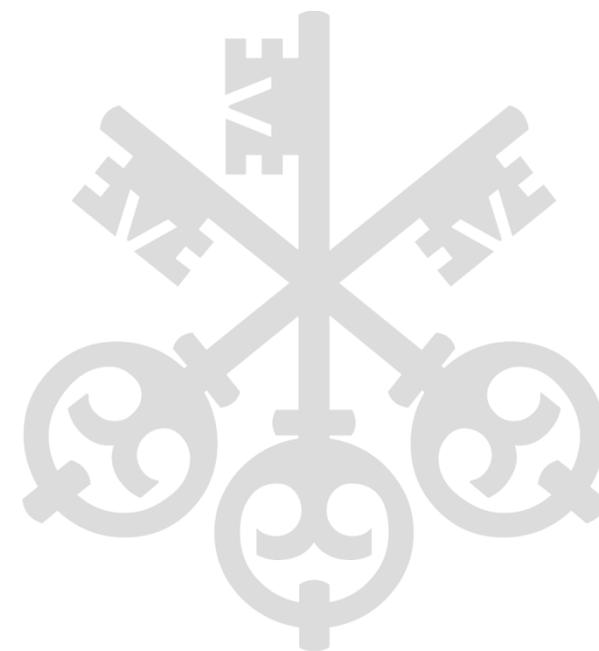


Behind the Scenes: How Asset Managers Use ESG Data

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Housekeeping matter's for today's webinar

- Deck will be distributed after the webinar by email and posted at <http://fsa.sasb.org/webinars>
- To receive CPE credit (California), please visit bit.ly/sasb-cpe
- Must respond to all poll questions to receive CPE credit
- Short survey at end of webinar

Generations of Sustainable Investing

From values-based to value-creating

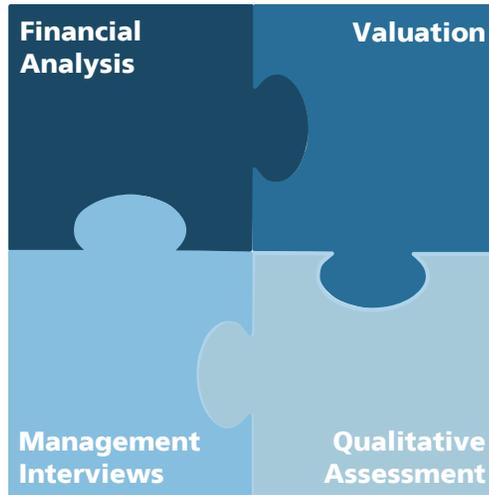
NEGATIVE SCREENING

POSITIVE SCREENING

Goal	Avoid investments in companies that are not compatible with mission and values	Use material sustainability factors seeking to improve performance
Motivation	Align investments with values or mission	<ul style="list-style-type: none">• Seek to generate alpha• Manage risk
Primary Techniques	Exclusionary screening to remove controversial industries such as tobacco, alcohol and gambling	Use sustainability factors to identify companies that are expected to outperform

