



Successful Investing with ESG – More Than Just a Trend

Topic of the month June 2020

by T. Rowe Price

ESG in Action

While all eyes are on Covid-19, in the short term, the issue of SRI has faded into the background. But the longer the crisis lasts, the more it can be concluded that especially the sustainability aspect is playing an increasingly important role. Pension funds have pointed out that ESG has become more critical with regard to successful investing according to Armin Prinz, Relationship Management Institutional Switzerland. However, transparency in how ESG is integrated in the investment process as well as defined exclusions should not be neglected. This notion has become a key element within the manager selection process. T. Rowe Price has committed itself to ingrain ESG into its investment processes, impacting how it interacts with thousands of company managements in its portfolios and how it casts its proxy votes. Moreover, disclosure became the number one topic for the firm.

ESG Disclosure #1 Topic of Engagements in 2019

The year 2019 proved to be exciting for ESG at T. Rowe Price. The responsible investing team has continued to grow in size. Now, ESG staff are present in each of the firm's major regions—Baltimore, London and Hong Kong. T. Rowe Price continues to focus on building ESG data tools that allow the company's analysts and portfolio managers to more easily understand their investment universe from an environmental, social, and ethical perspective. The firm's analysts and portfolio managers are supported by specialist ESG teams that have created proprietary tools to identify ESG factors that may impact an investment case, provide written research on ESG topics (both investment specific and thematic), and provide subject matter expertise on specific issues.

According to Maria Elena Drew, Director of Research, Responsible Investing, T. Rowe Price' engagement activities have sought to nurture steady improvements in ESG disclosure by helping companies understand how the firm uses ESG data in their investment analysis and decision making, how T. Rowe Price' clients process ESG data to evaluate their aggregated portfolios, and how they should report environmental data as a uniformly adopted standard does not exist.

ESG factors are considered in tandem with traditional criteria such as financial, valuation, macroeconomic, industry-related, and other factors as part of investment decision-making. The analysts and portfolio managers of the firm have responsibility for integrating ESG factors into investment decisions. Thus, T. Rowe Price' investment approach focuses on the ESG factors deemed to be more likely to have a material impact on the performance of investments in their clients' portfolios. This approach helps to focus on the ESG issues most relevant to a specific business model.



Proxy Voting as Crucial Link in the Chain of Stewardship Responsibilities

T. Rowe Price considers proxy voting a crucial link in the chain of stewardship responsibilities that the firm executes on behalf of their clients. T. Rowe Price uses its proxy voting power in a way that complements the other aspects of the firm's relationship with investee companies, including engagement, investment diligence and investment decision making. T. Rowe Price believes the scale and scope of its business puts it in a powerful position compared to many of its peers when carrying out ESG engagements with companies.

T. Rowe Price portfolio managers are ultimately responsible for the voting decisions within the strategies they manage. They receive recommendations and support from a range of internal and external resources:

- The T. Rowe Price ESG Committee
- The global industry analysts
- The specialists in corporate governance and responsible investment
- ISS, the external proxy advisory firm

T. Rowe Price believes proxy voting is crucial. In contrast, the firm's view on shareholder proposals is more critical.

Shareholder Proposals

While the firm consistently supports effective, well-targeted proposals that reflect its concerns as an investor, T. Rowe Price believes it is debatable whether many shareholder resolutions represent a meaningful solution to various ESG related challenges. In almost every instance, shareholder proposals are non-binding votes that are opposed by the company's management and board. Based on the firm's experience, one-on-one engagement with companies produces better outcomes than shareholder resolutions. It is also important to note that out of 64'249 proposals that T. Rowe Price cast a vote on globally in 2019, only 0.5% were dedicated to environmental and social issues. In 2019, T. Rowe Price continued to evolve its stewardship programme¹:


- The number of meetings with management exceeded 11'000 (with 656 classified as ESG engagements);
- Cast proxy votes on 64'249 proposals at 6'350 meetings globally – representing 99.2% of all meetings held.

