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Baer Pettit Interview

Moderator: Larry White, Managing Director Business Development, DBRS | Morningstar
Speaker: Baer Pettit, President and Chief Operating Officer, MSCI

- ESG topics are increasingly viewed through the lens of financial risk and are weighted more heavily now in the context of climate change. In some ways, ESG is a way of thinking about companies' approach to climate change.
- MSCI surveyed over 200 institutional investors globally and highlighted several key challenges and trends driving investment decisions, including the accelerated move to ESG.
    - North American asset owners put ESG and climate considerations as a top priority, and EMEA investors experienced more regulatory pressure to involve ESG in their investment decisions. Conversely, APAC investors were more focused on mitigating market volatility and turbulence. Both APAC and EMEA investors cited ESG and climate as secondary concerns.
- There seems to be a correlation between the size of an institution and the concern for ESG; the larger the organization, the greater the focus on ESG and climate.
- Larger firms are generally better equipped to handle the cost of procuring ESG data, and there is enormous diversity across the population of data providers.
- The concerns are not so much cost related as it is around determining and reconciling the fundamental approach on ESG integration with traditional asset allocation and risk management strategies. Fiduciary duty and risk management are central concerns that are top of mind for investors.
- In Europe it has been adopted as best practice; Canada is ahead on the topic compared to the US, and domestically there is less of a uniform response on the topic of ESG integration and adoption.
- 2020 saw record investment into ESG related funds. How much of this trend was due to the pandemic or other factors at play?
    - Dramatic decline in demand for air transport, unusual oil price activity and various containment measures have contributed to the underperformance experienced by certain industries that contribute to carbon emissions, such as the aviation industry, which saw significant underperformance relative to other sectors. In practice, many ESG tilted funds had extremely strong performance during the same timeframe, and the combination of these factors accelerated a trend that was already on an upward incline.
    - Are these returns sustainable? There is some data to support the thesis that companies running to a higher ESG score correlate to higher quality scores, as those companies have performed well over time, though it runs the risks of generalizing across portfolios and asset classes. There could be a trend reversal of a similar magnitude coming out of the pandemic for those industries, and the focus should be around longer-term trends on best management practices of an organization, which will likely lead to stronger or less volatile returns in the long run.
- It is crucial to look at sectors on its own terms and avoid grouping things together in terms of an approach / methodology, and use comparables as a way of benchmarking.
- Some concerns around the increasing regulatory pressure around ESG integration may be that there is a rush to create blunt instruments in a complex asset class without sufficient due diligence.
- There should not be a need for the industry to streamline ESG ratings from different companies, as differentiation in ratings introduces different opinions and inputs, which is a net positive for the growing space.