

# ESG Investing in Equity Markets

= Fall 2022 =

**Mondays & Wednesdays, 3:50pm to 5:20pm**

**PROFESSOR MARK ZURACK**

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## COURSE DESCRIPTION

Most Asset Managers are evaluating how to incorporate Environmental, Social and Governance factors into their investment process. Applying ESG considerations raises the following questions:

- How specifically is a company rated on ESG guidelines? Is there subjectivity in the process because of data limitations and assumptions made in data interpretation?
- Does consideration of ESG factors improve investment performance?
- For investors that emphasize ESG factors for non-financial reasons, how do they measure the positive societal impact their portfolio is having?
- Does an investor add more positive impact buying "good" companies, or focusing on "bad" companies and trying to change their behavior?
- How does an Asset Manager use the power of the Proxy vote and Corporate Engagement to affect change in Environmental, Social and Governance policies?

In this course we focus on how Asset Managers address these questions using a combination of lectures, case studies and guest speakers. This course explores ESG issues faced by the Asset Manager. It does not address how a company manages its ESG risks and opportunities.

The course has three main sections:

- Building Blocks
- Best Practices in Asset Management
- Social Activism and the Future of ESG Investing

All readings and cases can be accessed by control/clicking on the syllabus.  
Most supplemental readings will be accessible through Yellowdig.

## **PREREQUISITE COURSE: CAPITAL MARKETS AND INVESTMENTS**

### **LEARNING OBJECTIVES**

By the end of the course, you should be able to:

- Describe how a company's ESG rating is measured and express the challenges in using ESG ratings
- Use a Sustainable Accounting Standards Board (SASB) report to identify material ESG risks and opportunities for a company you follow
- Examine Climate Reporting practices currently used in light of potential regulation
- Recognize the controversy of whether actively incorporating ESG criteria in the investment process enhances or detracts from performance
- Explain generally how ESG risks and opportunities are used to value a company's stock
- Explain the approaches followed by some of the most prominent Active Equity managers in ESG and Impact investing
- Contrast ESG and Impact strategies used by Private Equity and Hedge Fund managers with strategies used by managers used in Public Equity markets
- Compare the differences between ESG Indices and learn how passive and quantitative managers use them
- Question Social Activism initiatives in Asset Management using Corporate Engagement and Proxy Voting Strategies

### **ASSIGNMENTS**

All assignments must be completed and submitted into Canvas before class. All assignments will be Type A.

For Type A assignments, each student must participate in a group discussion regarding the assignment before submission and review and if needed edit the final submission.

**Collaboration across groups is not allowed. Please hand in one solution per group.**

### **METHOD OF EVALUATION**

Class Attendance and Participation	35%
Assignments	40%
Final Project	25%

The reason for the high weighting in Class Participation is to hear your views on what is a new investment discipline that is still in development. We can all learn from each other.

Posting interesting articles and videos on Yellowdig is another useful way to encourage discussion of current events in the ESG world. I strongly encourage it.

Note there is a Final Project in the Method of Evaluation. The Project involves evaluating the ESG risks and opportunities for a company you select. It is due at the end of the semester.

## **COURSE OUTLINE**

### **SECTION 1 – Building Blocks**

#### **1. ESG Introduction (10/24)**

After a quick review of the course structure, I introduce Environmental, Social and Governance investing in Equity Markets. I then provide some historical perspective on how this process began and the current size of the asset base following ESG guidelines.

Readings:

- [Does ESG Really matter-and why?](#) McKinsey Quarterly
- [ESG Disclosures for Investment Companies and Advisers](#) Simpson Thatcher

#### **2. How Companies are Rated on ESG Factors (10/26)**

In this class we compare the different methods used to classify companies according to ESG standards. Included in our discussion is a review of three companies using the MSCI methodology

Readings:

- [Four Things No One Will Tell You About ESG Data](#) (Kotsantonis, Serafeim)
- [The Devil is in the Details](#) (LaBella, Sullivan, Russell, Novikov)
- [MSCI ESG Ratings Methodology](#) (MSCI)
- MSCI ESG Ratings – Tesla, Inc.

Expanded Readings/References:

- [Aggregate Confusion: The Divergence of ESG Ratings](#) (Berg, Koebel, Rigobon)

#### **3. The Role of the Sustainable Accounting Standards Board/Innovations in Climate Reporting (10/31)**

Bob Herz, a member of the SASB Board and CBS Executive in Residence, will lead a discussion on the development of accounting standards to measure material exposures a company has to Environmental, Social and Governance Factors.

Toward the end of the class, Maneesh Sagar, the founder of RS Metrics and a career coach at CBS will review what companies are doing in climate reporting given pending regulations.

Guest Speakers: Bob Herz, SASB Trustee  
Maneesh Sagar, RS Metrics

Readings:

- [Globally Consistent ESG Reporting - Deloitte](#)
- [Why ESG Data Needs to be Measured at Asset Level - RS Metrics](#)

#### **4. Does ESG Investing Improve Return? (11/2)**

After starting the class with a discussion of the "On Climate and Conscious" and "Does ESG really matter" articles, we discuss ESG portfolio performance. Some investors argue that accounting for ESG considerations will improve risk-adjusted return in addition to allowing you to own a portfolio that better reflects your values. In other words, you can do well by doing good. This class attempts to answer the question theoretically and empirically.

