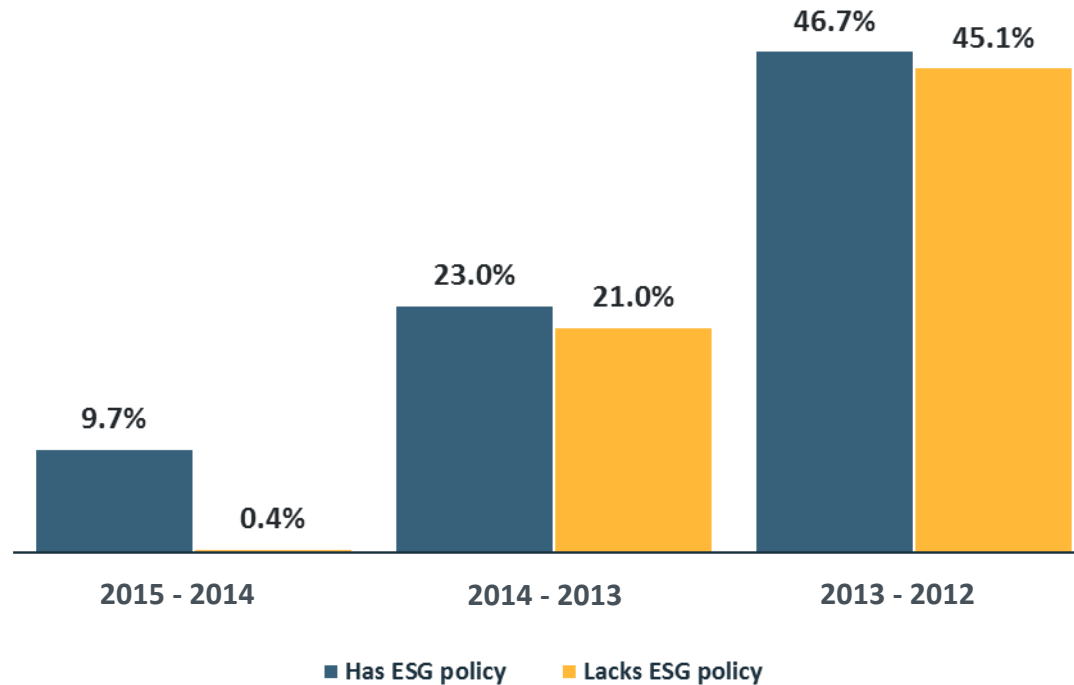


# HOW AM HAVE RESPONDED TO ESG DEMAND



# ESG: A GROWTH CATALYST ACROSS AM?

Growth AUM 2015 - 2012: ESG strategy vs none





# HOW AM HAVE RESPONDED TO ESG DEMAND

## INTEGRATION



Incorporate ESG criteria to enhance long term return, manage ESG financial risk

## VALUES



Align portfolio with investor's ethical or political values

## IMPACT



Generate measurable social or environmental benefits as well as financial returns

# HOW DOES ESG COMPLEMENT FUNDAMENTAL ANALYSIS?

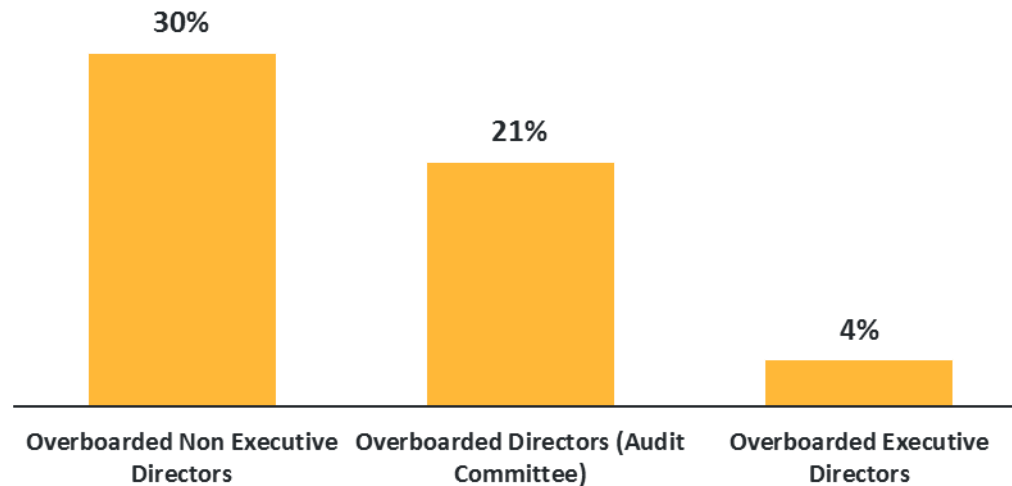
Case studies on how and where ESG can add value in the financial sector

