**ESG Investing in Public Equity Markets**

**=Spring 2021=**

**Mondays & Wednesdays, 5:40pm to 7:10pm**

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**REQUIRED COURSE MATERIAL**

Some selected cases can be accessed by control/clicking on the syllabus, some readings are on electronic reserve and accessible through the Library Reserves tab in Canvas (LR), and in PDF files under “Miscellaneous” in the Files tab in Canvas (PDF).

**REQUIRED PREREQUISITES: CAPITAL MARKETS AND INVESTMENTS**

**CONNECTION WITH THE CORE**

This course builds on knowledge from the Capital Markets and Statistics courses (B8306). Specifically, statistical techniques are used to evaluate portfolio risk and return. In addition, concepts introduced in Capital Markets like Beta, the Capital Asset Pricing Model, Sharpe Ratios, and Active and Passive Management are used in various forms of ESG investing and referenced throughout the course

**COURSE DESCRIPTION AND OBJECTIVES**

As you probably know, more and more institutions are re-evaluating their Investment Guidelines to take into account Environmental, Social and Governance considerations.

This process raises a series of tricky/interesting issues:

* How specifically is a company rated on ESG guidelines?
* There are multiple companies that provide ESG ratings, which one should an investor choose? Are they consistent with each other?
* Does consideration of ESG factors improve investment performance?
* Do some investors incorporate ESG factors for reasons other than investment performance?   
  Is there a cost of that decision? How does that cost square with the Fiduciary responsibility an Asset Manager has?
* How does an Asset Manager use the power of the Proxy vote and Corporate Engagement to affect change in Environmental, Social and Governance policies

This course tries to answer the questions just raised as well as address other issues Equity Investors face. Its main topics cover:

* Comparing ESG Classification Systems
* Comparing historical returns, risks and costs of portfolios that incorporate ESG factors versus ones that don’t
* Evaluating how Active managers incorporate ESG factors into their portfolio management process, contrasting Fundamental versus Quantitative approaches
* Review Passive ESG investing focusing on Index Selection and the use of Exchange Traded Funds
* Explore how Asset Managers use the power of the vote and other forms of engagement to affect change in Corporate Behavior.

**ASSIGNMENTS**

All assignments must be completed in writing with hard copies handed in before class.   
Some assignments will be Type A, some Type B.

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.

For Type B assignments, each student should attempt to answer the questions on their own   
before collaborating with other students.   
Each student should hand in their own submission for Type B assignments.  
  
**METHOD OF EVALUATION**

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| --- | --- |
| Class Participation | 40% |
| Assignments | 25% |
| Final Research Paper | 35% |

An important component of Class Participation is attendance which will be tracked.

I reserve the right to downgrade (including failing) any student who misses a significant number of classes or does not complete all of the assignments. It is expected that your camera is on during class, unless there are special circumstances which you should discuss with me in advance.

Notice that there is a Final Research Project in the Method of Evaluation. The Final Paper can be worked on by your group or individually (expect the same amount of work either way) based on a topic of your choice related to ESG Investing in Public Markets.

**COURSE OUTLINE**

1/2. ESG Introduction/ESG Rating Agencies (03/08 & 03/10)

After a quick review of the course structure, I introduce how Environmental, Social and Governance factors influence 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.

We then compare and contrast the different methodologies used to classify public companies according to ESG standards. In this discussion we introduce the role of the   
SASB (Sustainable Accounting Standards Board) as well as the United Nations Principals for Responsible Investment.

Readings:

* On Climate and Conscious (Blair)
* 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)
* Measuring Unethical Behavior: Rigobon (<https://www.statestreet.com/events/statestreetlive/stt-live-esg-forum-2019/roberto-rigobon.html>)

Advanced Reading:

\* Aggregate Confusion: The Divergence of ESG Ratings (Berg, Koelbel and Rigobon)

3/4. How ESG Investing Impacts Performance, Risk and Cost (03/15 & 03/18)

Any institution considering establishing an ESG policy should start by defining its goals. If you believe the policy will improve risk adjusted return, then it is an easy decision, you are doing well by doing good.

