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The “S” in ESG: the ugly duckling of investing

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01

Preface: The ugly duckling of investing. Why the middle initial is key

Christian Nolting
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Social sustainability is a term rarely heard in the context of investment management, especially in the past. It has taken a lot longer than environmental sustainability to reach the investment mainstream, in fact it is only in the past decade that social metrics have started being reported consistently by companies and analysed by investment managers. To this day, substantially more consistent frameworks exist for measuring environmental impact than overall social impact. For instance, only 14% of the purely "social" ratings compiled by the Global Reporting Initiative (GRI), an independent organisation focused on sustainability reporting, are targeted at an audience of investors. In contrast, 97% of environmental ratings and 80% of governance ratings have investors as their primary audience. One reason is probably that social issues span a rather broad spectrum of factors: from consumer rights and product safety to worker rights and worker safety, including child labour and slave labour; to the wider community including inequality, social inclusion and financial inclusion issues, and finally political and geopolitical issues ranging from human rights to conflict minerals, bribery and corruption.

It has been proven time and again that non-financial considerations such as social metrics have a measurable financial impact on investments.

While the ethical beliefs behind these efforts are evident, what is perhaps less evident is the meaning of this approach to investing: it means that the effect an investment has on society has been taken into consideration before investing. Prospective financial return and prospective consequences on society become part of one and the same investment decision. Herein lies the definition of the S in ESG. Nowadays it is not uncommon to hear companies talk about their concern for employees and stakeholders, but from an investor's point of view, taking into consideration the social implications of an investment is still new to many, even though it has been proven time and again that non-financial considerations such as social metrics have a measurable financial impact on investments. Nevertheless, so far the middle initial of ESG investing has been neglected to the point where it has become the ugly duckling of the investment world. However, this status does not do the S in ESG justice. Essentially, attention to social considerations is nothing less than an effort to put the human being at the centre of any economic activity with the purpose of preserving the welfare of all economic stakeholders.

Bluntly put, in terms of social awareness, things need to change. In our last CIO Special on the "E" in ESG we pointed out how environmental considerations need to be part of a wider societal debate and at the same time need to be taken into consideration before taking any investment decision. In this in-depth look at the „S" in ESG we draw the attention to social criteria that have, so far, played second fiddle to environmental considerations. Going further, we aim to throw social considerations into the spotlight of public awareness in order to give them the visibility they deserve. Looking ahead to next year, we will publish a CIO Special on governance, which we consider to be the facilitator that helps implement environmental and social criteria into corporate policy.

02

"S" is for social: setting the scope for investment management

What do we mean by S in the context of ESG? Social issues are very broad. The scope of S in ESG covers almost any public policy objective that companies might influence, such as reducing inequality, enabling more inclusive growth and promoting greater diversity in the workforce, in company management and on boards. The illustration in Figure 1 shows a few of the main elements that make up the S in ESG.

Figure 1: The many facets of the S in ESG

Source: Deutsche Bank AG. Data as of September 2019.

In Europe, Middle East and Africa as well as in Asia Pacific this material is considered marketing material, but this is not the case in the U.S. No assurance can be given that any forecast or target can be achieved. Forecasts are based on assumptions, estimates, opinions and hypothetical models which may prove to be incorrect. Past performance is not indicative of future returns. Investments come with risk. The value of an investment can fall as well as rise and you might not get back the amount originally invested at any point in time. Your capital may be at risk.

While many companies and industries have performed well despite not holding to some principles of S, this may not be true for all of them in the future. In a world in which the public is becoming more concerned about social problems, attitudes are changing and governments and regulators are coming under pressure to intervene, deficiencies in social criteria could be a long-term existential threat to certain sectors. According to Porter and Kramer (2006) and shown in Figure 2, "the principle of sustainability appeals to enlightened self-interest, often invoking the so-called triple bottom line of economic, social, and environmental performance. In other words, companies should operate in ways that secure long-term economic performance by avoiding short-term behaviour that is socially detrimental or environmentally wasteful".

Figure 2: Social criteria across primary and support activities

Source: Porter and Kramer (2006).

As ESG screening is moving into mainstream investment thinking, it has become more closely integrated into the investment process. Even for investment vehicles that are not explicitly following socially responsible guidelines, a focus on companies' social responsibility and their policies on everything from product safety to staff wellbeing has grown, although there is still a long way to go.