But how is responsible investing made possible? How can we be assured that companies own a responsible investing profile? T. Rowe Price uses the Responsible Investing Indicator Model (RIIM) as one of many critical components that contribute to the firm's deep, fundamental investment research.

RIIM Model: Building a distinct responsible investing (RI) profile of each corporate entity

The firm's fundamental investment process is supported by a proprietary Responsible Investing Indicator Model (RIIM) that proactively assesses responsible investing profiles of more than 14'000 corporate and sovereign entities, globally. The RIIM analysis spans over 20 indicators such as supply chain (environment), employee treatment and business ethics to evaluate companies' ESG risks and positive characteristics. In addition, applying RIIM portfolio analysis can help quantify the amount of risk pertaining to ESG issues across a portfolio manager's whole portfolio and compared to the benchmark.

One example of ESG integration in action is the assessment of AIA Group, a pan-Asian insurance provider. Analyst Zenon Voyiatzis notes that investors continue to underestimate the durability and resilience of the



growth achieved by AIA Group. However, the Responsible Investing team's analysis confirmed AIA's robust environmental management program with a particular emphasis on climate change factors. The company incorporates ESG factors such as water scarcity, climate change, environmental regulations, and labor issues, across all asset classes in which it invests, thereby reducing exposure to potential downside risks. This input provided further support for the firm's overall investment analysis.

Furthermore, a second RIIM module is designed to build ESG risk profiles of sovereign debt issuers. In addition to a range of environmental and social factors, the model quantitatively assesses governance factors such as political stability, government effectiveness, regulation and corruption.

While the RIIM model presents a valuable tool in the assessment of ESG risk factors, climate change has not yet been factored in by markets.

The Risk of Climate Change Not Yet Factored in by Markets

Climate change has not been particularly impactful to near-term cash flows for the broader market. This does not mean, however, that companies are not vulnerable to climate change today, but more that they are not yet directly feeling the effect. In many instances, insurance is covering physical risks. Meanwhile governments have not started to regulate or tax companies for greenhouse gas (GHG) emissions, deforestation, or other catalysts of climate change. T. Rowe Price believes that valuations will eventually start to factor in climate change risks, and opportunities, affecting virtually the entire investment universe - albeit to varying degrees. Therefore, it is important for T. Rowe Price' ESG and analysis teams not to neglect the issue of climate change when conducting an in-depth research in these important issues.

Access the full ESG 2019 Annual Report, please [click here](#).

Sustainable funds to further support firm's commitment to responsible investing

T. Rowe Price plans to launch sustainable funds based on five long-established T. Rowe Price portfolios. The range imposes values-based parameters, via an overlay of a proprietary exclusion list, while maintaining the same investment processes and objectives as the core strategies.

Maria Elena Drew says the launch of the sustainable equity funds adds yet another pillar to the group's ESG capabilities. The funds will incorporate the ESG research capabilities that are already integrated across the firm's research platform, as well as safeguard that certain types of securities will not be held in the portfolio. It offers clients access to portfolios that exclude specific companies whose business activities involve controversial weapons, assault-style weapons for civilian use, the production of tobacco, the production of thermal coal and adult entertainment. In addition to this, T. Rowe Price's actively-monitored conduct-based component of the exclusion list ensures the avoidance of investing in companies that have had an extreme environmental, social, ethical or governance breach and are not taking credible steps to remediate the issue.

Take a look at our [ESG Thinking](#)



Reference:

¹ ESG Annual report, as of 31st December 2019

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At T. Rowe Price we're solely focused on providing investment management and long-term results for you and your clients. Founded in 1937, we're an independent investment management firm managing over USD 1'000 billion in assets. We service clients in 50 countries across Europe, the Americas, Asia and the Middle East.*

We offer investors a full range of equity and fixed income strategies across multiple asset classes, sectors, styles, and regions. Our experience through all types of market conditions contributes to a proven investment strategy designed to produce strong performance for the long term.

*Firmwide AUM includes assets managed by T. Rowe Price Associates, Inc. and its investment advisory affiliates. All figures above are as of 31 March 2020 unless otherwise stated.