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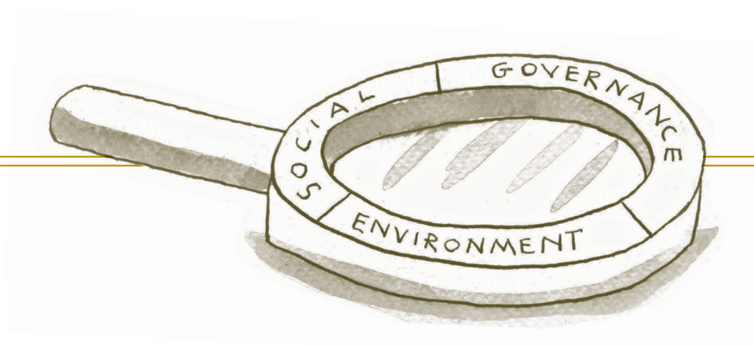
# THE HISTORY & EVOLUTION OF ESG




As with any industry, the investment management industry has its abiding truths. One is that investors constantly seek new ways to generate superior performance; another is that portfolio managers will latch on to any narrative if they believe it will help them raise assets. As it pertains to ESG, it seems we have hit an inflection point at which ESG is no longer just something that people talk about but rather is now becoming a source of competitive advantage and may soon be a requirement to survive. »

In this first article of a two-part series, we provide an overview of the history and evolution of ESG, explain why it is becoming an integral part of any investment organization, and give a preview of RMB's approach. Our second article will delve deeper into the steps RMB has taken to further integrate ESG into our investment process and what our clients can expect going forward.

The term ESG refers to investors' evaluation of environmental, social, and governance factors—i.e., factors beyond traditional financial metrics—when evaluating investments. Its roots date back to the 1960s, when socially responsible investing (SRI) was originally introduced as a result of those who were opposed to the Vietnam War, as well as from the civil rights movement, and it was heightened in the 1970s and 1980s by strong opposition to apartheid in South Africa.[1] Since that time, the industry has evolved and branched out, incorporating such concepts as impact investing (an investment strategy that seeks to generate financial returns while also creating a positive social or environmental impact) and corporate social responsibility (a self-regulating business model that helps a company be socially accountable—to itself, its stakeholders, and the public). These terms can all be interrelated, and there are not precise nor common definitions, but the industry is coalescing around the concept of ESG as a means of expressing, measuring, and implementing the notion of investment considerations beyond traditional financial metrics.

The advancement of ESG in recent years can be attributed to a number of factors. Increasing attention paid to climate change and social inclusivity, particularly by younger generations, is apparent. Importantly, transparency and access to data has been crucial in providing the industry the means to measure how companies stack up on ESG issues, and also to analyze to what extent they affect stock price performance. For example, according to JPMorgan, in 2011, just 20% of S&P 500 index companies reported on sustainability; today, 85% do. »


## ENVIRONMENTAL

Factors relating to the quality and functioning of the natural environment and natural systems—e.g. carbon emissions, environmental regulation, water stresss, and waste.

- Carbon emissions
- Waste management
- Water management
- Biodiversity
- Climate change
- Material sourcing

## SOCIAL

Factors relating to the rights, well-being, and interests of people and communities—e.g., labor management, health and safety, and product safety.

- Human rights
- Diversity
- Communities
- Health and safety
- Labor management
- Employee well-being

## GOVERNANCE

Factors relating to the management and oversight of companies and other investee entities—e.g., board, ownership, and pay.

- Board
- Ownership
- Remuneration
- Pay
- Accounting

Note: Examples are illustrative and not comprehensive

If ESG was historically confined to the fringes, today it cannot be ignored. Company boards, shareholders, and regulators are increasingly taking aim, making ESG considerations central to company operations. Nearly 80% of directors now report that their boards are focused on aspects of ESG.[3] Recent SEC proxy filings indicate that ESG considerations are becoming a major part of shareholder proposals. And the SEC has increased its focus on ESG reporting, indicating that it eventually intends to create and enforce a comprehensive ESG disclosure framework for public companies. From the investor's perspective, the ESG phenomenon may not just be about complying with the desires of shareholders and regulators. According to JPMorgan, "a growing body of evidence finds that equity funds, for example, that overweight companies with good ESG metrics outperform their benchmarks, and this effect has become more pronounced in recent years. Taken together, this body of research suggests not only that ESG factors affect future profitability but that these future benefits are not fully priced in by equity markets."[4] While there is fierce debate within the academic and practitioner community as to how an ESG focus can affect investment results, there is an undeniable logic that long-term thinking about issues beyond traditional financial metrics should lead to more healthy and sustainable businesses.

At RMB, we do not think ESG is a fad and thus are following a thoughtful and methodical process to building out our approach. This will be expounded on in a future article, but we will share a preview here. We believe that an ESG focus can be incorporated into portfolios for two objectives. First, financially material ESG factors can be systematically included in investment analysis and decisions, with the goal of enhancing long-term risk-adjusted returns. JPMorgan calls this approach "ESG Integrated." Second, some clients may desire "sustainable investment strategies," strategies that go beyond ESG integration. These seek to achieve specific sustainability-related outcomes in addition to financial returns and are typically constructed by screening or tilting portfolios based on sustainability-related criteria. Our goal is to bring an ESG Integrated approach to managing our strategies. A central tenet to our thinking is authenticity. If done well, integrating ESG considerations more deeply into our investment decision-making is a natural extension of what we have always sought to do: consider the future, factor in potential risks and opportunities around companies' financial growth trajectories, assess valuation, and invest accordingly, based on the sustainability of those business models.

In more explicitly defining what ESG means to us at RMB, we will stay grounded in our roots of investing in high-quality companies with strong management teams and a long-term orientation. These types of businesses fit naturally into an ESG framework, and we are excited about the prospect of further refinement. And should a client have specific goals beyond our ESG Integrated approach, we can assist them in identifying a solution that meets their needs.

Our fundamental investment process and long-term philosophy has always naturally led us to invest in companies with favorable ESG characteristics. Smart investors are constantly balancing the desire to evolve and improve with maintaining discipline and not chasing fads. We believe our further focus on ESG-related factors will only result in better portfolios for our clients, while also supporting better-managed businesses in the long-term. ■

1 *William Blair—ESG Spotlight: IDEXX Laboratories. ESG: Change the World (for the Better) One Company at a Time. July 27, 2021*
2 *July 2020 JPMorgan report. Building Stronger Portfolios: ESG Integration. Investment-Led, Expert Driven.*
3 *William Blair—ESG Spotlight: IDEXX Laboratories. ESG: Change the World (for the Better) One Company at a Time. July 27, 2021.*
4 *July 2020 JPMorgan report. Building Stronger Portfolios: ESG Integration. Investment-Led, Expert Driven.*