However, for those are not confident that is the case, perhaps there is a cost to own an equity portfolio that better reflects your values. Is it possible to measure the cost?

This class attempts to answer the question theoretically and empirically. Drawing on what you’ve studied in Capital Markets we look at the systematic and non-systematic risks of an ESG portfolio to determine what “Alpha” is needed to justify the cost.

Empirically, I try to summarize the literature on performance of ESG funds versus their unrestricted counterparts. Finally, I look at the fee differences between ESG and non-ESG funds.

Readings:

* Sustainable Reality (Morgan Stanley)
* Fiduciary Duty in the 21st Century (<https://www.unpri.org/fiduciary-duty-in-the-21st-century-final-report/4998.article>), Principals for Responsible Investment
* Public Sentiment and the Price of Corporate Sustainability (Serafeim) (<https://www.statestreet.com/events/statestreetlive/stt-live-esg-forum-2019/george-serafeim.html>)

5/6. Passive Investing in ESG – Indices and Exchange Traded Funds (03/22 & 03/24)

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 and contrasting the different ESG indices which will tie to our earlier work on ESG classification systems. We then move the use of Exchange Traded Funds (ETFs) on ESG Indices, a popular vehicle for investors

A guest speaker will then discuss how they use ESG based ETFs in their Fund.

Readings:

* Bloomberg SASB ES

Assignments:

\* Assignment 1 – CAPM Approach to ESG Investing (Type B)

7/8. Using ESG factors in Fundamental Active Strategies (03/29 & 03/31)

As you probably know, most active managers employ Fundamental analysis of companies to select stocks. More and more of those managers take into an account ESG factors in their analysis of companies.

Following our discussion of the Wellington case, one or two guest speakers will describe how their organizations consider ESG factors in constructing portfolios.

Readings:

* A Blueprint for Integrating ESG into Equity Portfolios (Bender, Bridges, He, Lester and Sun)
* A Practical Guide to ESG Integration For Equity Investing – Principals for Responsible Investment
* Guidance and Case Studies For ESG Integration – CFA Institute
* Wellington Global Impact (HBS case)

Assignments:   
Assignment 2 – Questions on Wellington Global Impact Case (Type A)

9/10. Using ESG factors in Quantitatively Managed Portfolios (04/05 & 04/07)

Some active managers heavily rely on quantitative processes to construct portfolios. In some cases, those portfolios attempt to identify common factors inherent in companies that potentially lead to outperformance. That approach is often referred to Factor or Smart Beta investing.

With the help of two guest speakers we explore how Quant Managers integrate ESG Factors into their models and whether ESG indicators are compatible with the factors their models have relied on in the past.

Readings:

* Responsible Asset Selection: ESG in Portfolio Decisions

11/12. Influencing Corporate Behavior (04/12 & 04/14)

To complete the course, we explore how asset managers use Proxy Voting and Corporate Engagement to influence the behavior of the companies they own. Prominent in this process is the role of the Corporate Governance advisors like Institutional Shareholders Services (ISS).

Advisors like ISS have set specific standards on how they handle ESG related matters which we review. We then discuss how more and more Asset Managers have become more directly involved in Corporate Governance and what trends to expect going forward.

We end the course with a look to the future. Going back to before I went to business school, we were all taught that to fulfill their fiduciary responsibility, senior management should maximize shareholder value. Consistent with that, the goal of an Asset Manager is to maximize risk-adjusted returns.

How does that behavior square with Socially Responsible investing under ESG guidelines? What do the laws say? Is regulation needed to truly change behavior?

Readings:

* BlackRock: Linking Purpose to Profit
* Stewardship Report 2019 – Goldman Sachs Asset Management (GSAM)

Assignments:

Assignment 3 – Questions on Blackrock Case and GSAM Report (Type A)