Strategies with a focus on social matters are becoming increasingly sophisticated, i.e. by looking for firms that are actively trying to do good and improve their standing on a range of criteria rather than just by applying exclusion filters to conventional investment portfolios. Active approaches typically seek to improve company behavior through engagement and voting, often in collaboration with other investors. Social goals can be pursued through active or passive investment strategies.

Demarcating issues into E, S and G is of course sometimes artificial to the extent that S can overlap with E and G. For instance, pollution is both a workplace and a wider societal issue, and coal can give miners black lung disease, apart from contributing to carbon emissions. Similarly, aspects of governance such as worker representation clearly overlap with some social criteria while another facet of governance – proxy voting – has been used to vote on social issues since a landmark case in the 1970s (Medical Committee for Human Rights vs. U.S. Securities and Exchange Commission (SEC)). More fundamentally, if poor corporate governance prevents adequate disclosure, it is not possible to implement a socially responsible strategy. Therefore, some of the milestones in S investing have naturally gone hand in hand with initiatives raising the profile of E and G issues.

Social strategies so far have mainly been implemented within equities, but can equally be applied to fixed income instruments. So far, the universe of social bonds is still much smaller than the green bond market. According to International Capital Market Association (ICMA), outstanding social bonds are worth about EUR 50 billion, compared to EUR 599 billion for green bonds, while the annual issuance is about EUR 47.4 billion for social bonds and between EUR 180 and 240 billion for green bonds.[1]

We believe that social bonds have considerable potential ahead of them. In order to exploit this potential fully, it will be important to avoid a number of possible pitfalls. Critics have admonished that it is wrong to put a financial value on improving the lives of vulnerable people. Further, is has been noted that when governments use social bonds to pursue specific objectives, they all too easily end up imposing performance requirements on private sector fund managers, which should not happen. However, these concerns can be addressed. It is a matter of implementation, as with green bonds. Studies have shown ways in which this can be done, and certainly more solutions will be found as the social bond sector evolves.[2]

[1] See Impact Invest Lab (2018) for more details.

[2] See Forbes (2018).

03

Social criteria have a long history in investment management

Sustainability and social responsibility are arguably as old as mankind itself, as we have pointed out in the first iteration of our CIO Specials on ESG, published in 2017 with the title "Act today to ensure our future – understanding ESG". Even when it comes to applying social considerations to investment management, as far back as the early 18th century John Wesley, the founder of the Methodists, advocated applying what nowadays we would call social exclusion filters to investments. Essentially, he preached against earning money from a wide range of industries such as alcohol production, gambling, usurious lending and unethical business practices such as bribery. In the century before John Wesley, the Quakers in England already practiced an early form of socially responsible investing by applying ethical criteria to their business ventures. In fact, Friends Provident, who launched the UK's first ethical unit trust, trace their roots back to the Quakers. The eighteenth-century economist and philosopher Adam Smith, credited for laying the intellectual foundation of today's free-market economy, formalised the principle that concern for others must exist alongside self-interest when he wrote that: "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it."[3]

As far back as the early 18th century, the founder of the Methodists advocated applying social exclusion filters to investments.

In Scandinavia, the Lutheran Church pension funds have also been investing along ethical lines for many decades.

The concept of social responsibility began to spread into the mainstream in earnest in the middle of the last century, when mutual funds began to take up the idea (the Pioneer Fund began screening out what they called "sin" stocks, i.e. investments in activities not considered virtuous such as gambling and alcohol, in 1950) and some institutions such as pension funds began including ethical restrictions in their mandates. Figure 3 illustrates the evolution of social considerations in modern times. This approach initially was limited to excluding specific industries (mostly tobacco, gambling, pornography and weapons) that investors considered to be social evils, but from the 1960s onwards, investors and institutions started focusing on how wider social and political considerations should affect investment decisions. Sanctions applied against South Africa (under The Sullivan principles conceived in the 1970s) to protest against apartheid are an early example of negative screening at the country level.

In many developed countries, the post-war period saw the spread of labour unions that were created specifically to uphold social standards in working conditions. But these considerations were not integrated into the realm of investment management, they were the object of negotiations between employees and employers. In 1953 Howard Brown coined the term Corporate Social Responsibility (CSR) in his book "Social Responsibilities of the Businessman", but it was not until 46 years later, in 1999, that the Global Reporting Initiative (GRI), now followed by 11,000 companies, was introduced. It was followed by the International Integrated Reporting Council (IIRC) in 2010 and the Sustainable Accounting Standards Board (SASB) in 2013.