Readings:

- [On Climate and Conscious](#) (Blair)
- [Sustainable Reality](#) (Morgan Stanley)
- [Morningstar's ESG-Screened Indexes Protect on the Downside](#)

Expanded Readings/Reference:

- [ESG and Financial Performance](#) (Whelan, Atz, Van Holt, Clark)

Assignments:

Assignment 1 - On Climate and Conscious Questions (Type A)

### **SECTION 2 - Best Practices in Asset Management**

#### **5. Case Study: Generation Investment Management (11/09)**

Generation Investment Management, founded by Al Gore and David Blood, was one of the first investment managers that believed it could generate superior financial returns by investing in sustainable companies that created long-term value for society.

As you read the case, try to think about their mission, organization, and culture in the context of where the world was in 2004.

## Readings:

- [Generation Investment Management](#) (HBS Case)
- John Deere report

## Assignments:

Assignment 2 - Generation Investment Management Questions (Type A)

Guest Speaker: Vikas Jain, Generation Investment Management

## 6. Wellington Global Impact/Public Equities Impact Investing at BlackRock (11/14)

The Wellington and BlackRock Cases describe the creation of Mutual Funds designed to outperform its benchmark as well as have a positive societal impact. In class we will discuss both cases.

## Readings:

- [Wellington Global Impact](#) (HBS case)
- [Public Equities Impact Investing at BlackRock](#) (HBS case)

## Assignments:

Assignment 3 - Questions on Wellington Global Impact/BlackRock Cases (Type A)

Guest Speaker: Eric Rice, BlackRock

## 7. Impact Investing in Private Equity Markets (11/16)

Some investors believe that it is easier to manage a company that provides positive societal impact in private markets. The reasons they cite is that more mature companies are saddled with legacy policies and investors in private markets are under less pressure to deliver strong financial results in the short-term and can focus on achieving their mission.

In this class we will discuss a HBS case on Imprint, a private Impact Fund which became the engine for Impact Investing at Goldman Sachs.

## Readings:

- [Goldman Sachs: Making an Imprint in Impact Investing](#) (HBS case)

## Assignments:

Assignment 4 - Questions on Imprint Case

Guest Speaker: John Goldstein, Goldman Sachs

## **8. Passive and Factor Based ESG Investing (11/21)**

Investors looking for a low-cost way to obtain ESG equity exposure can look to a fund designed to track an ESG index.

We start class by comparing the different ESG indices which ties to our earlier work on ESG classification systems. We then move to the use of Exchange Traded Funds (ETFs) on ESG Indices, a popular vehicle for investors

Toward the end of the class, we will discuss how Quantitatively based Factor portfolios are impacted by ESG considerations

## **9. Analyzing ESG Risks and Opportunities in Stock Valuation (11/28)**

As you probably know, most active managers employ Fundamental Analysis of companies to select stocks. More and more, those managers take into an account ESG factors in their analysis. Two guests will go through a Financial Analysis of a company with and without consideration of ESG factors and discuss how ESG considerations impact the valuation of stocks in the Utility industry.

Guest Speaker: David Wei, SolarKal

Steve Fleishman, Wolfe Research

## **10. ESG Investing in Alternatives: Hedge Funds and Private Equity (11/30)**

Short selling is an important component of many Hedge Fund strategies. Short selling can also be used to change the net amount Carbon Emissions coming from a portfolio of companies.

With the help of a Lukasz Pomorski of AQR, we explore how a quantitatively oriented asset manager uses short-selling strategies to reduce the Carbon Emissions of an Equity Portfolio without sacrificing a material amount of Expected Return

Note there is some disagreement on how to measure short selling in the context of measuring the ESG components of a portfolio, most notably, Carbon Emissions which we will discuss

Then, Elizabeth Seeger, formerly at KKR and the new co-head of the IFRS Foundation, will review how large Private Equity Funds integrate ESG into their investment processes.

Readings

- [ESG Reporting in Long-Short Portfolios](#), Executive Summary
- [US Private Equity Firms: ESG and Impact \(A\)](#) (HBS Case)

Expanded Readings/References:

- [Clearing the Air: Responsible Investment](#)
- [Responsible Asset Selection: ESG in Portfolio Decisions](#)

Guest Speakers: Lukasz Pomorski, AQR  
Elizabeth Seeger, IFRS

### **SECTION 3 - Corporate Engagement and Activism/The Future**

#### **11. Influencing Corporate Behavior (12/05)**

By reviewing the BlackRock case we explore how asset managers use Proxy Voting and Corporate Engagement to influence the behavior of the companies they own. We then discuss how the Hedge Fund, Engine 1, influenced the Board of Exxon to alter its policy on environmental sustainability

Readings:

- [Public Equities Impact Investing at BlackRock](#) (HBS case)
- Larry Fink's 2022 Letter to CEOs
- The Little Hedge Fund Taking Down Big Oil
- [Exxon Mobil declares new goals](#)
- [Investment Stewardship Ecosystem, pp. 5-11](#)

Assignments:

Assignment 5 - Questions on BlackRock Case and Engine 1 Reading (Type A)

#### **12. The Future of ESG Investing (12/07)**

A group of industry experts will share their views on the future of ESG investing.

Please come to the class with questions.

Guest Speakers:

Abby Cohen, Goldman Sachs

Jonathan Bailey, Neuberger Berman