# CalPERS: Managers Who Ignore ESG Will Lose

By Tim Sturrock May 9, 2014

Managers that haven't integrated environmental, social and governance (ESG) factors into their investment process will increasingly be left behind by institutions, according to the governance chief for the **California Public Employees' Retirement System** (**CalPERS**).

CalPERS, which has adopted several ESG considerations into its investment beliefs, is also working with a number of organizations to create and promote standards and measurements for ESG factors, says **Anne Simpson,** CalPERS' senior portfolio manager and director for corporate governance. As it becomes easier to discern and track just how the issues affect an investment, managers will need to prepare for the demand for the investment style or face the consequences.

"They have to raise their game in terms of their understanding of these issues. That will create more demand for rigor and quality on the analytics that address these issues. I hope that we will be able to recruit those managers in the call for getting the information integrated into the main financial reports," she says, adding that the issue will eventually become dire for managers that do not adjust. "They will lose mandates. It's that simple."

Even without standardized ways of viewing ESG factors, CalPERS is examining how environmental, social and governance factors create risks and sustainability in a portfolio, she says.

CalPERS is also working closely with the **Sustainability Accounting Standards Board (SASB)**which is formulating drafts of standards by sector, Simpson says, speaking on the sidelines of the **Pension Bridge** conference in San Francisco.

"We don't have reporting metrics that would allow you to compare companies within a sector, on a particular issue or by performance over time," she says.

For example, potential reporting standards in the energy sector would assess greenhouse gas production and standards for retailers would address retail supply chains and labor issues, she says.

The SASB plans to release standards on several sectors over the next year. The next set of standards is set for the non-renewable resources industry in June.

“At the moment bad things happen and we really don’t have a sense as investors of what we should be looking for,” she says, adding that implementation of various standards will take time.

Even as various methodologies come online, interpretations remain subjective and will continue to remain so even as widely adopted standards develop, says **Andy Iseri**, v.p. and international investment consultant at **Callan Associates**.

“You have to understand the data and analysis. A lot of it of is subjective. A lot of it depends on the ethical values of the entity doing the scoring,” he says. “We’ll have one manager like a [soft drink] company because they are going water neutral in their process, but we will have another manager not like that company because it contributes to diabetes and childhood obesity.”

ESG factors will be calculated on an increasing number of variables and require more research to understand, he says, adding that some managers have hired scientists to better understand the risks and merits of investments.

For portfolio managers, there’s a learning curve implementing the strategies into their investments, said **Matt Christensen**, global head of responsible investing for **AXA Investment Managers**, speaking at a ESG panel at Pension Bridge. Clients are creating pressure for managers and the methodologies that they use are on the top of clients’ minds, he adds.

“One of the biggest things that we’ve found working with clients is the question, ‘How do you integrate this stuff?’ Clients sometimes want to see ESG scoring across the aggregate portfolio,” he says, adding that AXA has found success through metrics that track minimization of risk.

AXA includes a research report for its investors that tracks ESG integration, identifies ESG risks at individual companies and includes discussion of potential future risks like carbon use, water use and high-profile social issues.

But, getting correct information from companies can limit the effectiveness of ESG policies, says**Kevin Bourne**, managing director for the **FTSE Group**, speaking on the same panel.

“We look at just over 3,000 companies and I can tell you there is a big data collection issue where companies will not disclose information. They refuse. They just don’t want to,” he says.

In many cases companies already produce and track certain information, but the data is submitted to regulators, not investors and that must change, Simpson says.

Transparency is often an issue in investment and implementation will take decades and continue to evolve, says Callan's Iseri.

"It's still very early in the game…I expect the interpretation of the data to change pretty dramatically going forward," he says. For example, he says that nuclear power was once viewed more favorably until the risks became clear after Japan's 2011 earthquake and subsequent Fukushima disaster.

As more companies and managers transition towards the new methods, so too will pensions pursue the strategies, particularly those institutions without the resources to do their own research, says CalPERS' Simpson, who predicts the conversation will change as research and available data mount.

"As a subject it will be a natural and well-documented part of doing thorough investment. It's separate just at the moment because you have to put extra care and attention to it," she says.