Modern sustainable investing: Extension of the Mosaic Theory

Traditional Investment Process Based on Security Analysis (1934)¹



- Built for companies with physical assets
- Book value = market value

Modern Sustainable Investment Process Based on evolution of company strategy



- Built for "asset light" companies
- Market value is a multiple of book value

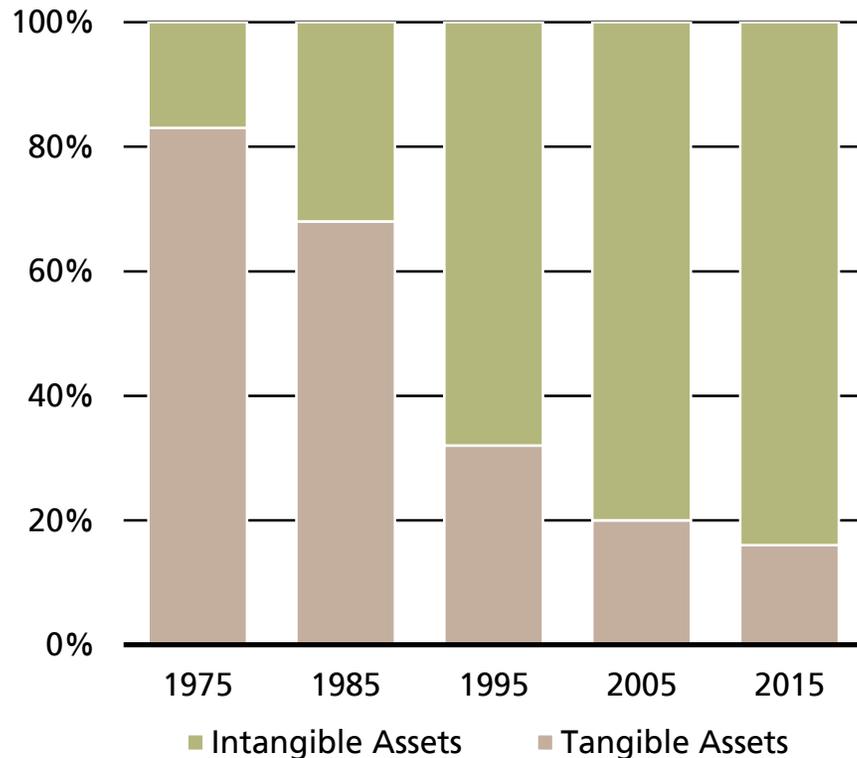
¹ Security Analysis, Benjamin Graham and David Dodd (1934)

Why sustainability data helps the investment process

- Graham and Dodd, *Security Analysis* (1935) first describe **mosaic theory**
- In 1935 book value and market value closely related
- Aimed to provide investors with a logical way to make good decisions
- Focused on financial data but includes non-financial factors
- Material sustainability data extends the mosaic of fundamental data **beyond financial analysis**
- Today market value is a multiple of book value because it includes intellectual property, patent libraries, brand equity and other intangible assets
- **The emergence of material non-financial data is the modern way to extend the mosaic theory of investing to better assess business models**
- Completely **compatible with traditional fundamental investing**, portfolio construction and financial theory

Evidence

Intangible Assets drive market value today



- Brand value (price premium, brand awareness)
- Reputation (social media profile, opinion research)
- R&D pipelines (# patents)
- Customer satisfaction (retention, loyalty programs, boycotts)
- Health and safety record (incidents, accidents, near misses)
- Environmental performance (pollution, penalties, fines)
- Social license to operate (production delays, cost overruns, labor protests)
- Governance (board composition, bribery, ethics charges)

Source: Ocean Tomo, "Ocean Tomo's Intangible Asset Market Value Study," 2015

Sustainability factors are material

Sustainability factors are indicators of operating activity

- **Sustainability** factors create operating efficiencies, support value creation and create brand equity
- **Shared value** = creates value inside and outside the company
- Modern way to manage all corporate resources—tangible and intangible