# CASE STUDY 1: EFFECTIVE BOARD OVERSIGHT

## OVER-BOARDING

- **Why:** It represents a concern in terms of effective representation of shareholders' interest, questioning the time directors have to devote to their responsibilities.
- **Action:** We compared companies to country practices in the whole MSCI Governance Metrics Universe to find outliers.
- **Results:** One third of companies in this industry exhibited at least one over-boarded non-executive director, **UBS**, **Daiwa** and **Nomura** were outliers.

### Over-boarding in Capital Markets, MSCI ACWI

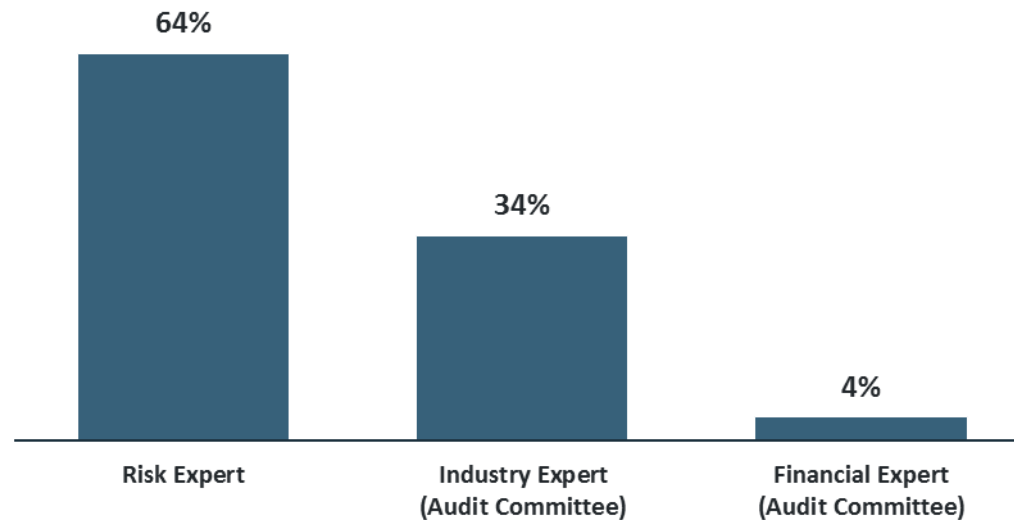


# CASE STUDY 1: EFFECTIVE BOARD OVERSIGHT

## LACK OF KEY EXPERTISE ON BOARD

- **Why:** It may undermine directors' understanding of the business and their ability to satisfy shareholders' interests.
- **Action:** We compared companies to country practices in the whole MSCI Governance Metrics Universe to find outliers.
- **Results:** Two thirds of companies lacked of risk expertise in the industry. **Daiwa** and **Northern Trust** underperformed their industry and home market peer groups.

### Lack of Key Expertise in Capital Markets, MSCI ACWI



# CASE STUDY 1: EFFECTIVE BOARD OVERSIGHT

## INTEGRITY AND NEGATIVE VOTES

### Negative votes against directors

- **Why:** To identify potential deviation from shareholders' interests.
- **Results:** In Capital Markets, 17% of the companies were flagged for having (at least) one director with more than 10% negative votes against from shareholders.

| Companies      | Directors with more than 10% votes against | Including Chairman | Votes against Chairman |
|----------------|--|--------------------|------------------------|
| Schroders      | 1  | ✓                  | 16%                    |
| TD Ameritrade  | 1  |                    |                        |
| Blackrock      | 1  |                    |                        |
| Platinum Inv.  | 3  | ✓                  | 48%                    |
| Partners Group | 4  |                    |                        |
| IGM Financial  | 5  | ✓                  | 13%                    |
| Investec       | 5  |                    |                        |
| Deutsche Bank  | 19   |                    |                        |