[3] See Smith (1759).

Figure 3: A timeline of social responsibility within modern investment management

Source: The Alliance of Religions and Conservation, Deutsche Bank AG. Data as of October 2018.

The discovery of an economic impact of the social aspects of businesses in some ways anticipates sustainable investing as we know it today, inasmuch as CSR can be seen as an ESG focus before its time. In the early 1990s, CSR gained public prominence after a scandal about controversial labour practices among sports apparel producers received extensive media coverage. Soon after, major oil companies and the pharmaceutical world found themselves in the media spotlight as well. These developments show how social considerations have had a slow start in reaching the public awareness that they are only just beginning to obtain. While locally there have been several initiatives to promote what we may call a social consciousness in business and, gradually, in investment management, only now is the speed starting to accelerate to a level where social criteria are no longer a niche interest of a few early adopters.

Nonetheless, a growing body of institutional investors are setting up groups to focus specifically on social issues, such as human rights. The Corporate Human Rights Benchmark (CHRB), backed by investors managing USD 5 trillion, was founded in 2013. Last year it publicly criticised a number of companies for not meaningfully engaging with investors on modern day slavery, worker rights, and freedom of association.[4] The Investor Alliance for Human Rights, founded in 2018, represents investors with over USD 2 trillion in assets under management and uses investor leverage to avoid adverse human rights impacts.[5] The U.S. Human Capital Management Coalition (HCM Coalition) – an organization comprising 25 investors with USD 2.8 trillion in assets, petitioned the SEC in 2017 to require issuers to disclose information about their human capital management policies, practices and performance. Currently, the SEC only requires disclosure of headcounts, which goes some way towards explaining why some parts of S have been orphans within ESG. Generally speaking, the social impact of what companies do is one of the most important aspects of sustainability. Products and services are delivered by employees to customers, and the wellbeing of both parts in this transaction is paramount for the wellbeing of society at large.

[4] See The Alliance of Religions and Conservative (2017) for more details.
[5] See Investor Alliance for Human Rights (2018).

04

Recognizing and reporting the “S” in ESG

Measuring social impact is difficult because much of the data is qualitative or binary information relating to inputs or intentions, rather than measurable outputs. The latter can be turned into various frameworks of reporting standards, but they are not always consistent. Geographically, some are global, others U.S.-based, and others come from Europe. Within geographic regions, there are differences between standards, which might be seen as competing or complementary. The fact that larger firms tend to have more extensive reporting also makes it harder to make fair comparisons between companies.

One reason social criteria are difficult to measure is “the babble of many tongues”. For instance, the correlation between ESG ratings providers’ S-scores for 2,450 companies is as low as 0.3 between MSCI and either Sustainalytics or Thomson Reuters, and around 0.6 between Sustainalytics and Thomson Reuters.[6] Sometimes it is simply not feasible to obtain comprehensive data. For instance, any company that operates a complex global supply chain has to be confident in the quality of its supply chain audits, but this can become an enormously complex exercise, as a thorough analysis needs to go through multiple iterations of looking at a long chain of subcontractors which could span multiple countries.

Nonetheless, the perfect should not be the enemy of the good. Measurement difficulties should not stop investors from considering social factors on a best efforts basis, because there is plenty of evidence that shows a correlation between better social aspects and stronger investment performance. As measurements of the impact of social criteria on businesses have started, we have begun to see how companies with more diverse boards have outperformed and data breaches and product recalls have been bad for shareholders. Diversity can be considered as the social equivalent of biodiversity in nature. Similarly to how biodiversity is the lifeblood of nature, social diversity in its various manifestations enriches society and business.

