ESG Framework

CanterburyConsulting

Purpose of ESG

Canterbury believes that investment advice, whether it be asset allocation, manager selection, or client engagement, should be independent and tailored for the client. Taken one step further, a client should have the choice to incorporate their mission, values, and morals within the construct of their investment portfolio or by investing in mission-related projects. Clients are placing a greater focus on how to implement ESG (environmental, social, and governance) factors through both active and passive mediums. Historically, clients have emphasized negative screening, where companies or stocks that misalign with respective values were discarded from the portfolio. Clients have since expressed interest in making a positive impact within an ESG framework by focusing on specific project-based initiatives or by choosing strategies that focus on best-in-class companies. While the data is still mixed, there is interest in whether ESG factors could potentially lead to better risk-adjusted performance.

Canterbury believes that by offering a wider array of ESG solutions, clients will be better equipped to use an approach that fits their mission, values, and investment objectives. In 2018, Canterbury created an ESG Committee in order to synthesize and streamline the ever-growing ESG universe. The committee includes senior consultants, executives, and members of research.

How Canterbury Defines ESG

Canterbury defines ESG as three separate categories: exclusionary screening, best-in-class selection, and positive impact. All three categories offer different strengths and weaknesses.

Exclusionary Screening

Exclusionary screening removes from an investment portfolio companies and sectors that go against a client's social or moral values. This strategy excludes companies based on core or significant business activities and uses revenue or other business-related factors to justify the exclusion. While effective in ensuring compliance with a client's ESG guidelines, overly broad screening constraints could create significant tracking error and return differentials relative to an "unscreened" portfolio. Furthermore, ESG analysis ends once portfolios exclude the targeted securities or sectors. Portfolios are updated only if the screening criteria is altered. This exacerbates the potential for portfolio style drift and return variation. Exclusionary screening is typically implemented across liquid equity strategies that are situated in vehicles that allow for customization (i.e., separately managed accounts). Screening is much harder to implement in fixed income or less-liquid asset classes, given the size and liquidity needed to execute in a fee-sensitive manner.

Best-in-class Selection

Best-in-class selection is a strategy that invests in companies or industries with the best ESG attributes. Companies can be evaluated on an absolute basis, where the total ESG score of a company is compared with the entire ESG universe, or on a relative basis, where companies are compared with their relevant peer groups or sectors. Additionally, investment managers can utilize bottom-up ESG scoring to assist in the fundamental evaluation of a company. Positive ESG attributes can potentially correlate with long-term business sustainability, which could lead to higher and more persistent expected returns. Many indices are available to help measure ESG parameters, such as the MSCI ESG Index, though investing directly in the index is not required. The index rankings are helpful for comparing a company against its sector and industry peers. Best-in-class can also dovetail into thematic-based investing, where companies and securities are selected based on specific ESG criteria or rankings. Best-in-class selection is easier to implement across asset classes relative to exclusionary screening, because investments are initiated based on the underlying ESG criteria, rather than taken out after the fact.

Positive Impact

Positive impact investing looks for companies or industries that directly involve specific initiatives, such as community development or environmental regulations. Investments are selected with specific outcomes in mind and typically have an estimated expected return. Impact investing can be highly customizable and can relate directly to a client's mission and values. For instance, many endowments and foundations are beginning to utilize program-related investing (PRI), where grant-dedicated funds are invested in a project that directly relates to the client's mission.

Positive impact investing can also promote meaningful change in companies or industries by addressing sustainable or impactful themes directly with management teams and shareholders. This form of activist investing can be achieved through public markets, where a group of like-mined shareholders use their combined influence to propose specific ESG-related changes. Meaningful change can also be realized in private markets. Private equity managers who control the boards of their underlying portfolio companies can propose and implement ESG-related changes in a quick and efficient manner.

How Canterbury Implements ESG

Implementing ESG initiatives and underwriting ESG-related managers can be much more nuanced relative to that of traditional asset classes. Clients tend to have a wide range of opinions and views on how ESG is defined, which leads to a wide assortment of potentially relevant solutions. Implementation varies for each ESG category.

Exclusionary Screening

Canterbury uses MSCI's ESG Screener to flag companies that are misaligned with a client's values. The screener is customizable and can be implemented as frequently as needed. Canterbury works directly with the targeted equity manager to remove stocks that hit the screen. Currently, we use the screen for active equity strategies that utilize a separately managed account, and are exploring the use of exclusionary indices.

Best-in-class Selection

Canterbury will look to approve managers who actively invest using ESG factors. Potential managers could utilize ESG as a single factor among other fundamental factors, or could focus on specific ESG themes, such as renewable energy or sustainable agriculture. Another layer of due diligence is required to accurately assess the quality of a manager's ESG rating system and ESG reporting capabilities. ESG manager selection will be implemented across the public markets, which includes equities, fixed income, and real assets.

Positive Impact

Canterbury will look to money managers who invest in companies that promote positive impact and sustainable initiatives. In order to find customizable ESG-related initiatives and projects, Canterbury will partner with PRI firms who solely focus on targeted and related investments. Canterbury will also encourage proactive shareholder engagement for clients who want to make a direct impact with public market companies. This can be implemented through the firm's relationships with money managers, custodians, and other ESG-related organizations such as the UNPRI (United Nations Principles for Responsible Investment).