### Controversies and Bankruptcy

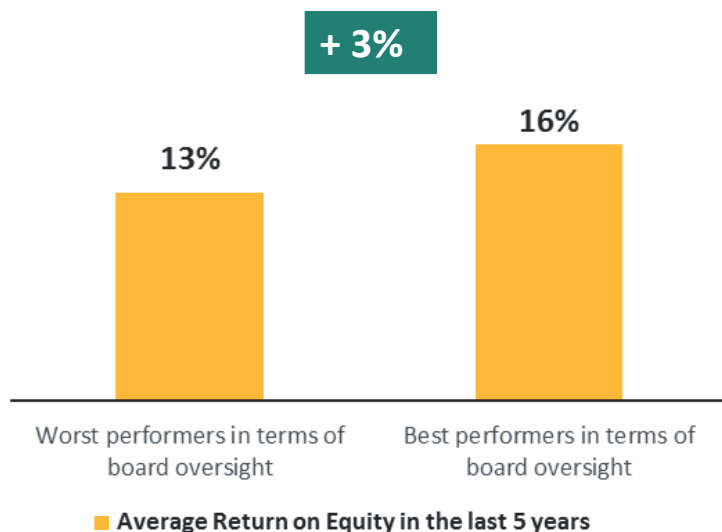
- **Why:** To identify potential risks to efficient management at the companies where they hold mandates.
- **Results:** In Capital Markets, 19% of companies were flagged for board integrity and only one company is flagged for executives' misconducts.

| Companies         | Board Integrity | Directors | Leadership    | Misconduct |
|-------------------|-----------------|-----------|---------------|------------|
| Blackrock         | ✓               | 2         | CEO + Chair   |            |
| Invesco           | ✓               | 2         |               |            |
| Northern Trust    | ✓               | 2         |               |            |
| E*Trade Financial | ✓               | 2         |               |            |
| Brookfield AM     | ✓               | 2         |               |            |
| Morgan Stanley    | ✓               | 1         | Lead Director |            |
| BNY               | ✓               | 1         |               |            |
| UBS Group         | ✓               | 1         |               |            |
| Raymond James     | ✓               | 1         |               |            |
| CITIC Securities  |                 |           |               | ✓          |

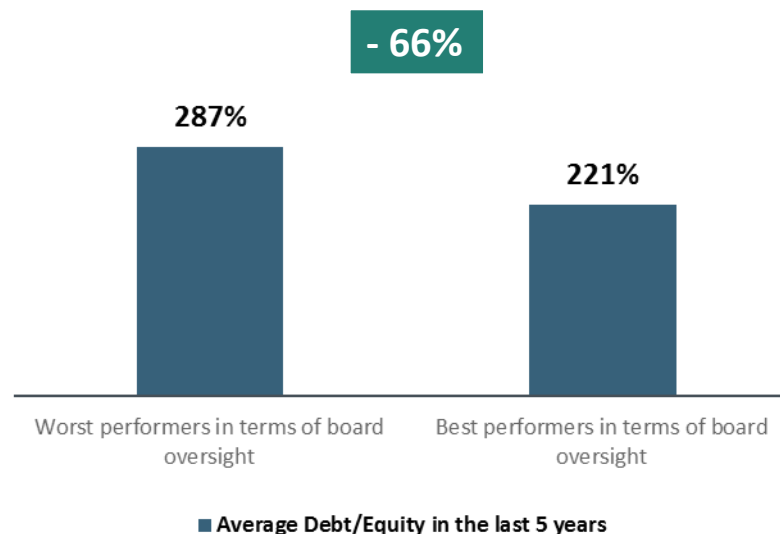
# CASE STUDY 1: EFFECTIVE BOARD OVERSIGHT

## MEASURING THE IMPACT

### Profitability in Capital Markets, 2011-2015



### Financial Stability in Capital Markets, 2011-2015



# CASE STUDY 2: THE IMPACTS OF BREXIT

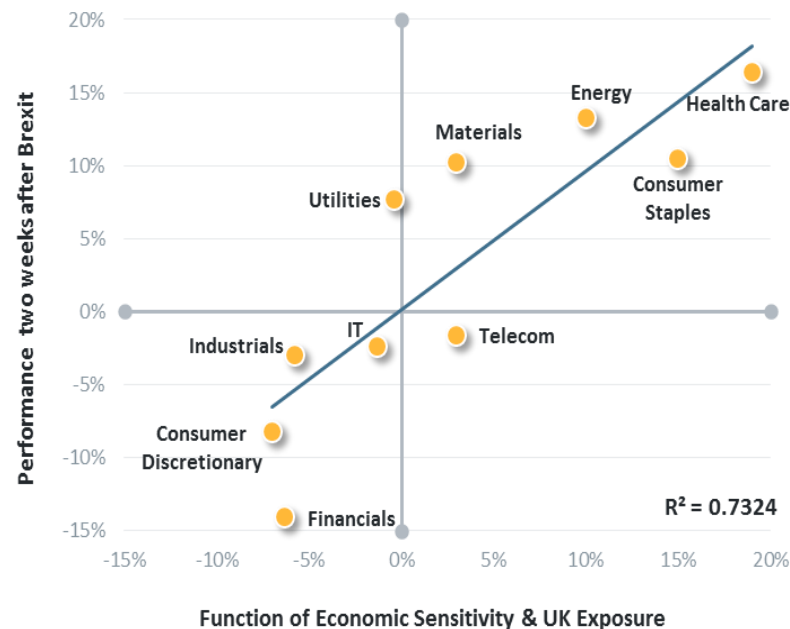
MSCI Equity Research published a study which explained UK sectors' performance after Brexit with the use of two metrics.