NYU Stern researchers conducted an in-depth study of the state of ESG measurement (The S in ESG) and broke down the frameworks used into three main groups:[7]

01 Company-focused frameworks: Sustainability and human rights reporting guidelines for companies to inform their public disclosures on social and sustainability practices.
E.g.: Sustainability Accounting Standards Board, Global Reporting Initiative, UN Guiding Principles Reporting Framework

02 Investor-focused frameworks: ESG data providers, third-party research services, and ratings and indices designed specifically to aid investment decisions.
E.g.: Bloomberg, Dow Jones, MSCI, Cambridge Associates, SustainAbility

03 Human rights-focused frameworks: Publicly available ratings and rankings designed by human rights experts to identify which companies are leading on labor and other human rights factors specifically.
E.g.: NGOs such as Oxfam, UN Working Group on Human Rights and Transnational Corporations and Other Business Enterprises, Investor Alliance for Human Rights

The NYU’s findings show how social impact is being measured from multiple angles, showing that a lot of work remains to be done in this area. It will take some time before the frameworks used to evaluate social considerations reach the rigour and consistency of environmental and governance criteria. same rigour and consistency we now see for environmental and governance issues.

[6] See Schroders (2018).
[7] See NYU Stern (2017).

These issues are extremely important from a public policy perspective and investors need to be conscious of the impact that they may have on specific sectors and the wider economy over the long term. However, given the unwieldy number of potential social factors that can be measured and may be incorporated into screens and indices, investors also need to consider which factors can reasonably be assumed to have an impact on company performance. A successful social investment strategy needs to distil them down to the most salient points, in particular those that can be effectively analysed. The named researchers find that out of the more than 1,700 social indicators they examine in their analysis, only 8% actually evaluate the effects of company practices. This comes down to so-called intangible asset creation.[8]

The social dimension is arguably the least standardisable of all sustainability criteria.

Notably, even the most investor-focused measurement frameworks (e.g. those developed by Dow Jones, FTSE, Bloomberg) are prone to qualitative factors, as 84% of indicators are vague or limited, making it hard to capture social impact. That said, there are positive developments underway. Company-focused frameworks such as those developed by the SASB include a higher proportion of indicators that measure effects. These frameworks are now starting to be used in academic research into investment performance, which will start to give us more evidence on whether better performance on S equates to better investment performance.

Reporting standards can be global or European. The proliferation of standards and reporting metrics makes it difficult to compare companies on a common basis. The EY 2018 Global Climate Change and Sustainability Services study of institutional investors suggests that there is a desire for harmonisation, with 70% of respondents believing this should be led by national regulators and 60% by international organizations and NGOs. If we home in on the issue of workplace accidents and fatalities, there is a lack of consistency between countries and over time. For instance, in 2017 the Australian Council of Superannuation Investors found that 67 of Australia's largest 200 companies were not reporting workplace fatalities. It also identified a lack of consistency in how companies reported various workplace injury and fatality issues.[9]

[8] See Nasdaq (2018) for more details.

[9] See Financial Review (2019) for a broader discussion.

05

Guest contribution by Professor Del Giudice: Social criteria can reduce risk – with clear corporate and investor benefits

Guest contribution by
Professor Alfonso Del Giudice, Università Cattolica del Sacro Cuore, Milan, Italy

There has been much talk over the past years that the attention to social matters within the corporate world can help avoid a number of risks, thereby contributing to the long-term health of an enterprise. However, the evidence for a relationship between social aspects and risk at firm level was, until now, anecdotal. For this reason, we have conducted a study in order to assess whether a statistically significant, quantitative causal link between social matters and firm risk can be established, and what types of risk are concerned. In particular, this study has focused on finding out how the adherence to ESG criteria, in particular the aggregated score in a third-party ESG index, influences the systematic, the idiosyncratic and the total risk of the firm. What we have found on the outset is that a company’s adherence to social guidelines has a very different impact on its risk profile than the adherence to environmental and governance criteria. Therefore, we have been able to isolate social criteria from the more general ESG criteria analysed by much of the preceding literature on the subject.

In order to conduct this study, we have built a sample of 1,063 firms from different sectors and industries and adjusted them for differences in size, leverage, return on assets, liquidity, debt and the volatility of their revenues. These companies were drawn from 18 countries, taking into account their financial performance for a period of 14 years, from 2002 to 2016, measured against the average performance of European, U.S., Japanese and UK stocks. The ESG scores were taken from two independent sources, Refinitiv and MSCI, in order to obtain an objective valuation of ESG impact. The social pillar, according to the definition used by Refinitiv, quantifies the ability of a company’s business model to generate trust and loyalty among its stakeholders, to create value that supports the quality of working conditions, to strengthen its reputation within the community and to safeguard human rights and safety.