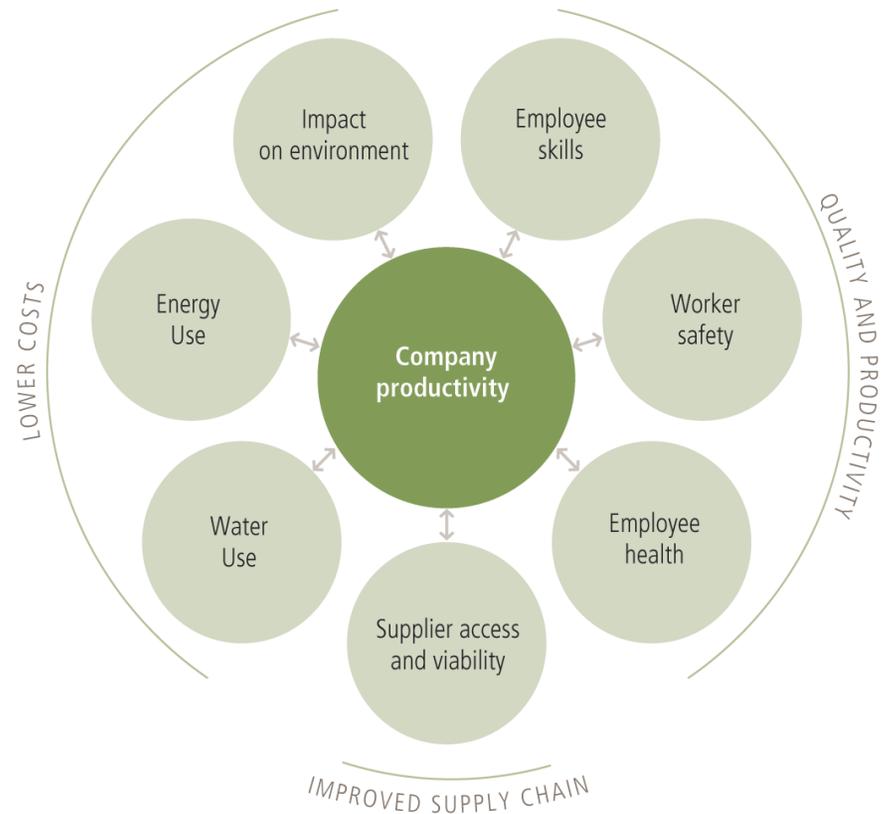
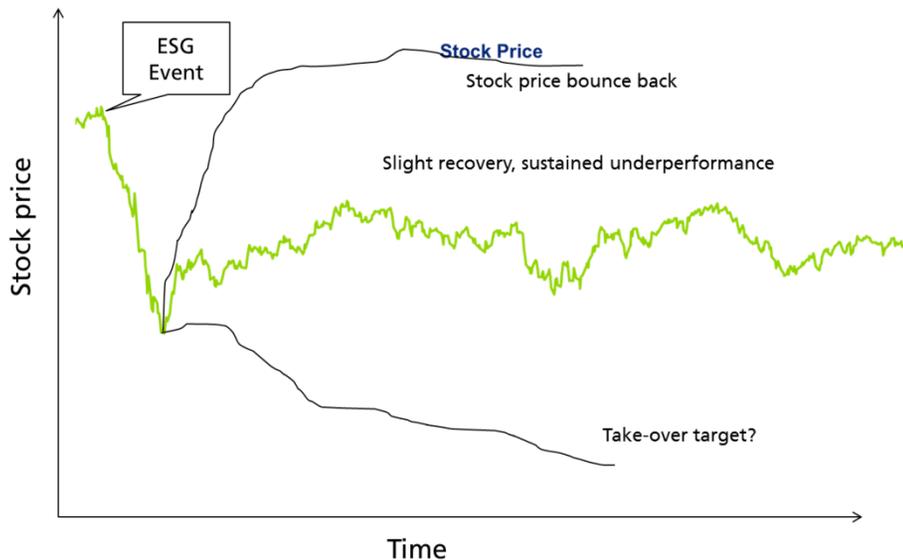


Diagram based on Michael E. Porter and Mark R. Kramer, "Creating Shared Value", Harvard Business Review, January 2011

Evidence

Sustainability factors = material non-financial factors



For illustrative purposes only.

Examples of ESG materiality:

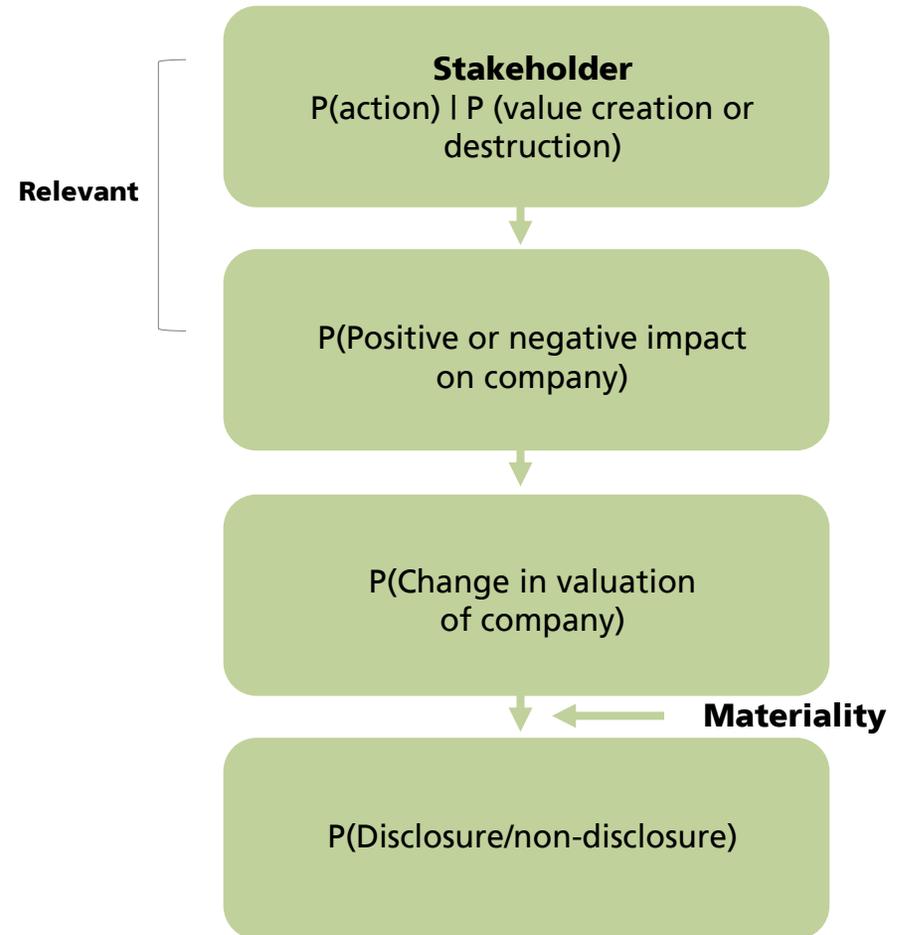
- Labor practices – e.g. Collapse of clothing factory in Bangladesh
- Extreme weather – e.g. flooding in Thailand and chip manufacturers
- Drought – e.g. bottling plants in Karala, India
- Environmental fines, penalties – e.g. chemical accidents, oil spills
- Earnings fraud
- Product quality lapses, boycotts and recalls
- Labor and local community relations – e.g. gold mines

Dinah A. Koehler and Eric J. Hespenheide, "Finding the value in environmental, social and governance performance," Deloitte University Press, 2013

Material sustainability factors affect equity prices

Stakeholder Model of Materiality

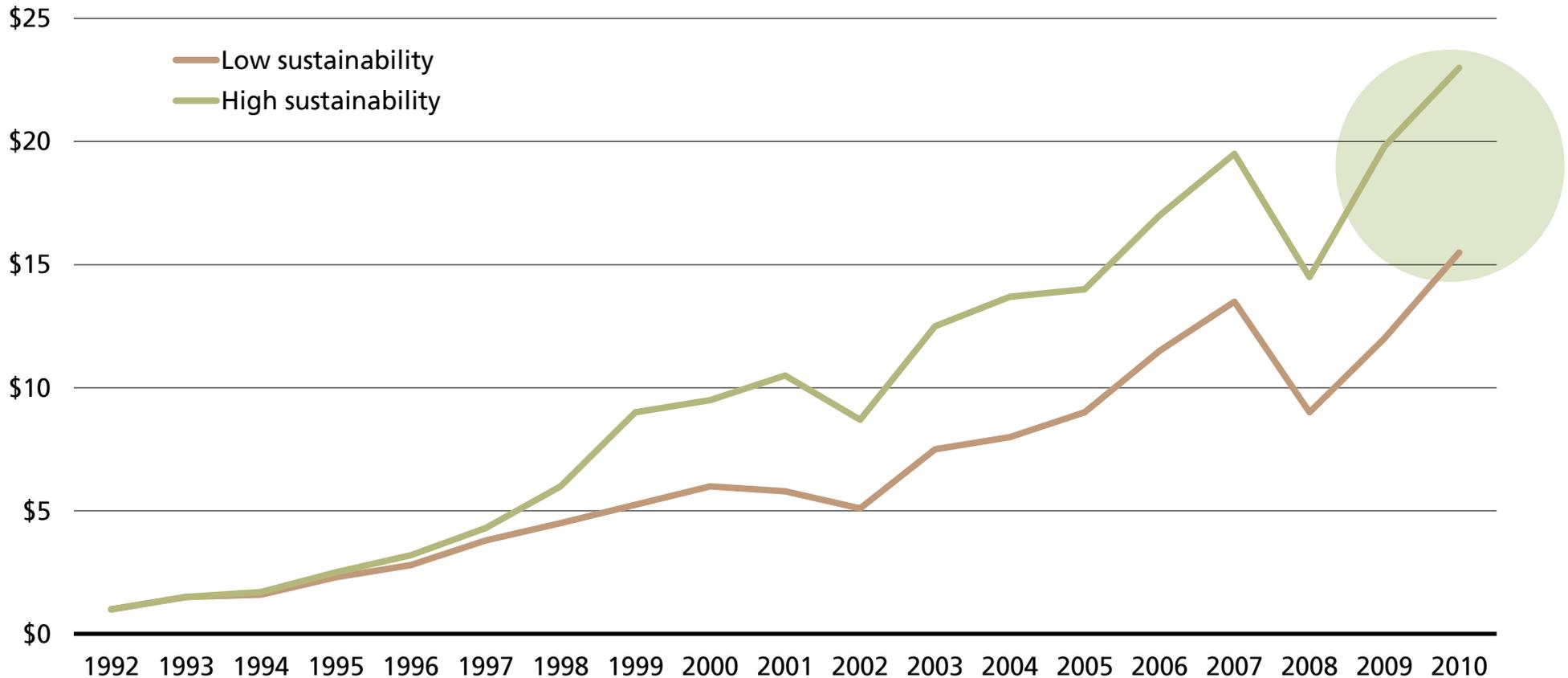
ESG issues can become material due to internal or external stakeholder actions driven, in part, by how they perceive whether a company is destroying or creating value. *Many issues can be relevant, but not all are material.*