- **Economic exposure:** the geographic distribution of companies' revenue had a considerable impact on stock price, especially in events of shock, such as the Brexit.
- **Economic sensitivity:** Sensitivity to economic activity's variation explained nearly half of the performance of cyclical sectors relative to defensive sectors in the two weeks that followed Brexit.

| GICS Sectors           | UK Economic Exposure | Economic Sensitivity | Performance after Brexit |
|------------------------|----------------------|----------------------|--------------------------|
| Health care            | 3.4%                 | -0.57                | 16.4%                    |
| Energy                 | 11.4%                | -0.24                | 13.3%                    |
| Consumer Staple        | 11.7%                | -0.51                | 10.5%                    |
| Materials              | 4.3%                 | 0.23                 | 10.2%                    |
| Utilities              | 67.1%                | -0.47                | 7.7%                     |
| Telecom                | 36.9%                | -0.19                | -1.6%                    |
| IT                     | 17.6%                | 0.25                 | -2.4%                    |
| Industrials            | 29.0%                | 0.36                 | -3.0%                    |
| Consumer Discretionary | 39.6%                | 0.27                 | -8.2%                    |
| Financials             | 48.8%                | 0.12                 | -14.1%                   |

Source: MSCI ESG Research

## UK economic exposure post-Brexit performance

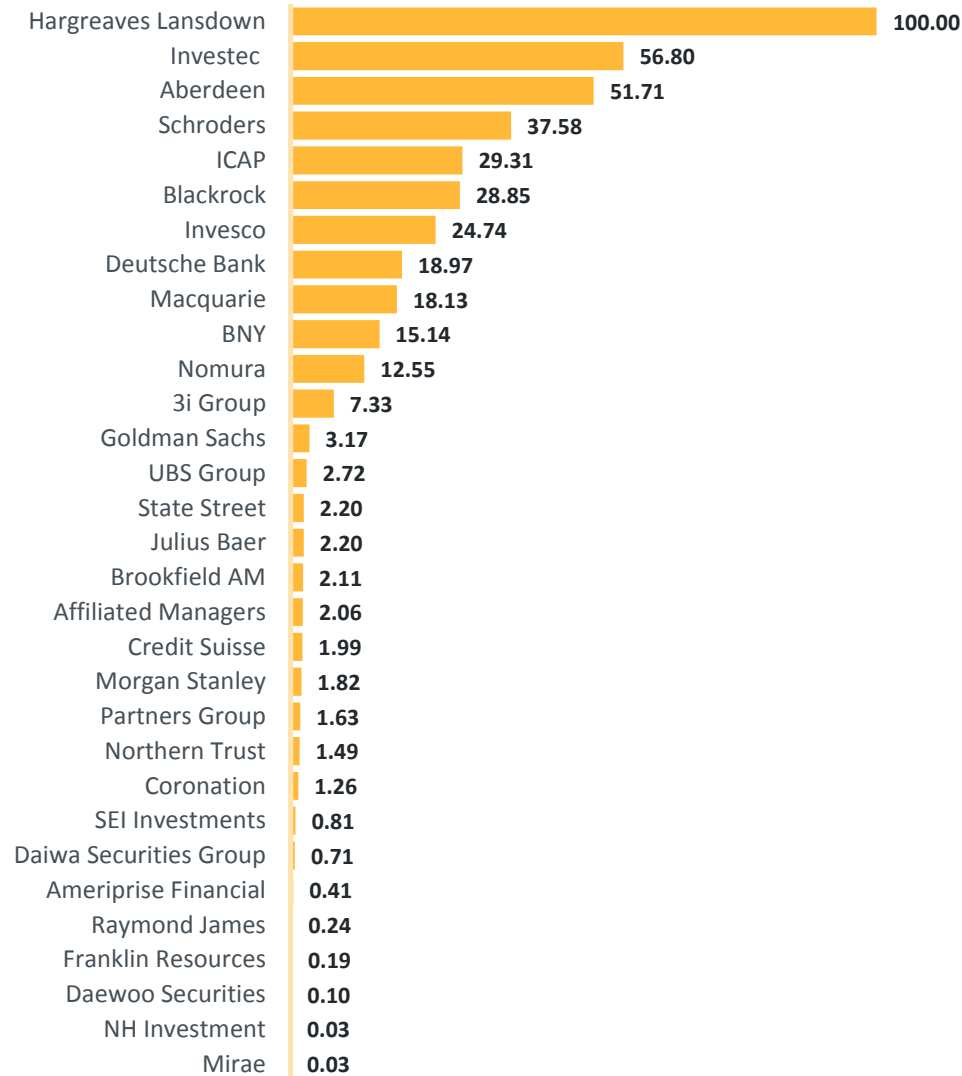


Source: MSCI ESG Research

**Results:** Companies with higher UK economic exposure and positive economic sensitivity to share prices were the most exposed to the impacts of Brexit, which resulted in negative performance .