Figure 4: How the social pillar reduces firm risk

The table reports results from regressing the Refinitiv ESG Index and control variables against … against total, systematic and idiosyncratic risk. ***, ** and * denotes significance at the 1%, 5% and 10% level, respectively. Data as of October 2019.

Variable	Total risk	Systematic risk	Idiosyncratic risk
E	-0.008*	-0.001	-0.003**
S	-0.009**	-0.042***	-0.005***
G	-0.012***	-0.009	-0.002**

A company’s adherence to social guidelines has a very different impact on its risk profile than the adherence to environmental and governance criteria.

Based on the data thus obtained, as shown in Figure 4, the study not only confirms that the social pillar significantly reduces all three types of risk examined, i.e. systematic risk, idiosyncratic risk and total firm risk, but also reveals that the social pillar is the only factor that reduces systematic risk.

On the other hand, environmental and governance criteria have an influence only on total and idiosyncratic risks, but not on undiversifiable risk. Therefore, we conclude that the social pillar seems to be the most effective in reducing corporate risk.

These results provide novel guidance on the relative impact of each ESG sub-index on firms’ riskiness, which can be exploited both at corporate and institutional level.

06

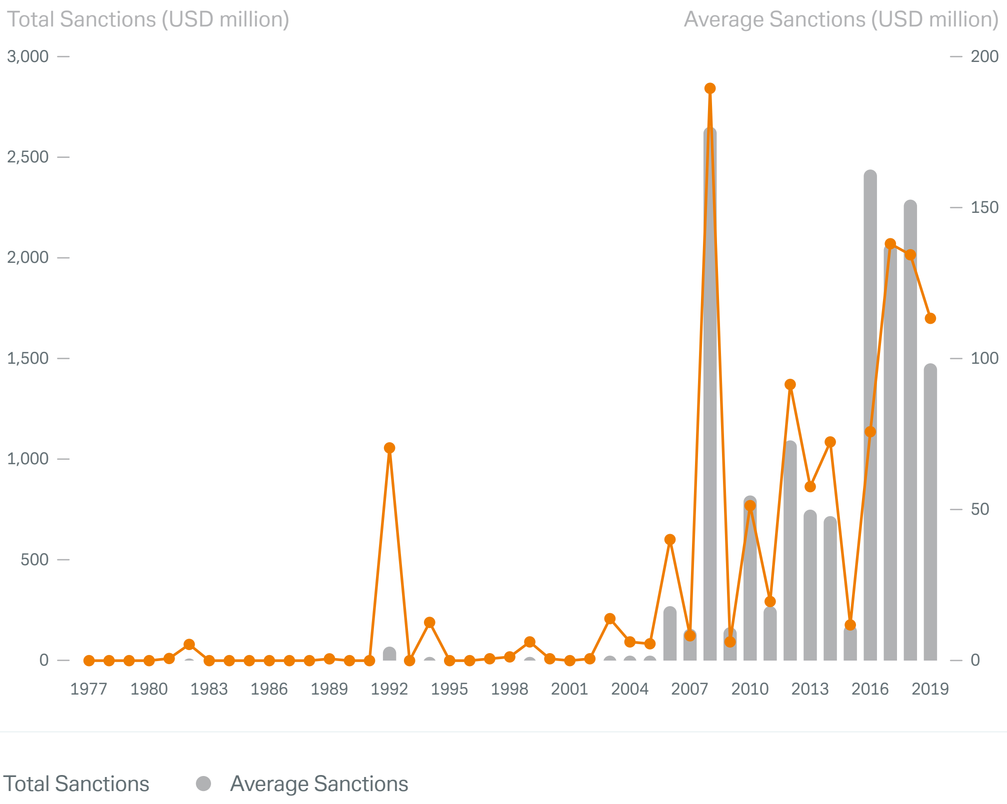
The "S" in ESG: both straightforward and subtle

One of the reasons why the economic impact of the social dimension of ESG has attracted less scrutiny than environmental matters so far is that the latter tends to cover a broader, macroeconomic spectrum, whereas the former is rather linked to the behaviour of each and every economic agent, be it a supplier, a regulator, a firm, a worker or a consumer.