Dinah A. Koehler and Eric J. Hespenheide, "Disclosure of Long-term business value – what matters?," Deloitte University Press, 2013.

Evidence

Material factors can drive outperformance



Note: The "High Sustainability group," as defined by the study's authors (Harvard Business School 2011, Professors Eccles, Ioannou, Serafeim in The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance) are companies that adopted all or most of certain environmental and social policies, outperformed the "Low Sustainability group," as defined by companies that adopted almost none of these policies. For illustrative purposes only. This does not represent the performance of any particular investment, and does not take into consideration any applicable fees, taxes or expenses.

Sustainable investing requires relevant data

Focus on material information

- Need to identify which ESG data is useful for business and investment decisions
- A matter is “material” if there is a substantial likelihood that a reasonable person... relying upon the report would have been changed or influenced by the inclusion or correction of the item... financial management and the auditor must consider both *quantitative and qualitative factors* in assessing an item’s materiality. (Securities Exchange Commission, SAB 99)

Emergence of sustainable accounting standards

- Material information should be available to all investors
- Through 2016, Sustainability Accounting Standards Board (SASB) is sustainability accounting standards
- Extends corporate disclosure to environmental, social and governance (ESG) factors
- Complements financial accounting standards
- Key Performance Indicators (KPI) listed in the SASB Materiality Map™ > 80 industries in 10 sectors
- End game - companies begin disclosing data in mandatory SEC filings (Form 10-K and 20-F), early adopters 2015
- Our UBS Sustainability database was developed in line with SASB Materiality Map™



Source: Sustainability Accounting Standards Board (SASB), www.sasb.org.

Why the SASB matters

- **Standards** are important because they provide a common reference point for conversations
- **Standards** for material Sustainability data should create equivalence with traditional financial data
- **Standards** extend the mosaic of information in a way that is consistent with the history, tradition and financial theory of fundamental investing
- **Standards** make sustainability data an accepted part of the analytical and decision-making process

Development of the end market – moving to the mainstream

- **Pension Funds and Institutional Investors** are interested in Sustainable Investing from an **alpha seeking and risk management approach**.
- **High Net Worth, Endowments and Foundations** are interested in Sustainable Investing from a **philosophical and mission alignment approach**. Recent US Trust study¹ found that 45% of HNW would like to have a conversation with their advisor on being able to invest in line with their values.
- **Large wirehouses** have **strategic values-based investing programs** that are open architecture and have clear AUM goals
- Many investors want **both** alpha seeking/ risk management and mission alignment
- **The development of accounting standards for sustainability data can make all this possible**

Source: U.S. Trust Capital Acumen, *ESG Investing Goes Mainstream*, <http://www.ustrust.com/publish/ust/capitalacumen/winter2014/features/ESG-mainstream.html>

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