# CASE STUDY 2: THE IMPACTS OF BREXIT

## UK economic exposure within Capital Markets (%)

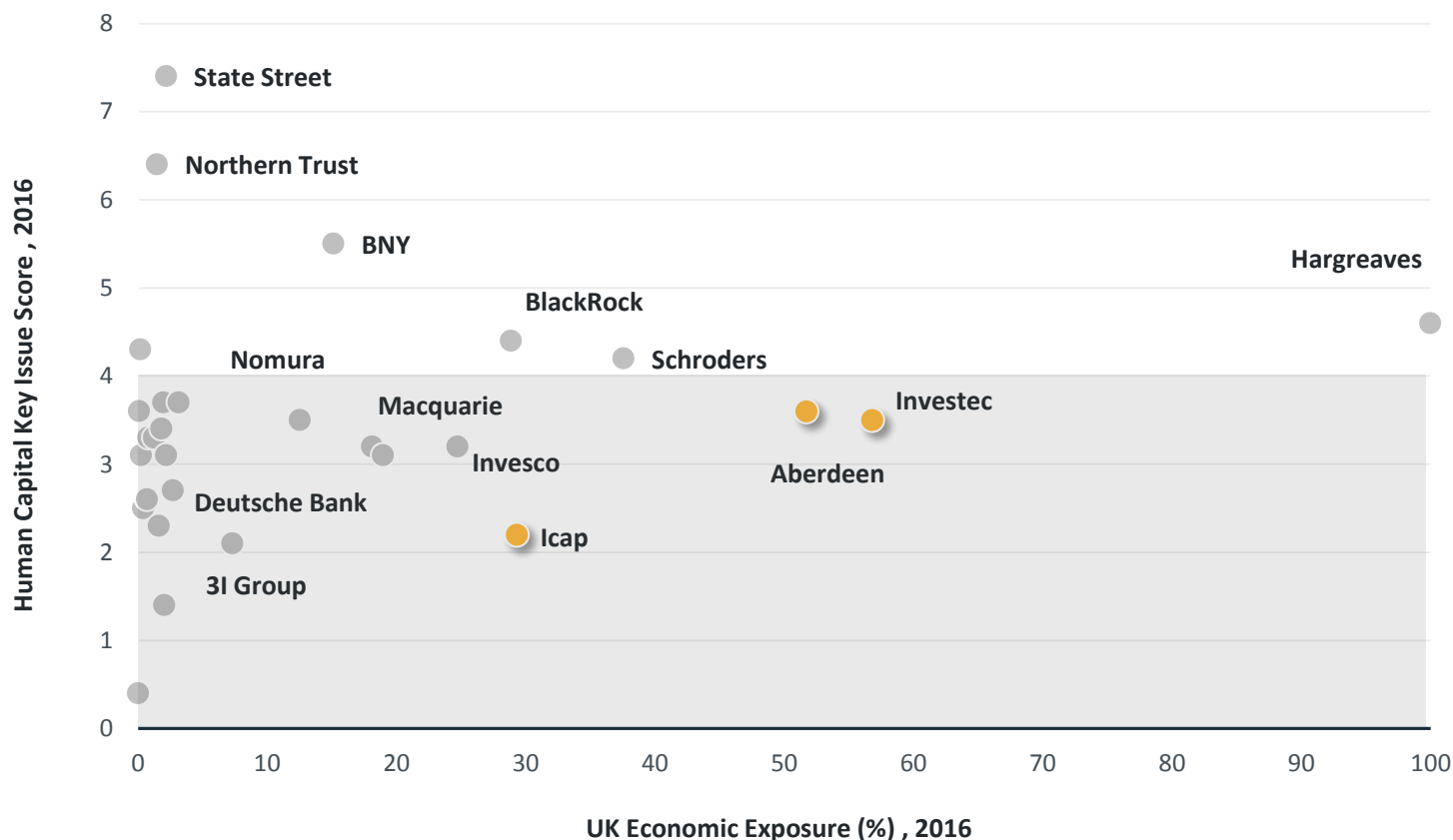




# CASE STUDY 2: THE IMPACTS OF BREXIT

We mapped the UK economic exposure of each company in the Capital Markets industry with our internal Human Capital Management (HCM) scores. We selected the companies with higher exposure and the lower HCM scores as outliers to sudden turnover and **corporate change affecting employees**.