However, things are moving fast, and the S in ESG will increasingly be the "next big thing" when it comes to investor focus, and hence may represent a source of market misalignment between present deeds – still insufficient – and future endeavours and challenges that the market will soon need to address. Board diversity is something that can be relatively easily measured at least in terms of gender; though other dimensions of diversity (which include background, education, gender, ethnicity, nationality, age, working and thinking styles, religious background, sexual orientation, ability and technical skills, according to EY's 2018 annual report) are not necessarily being measured. Most studies focus on gender diversity and find it is positively correlated with share price performance. For instance, Thomson Reuters found that companies with at least 10% of women on boards outperformed those with no women on boards.[10]

Figure 5: The rise of monetary sanctions over the past decade

Source: Foreign Corrupt Practices Act Clearinghouse, Stanford Law School in collaboration with Sullivan & Cromwell LLP. Data as of June 2019.



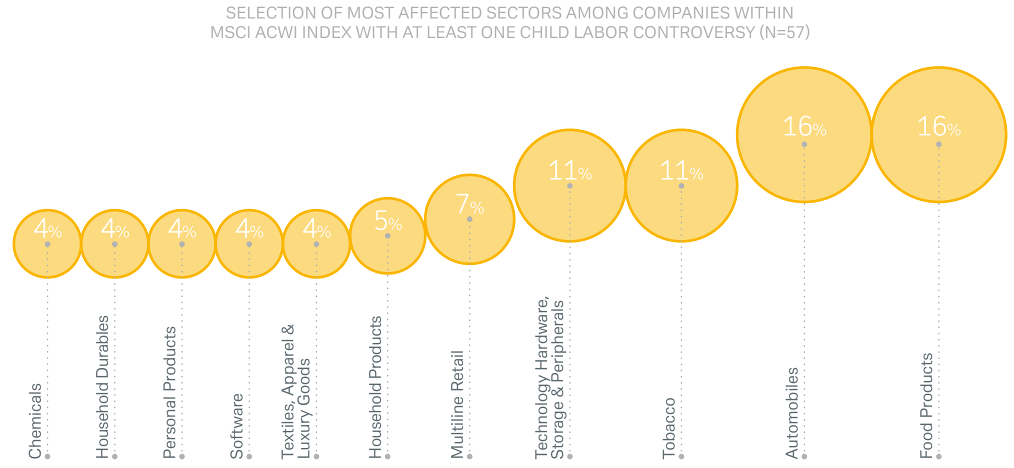
[10] See Thomson Reuters (2014).

Anecdotally, we can see that data and other privacy breaches, money laundering, accounting shenanigans, and trading with sanctioned countries have led to fines, sanctions, penalties and often sharp share price swoons. Corporate fines levied by the U.S. Foreign Corrupt Practices Act (FCPA) have been on an upward trend over the past few decades. Figure 5 shows how strongly monetary sanctions have risen in recent years, suggesting that they need to be taken very seriously by businesses and investors.

A recent study suggests that companies experiencing data breaches have underperformed the market,[11] while another study of product recalls found they are generally negative for share prices.[12]

Figure 6: Recurrent industries in the spotlight

Source: MSCI ESG Research, Deutsche Bank AG. The term "industry" refers to GICS classification. Data as of December 2017.