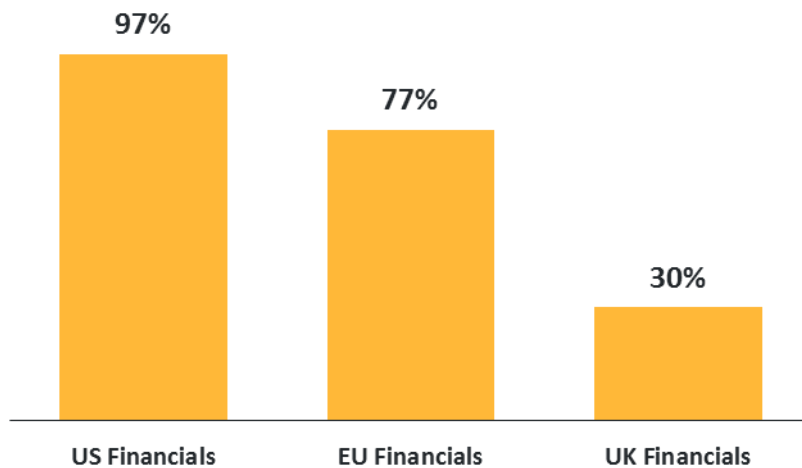
### Human capital performance vs. economic exposure



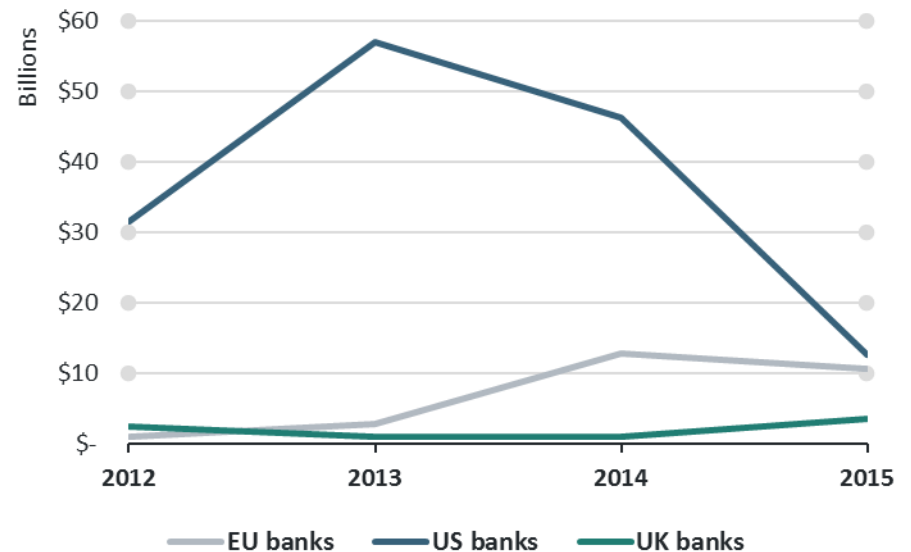
# CASE STUDY 3: REGULATORY SCRUTINY

- US and EU banks are mainly targeted by US regulators, but UK banks are mainly regulated by UK authorities.
- US regulators have increased their focus outside US since 2012.