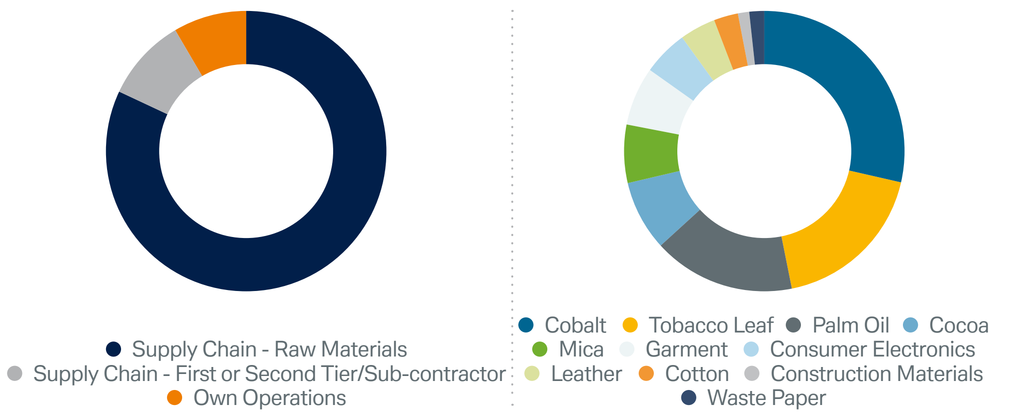


One area that represents a challenge for social impact analysis and that is increasingly in the spotlight is the supply chain. In an interconnected world, suppliers often account for large portions of the value added in the production of goods. While there are sound economic reasons for this, one consequence is that often the brand that markets a product has not directly manufactured it, meaning that it is not enough if the company that owns the brand applies high social standards to its own employees: the social welfare of the people employed by its subcontractors is equally important. More and more, public opinion is holding companies responsible for what happens within their supply chains, as evidenced by the outcry that followed after a fire at a subcontractor for the garment industry in Bangladesh in 2012 revealed the precarious working conditions behind many of the fashion world's most prominent labels. The basic human rights issued linked to working conditions are child labour, fair wages, health and safety standards, avoiding forced labour, and sourcing from conflict countries. The matter has been analyzed in a case study by MSCI.[13] In the paper, child labour controversies have been screened from the perspective of investors. The study found that 2.3% of the MSCI All-County World Index (ACWI) constituents were facing child labour controversies, and that companies with significant exposure to labour risk in their supply chains were almost five times more affected by child labour controversies. The study also found that firms at the bottom of ESG ratings performed on average three times worse on supply chain labour standards than top ESG rated peers. Figures 6 and 7 give a more detailed overview of the issue and how it affects the various economic sectors.

[11] See Comapritech (2019) for a broader discussion.
[12] See Bernon et al. (2018).
[13] See MSCI (2017).

Figure 7: The 73 main child labour controversies broken down by supply chain and sector

Source: MSCI ACWI Index, Deutsche Bank AG. Data as of December 2017.



Human rights issues prioritized include child labour, fair wages, health and safety standards, avoiding forced labour, and sourcing from conflict countries. Even today, the International Labor Organization (ILO) estimates 152 million children are engaged in child labour.[14] However, it is evident from recent events that mainstream investors would be unwise to discount the impact of social factors on company performance purely because of measurement difficulties.[15] However, this is not an excuse for ignoring it. Companies may not disclose all of their social policies, but the media will often end up highlighting any failings, even if only a small number of staff or customers feel they have been unfairly treated. The list of what can go wrong is long, and it includes, but is not limited to, poor labour relations and strikes; scandals around sexual harassment and misconduct; concerns over supply chains and product safety and security issues. All these can impose both short-term financial costs such as legal liabilities, fines, the loss of licenses as well as long-term reputational damage. The social dimension, while very diverse and fragmented, shows significant richness in its metrics. As such, it is probably the least standardisable of the three pillars, inasmuch as it is difficult for rating agencies to keep track of the wide array of initiatives that often is sponsored by the companies in order to create a positive impact on local communities. This lag in identification and tracking of social issues remains one of the main challenges in evaluating the S within the broader ESG framework. Companies don't always disclose or formalise policies on social responsibility because they do not think that these are value-enhancing. Even for those firms that do recognise the importance of disclosing and regulating social matters, their impact can be far from evident in the short term. Last but not least, the microcosm of social metrics is usually industry-specific, if not size-specific and country-specific. However, we should not forget the link between social and environmental matters as we dig deeper into the supply chains of the companies.

[14] See International Labour Organization (2017).

[15] See Financial Times (2017) for more details.

07

Conclusion: Social sustainability goes mainstream

The importance of the social dimension for investors is only likely to increase. Surveys suggest that nowadays investors are more socially conscious than in the past and are more likely to put pressure on firms, both as consumers and as investors. Regulatory pressures are growing in many areas. By way of an example, increasingly tough anti-bribery laws and probes in the U.S. and Europe are a threat to companies that have in the past indulged in these practices. At the same time, companies that demonstrate a positive social contribution may be able to command premium pricing for their products, and premium valuations for their shares. In our view, it is in the self-interest of the investor to embrace companies that deliver social benefits if they provide superior returns. Perhaps the most important conclusion to draw from this report concerns society and it is the benefit of diversity. Diversity has benefits on society that have been severely under-appreciated so far, but as importantly, diversity has benefits on business and on the investment landscape that make it a key factor to take into consideration for investors. Specifically, we have only started to scratch the surface of how diversity helps innovation and, therefore, investment returns. While this publication has illustrated a few key reasons of why this is the case, we believe that the importance of diversity is bound to increase further in the years to come.

Since 1978, the U.S. Business Roundtable – which today represents the chief executives of 181 blue-chip companies – has periodically issued a common understanding on the purpose of a corporation: the last statement has been particularly adamant in pledging that “While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders.” What will moving from shareholders to stakeholders entail for big corporates? It will surely mean an increased scrutiny of social inclusion, diversity, enhanced dialogue between stakeholders, more transparency in the sourcing of raw materials and on logistics, as well as reinforced attention to compensation and training of employees. In a world increasingly strained by inequality, environmental challenges and geopolitical fault lines, the economic benefits of promoting more inclusive corporate growth should no longer be neglected.

So what’s next? We believe that business is going to mirror the evolution underway in society towards better collaboration and more widespread acknowledgment of the benefits of social factors for companies and investors alike. Applying the S in ESG to business and investment decisions leads to a change in business models, with the consequence that traditional business models may no longer work, which will impact those enterprises that fail to adapt. Increasingly sophisticated risk measurement techniques will, in our view, point out more and more how attention to social criteria decreases systematic risk, as our guest contribution in this publication shows. Similarly, more sophisticated measurement and reporting methodologies of social criteria are bound to highlight the manifold ways in which social matters are intertwined with financial return. While environmental criteria are currently high on the political and economic agenda, investors need to look further towards the S in ESG to make sure they are not missing out on this crucial part of the ESG theme. This is also important from a portfolio diversification perspective.

Broadly speaking, there are two conclusions to draw from this report. The first is that social considerations are still, by and large, the ugly duckling of the investment world. They are far less talked about and appreciated than environmental and governance criteria, even though things are starting to change. The second conclusion is that, in stark contrast to common perception, the S in ESG has never been more relevant for corporate productivity and, as a consequence, investment returns. We believe that investors have much to gain from being early movers in a world increasingly sensitive to the social impact of any type of economic activity and to the welfare of stakeholders. Our aim is to keep researching this theme that, in spite of its often under-appreciated status, is extremely significant for the transition to a sustainable growth model.

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Glossary

ACWI stands for the All-Country World Index.

Bloomberg is a privately held firm that provides financial and market data.

CHRB stands for the Corporate Human Rights Benchmark.

CSR stands for Corporate Social Responsibility.

Dow Jones is a publishing company that compiles the Dow Jones Industrial Average (DJIA), an equity index of the New York Stock Exchange.

ESG stands for Environment, Social, Governance, and is the acronym most commonly used to sustainable investments.

FCPA stands for Foreign Corrupt Practices Act, a United States federal law known for addressing accounting transparency requirements under the Securities Exchange Act of 1934 and bribery of foreign officials.

FTSE stands for Financial Times Stock Exchange. The FTSE 100 is the leading reference index of the London Stock Exchange.

The Global Industry Classification Standard (GICS) was developed by Standard and Poor's and Morgan Stanley Capital International (MSCI) to define equities sectors.

Green bonds are bonds specifically earmarked to be used for climate and environmental projects. These bonds are typically asset-linked and backed by the issuer's balance sheet, and are also referred to as climate bonds.

GRI stands for the Global Reporting Initiative.

HCM Coalition stands for the Human Capital Management Coalition.

ICMA stands for International Capital Market Association and is a not-for-profit membership association that serves the needs of its wide range of member firms in global capital markets.

IIRC is the International Integrated Reporting Council.

ILO stands for International Labor Organization, a United Nations agency whose mandate is to advance social justice and promote decent working conditions.

MSCI stands for Morgan Stanley Capital Index.

The MSCI KLD 400 Social Index, previously known as the Domini 400 Social Index, is a market cap weighted stock index of 400 publicly-traded companies that have met certain standards of social and environmental excellence. Potential candidates for this index will have positive records on issues such as employee and human relations, product safety, environmental safety, and corporate governance. Companies engaged in the business of alcohol, tobacco, firearms, gambling, nuclear power and military weapons are automatically excluded.

NYU stands for New York University.

PRI stands for the Principles for Responsible Investment.

SASB is the Sustainable Accounting Standards Board.

SEC is the acronym of the Securities and Exchange Commission, an independent agency of the United States federal government responsible for enforcing federal securities laws, proposing securities rules, and regulating the securities industry.

Social Bonds are any type of fixed income instrument where the proceeds will be applied to eligible social projects with the aim to improve the social outcome for specific groups of citizens.

USD is the currency code for the U.S. Dollar.

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