**% of fines paid to US Regulators by Region, 2009-2015**

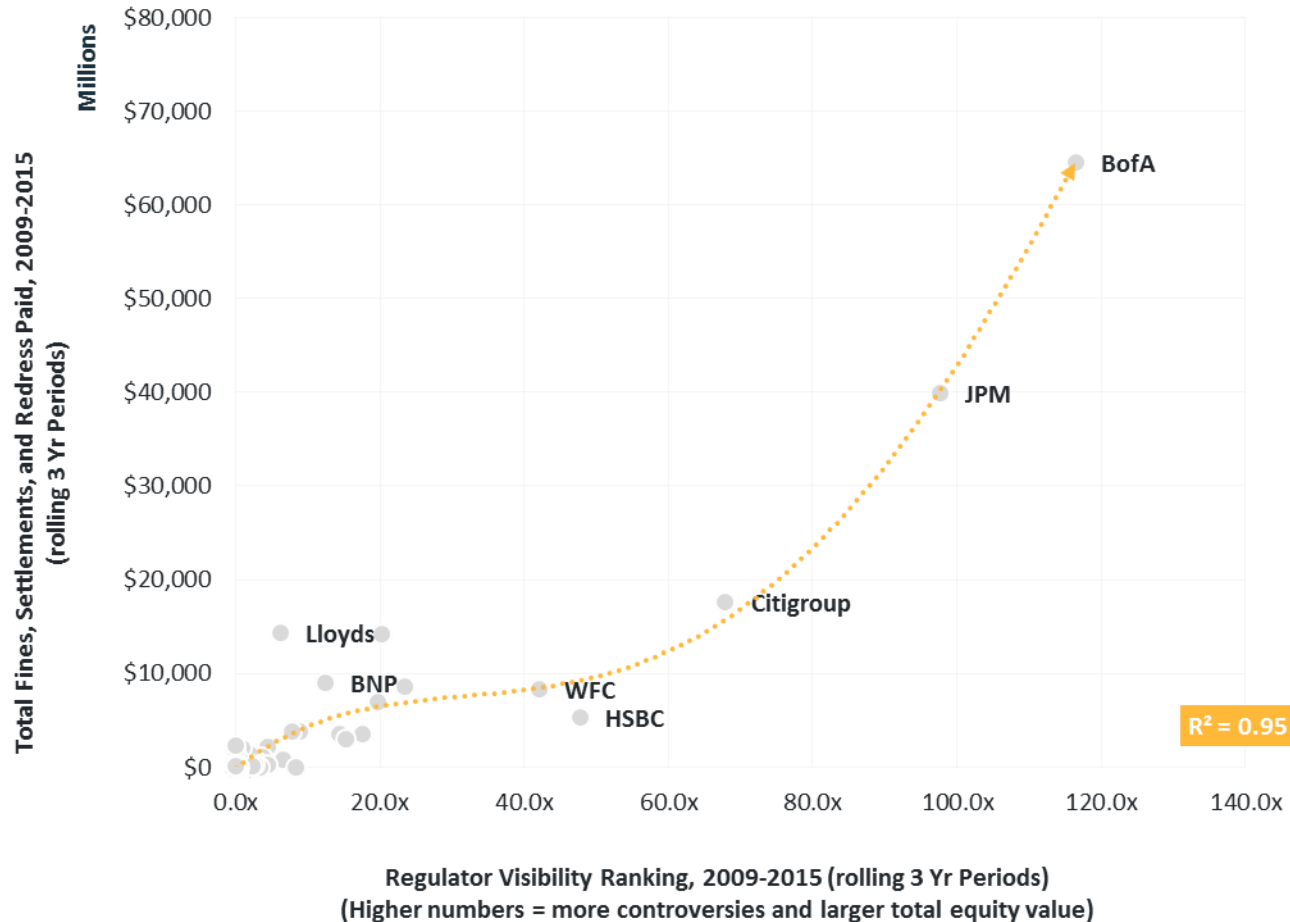


**Volumes of pay-outs paid to US regulators, 2012-2015**



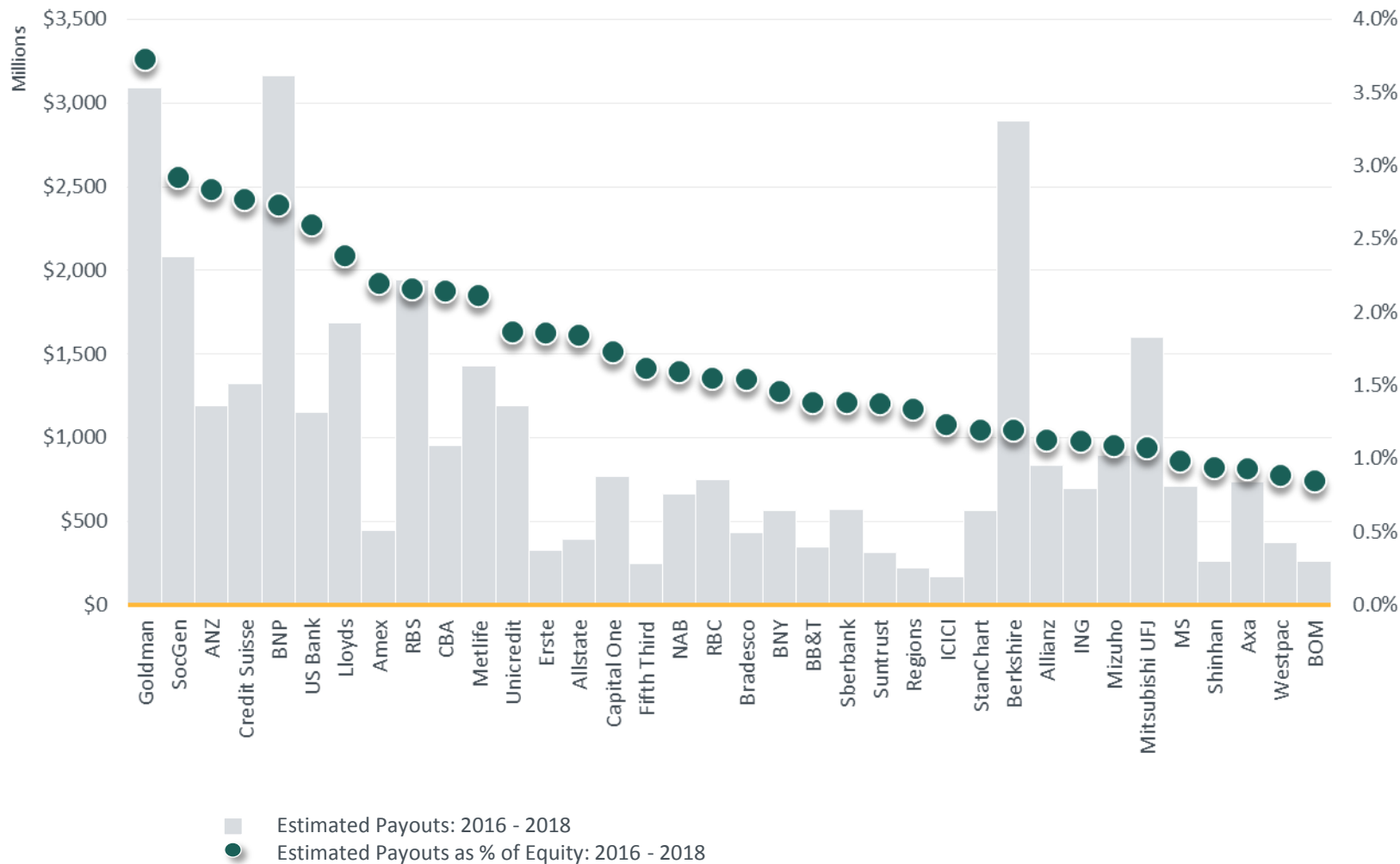
# CASE STUDY 3: REGULATORY SCRUTINY

**Regulator Visibility Ranking (RVR)** is the result of the combination of our internal controversy data with company size (measured using rolling three year average equity). Using the RVR and historical pay-out data, we generated a regression formula to estimate future pay-outs for each company in our sample.



# CASE STUDY 3: REGULATORY SCRUTINY

## Fines estimates in the Financial Sector, 2016-2018



Estimated Payouts: 2016 - 2018  
 Estimated Payouts as % of Equity: 2016 - 2018

# FINAL REMARKS

## Why ESG matters?

- **ESG integration:** integrating ESG factors can be a differentiator for assets growth – asset managers with strong ESG strategies saw a higher AUM growth between 2014 and 2015 than those without notable ESG strategies.

## How does ESG complement fundamental analysis?

- **Governance:** Companies with stronger board efficacy practices tended to manage investors' money more efficiently (higher ROE in the last five years) and had lower leverage ratios (in the last five years).
- **Brexit:** Combining ESG data to UK economic exposure, we were able to identify those companies at a potentially weak position for sudden turnover and corporate change affecting employees.
- **Regulatory scrutiny:** US regulators are increasing their focus on European institutions and we are able to estimate those future fines based on a metric that combines size and corporate behavior of financial institutions.

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