



BNP PARIBAS
INVESTMENT PARTNERS

| The asset manager for a changing world

Going Mainstream with ESG

July 6, 2015



OVERVIEW

As access to information increases, investors have wider opportunity sets to choose from, and the tools to manage risk are becoming ever more sophisticated. Investors are becoming more demanding – and more knowledgeable – in scrutinising their holdings. And the investment world is all the better for it.

One key change has come with ESG practices, an investment philosophy that looks to add an “ethical” dimension to the investment process by analysing companies’ environmental, social and governance practices. In contrast with earlier incarnations of ethical investment, ESG eschews a proscriptive approach in favour of enriching a fund manager’s tool kit for finding the best investments. So besides helping avoid questionable companies or prompting others to change their ways, ESG should also highlight the star performers in governance and social practices. This, in turn, should guide fund managers towards companies that are exemplars in strong, sustainable and profitable management.

Or so the theory goes. But what do fund managers themselves have to say on ESG? To find out, we talked to Dirk Molenaar and Edwin Simon, two managers at BNP Paribas Investment Partners whose experiences show just how developed and diverse ESG has become. This is the second of a two-part series on ESG and what ESG investment means in practice. To access the first part, an interview with Jacky Prudhomme, the head of ESG integration at BNP Paribas Investment Partners, click here (<http://institutional.bnpparibas-ip.com/the-ins-and-outs-of-esg-investing/>).

WHICH ASSET CLASS OR INVESTMENT CAPABILITIES DO YOU MANAGE?

Dirk: I am a portfolio manager for the Global Listed Real Estate team, with a particular focus on North America. I am also the ESG correspondent for the team.

Edwin: I am a portfolio manager with the Netherlands-based global equities team. I work out of the Amsterdam office and the team is managed by Sander Zondag.

EXPLAIN HOW YOU HAVE IMPLEMENTED ESG CRITERIA WITHIN YOUR INVESTMENT PROCESS? WHEN DID YOU FIRST BEGIN IMPLEMENTING ESG CRITERIA?

Dirk: We include ESG criteria in our bottom-up part of the process within a broader assessment of a company’s quality and risk. As part of our investment process, we have for each company in our investment universe a quality and risk score. In the real estate sector, environmental practices might relate to green building, social could be related to the percentage of men and women on boards, and governance could focus on, for instance, whether a board is non-staggered [ie, an annual election of all directors] or staggered, or whether it contains independent directors.



Corporate governance is very important, as some companies can use 'poison pills' or other structures to avoid takeovers. We don't see these as the best option because, in our view, it should always be up to the shareholders to decide. From the social angle, if we notice that the company has certain issues regarding working conditions, working opportunities and so on, we analyse that and try to raise it as a topic of conversation. As you can imagine, health and safety is a particularly big issue in construction, but there's also a bit of a trend emerging called wellbeing, which relates to such factors as working conditions and the impact on productivity, equal opportunities, and the social responsibility of the company.

Edwin: For each company we add to our portfolio we write an investment case containing a separate ESG chapter that includes an ESG score. This score is based on comprehensive internal and external research and provides us with insights into how the company is ranked within its industry, based on ESG criteria. We also look at disclosure around ESG factors on the company's website and annual reports, along with the ESG policies and standards the company adheres to. Finally, we also look at our main ESG topics, which frequently differ across industries. In the mining industry, for example, toxic waste, riverine tailings and CO2 emissions are important, while in the financial sector it is more about policies to avoid bribery, money laundering and litigation risks.

WHAT PERFORMANCE RESULTS HAVE YOU SEEN AS AN OUTCOME OF THE IMPLEMENTATION OF ESG CRITERIA?

Edwin: It's difficult to quantify the impact of implementing ESG criteria into the investment process as many factors influence the performance on a portfolio level.

However, we can say that we truly believe ESG factors are part of the investment case. It says something about leadership and vision when a company adheres to high standards regarding ESG. This can contribute to the performance of a company. In addition, from a risk perspective, it makes you sleep better at night when you know the company is doing its utmost to avoid environmental, social or governance scandals.

Dirk: For now, it's mainly qualitative: we give companies a score based on their ESG performance, but it's not yet directly linked to financial performance or total returns. It's something that needs to develop over the next few years. It's a broader challenge among companies implementing ESG, and I'm not aware of other investment sectors that are already quantifying its effects. Our colleagues here are embracing it and it may take a greater weight in future. We want to be ahead of the game and see what's going on in the market and act on that.

ARE THERE OTHER NON-PERFORMANCE BENEFITS YOU HAVE SEEN AS A RESULT OF IMPLEMENTING ESG CRITERIA?

Edwin: For BNP Paribas Investment Partners as whole, I have noticed that you can have a positive impact on the ESG policies of companies when you proactively discuss this with them. Especially when you hold the shares of the company, management is very willing to listen to you and carefully consider your proposals. At this moment, the centralised ESG team of BNP Paribas Investment Partners based in Paris is very involved in this, but I think portfolio managers can play a bigger role. In the end, we should actively cooperate together in order to make a difference.

Dirk: We are members of several organisations – for example, GRESB [the Global Real Estate Sustainability Benchmark] – that have developed a global real estate sustainability benchmark. For us as a team, we want to make sure we do what we say we will do. So if we say we want to make ESG a more central part of our investment process for the global listed real estate capability, then that has to be reflected in the actions of our investment team. Working through organisations like GRESB, we can identify companies which perform well by these criteria and win awards, thereby showing to the investment community there are leaders in this space and that we are serious about ESG.

WHAT CHALLENGES DID YOU EXPERIENCE IN IMPLEMENTING ESG CRITERIA? DO YOU BELIEVE THOSE CHALLENGES ARE UNIQUE TO YOUR ASSET CLASS OR SITUATION?

Dirk: There's a small group of companies running ahead with ESG, but the majority still has to make a serious effort. The fact is that ESG is still in the early stages of being accepted by most companies. It's a question of changing attitudes – definitely among companies in real estate – and making the effort to change behaviours.

That said, there are already trailblazers in ESG in the real world. Prologis is an industrial real estate company we consider a leader in corporate governance. They have a high score compared with peers in areas such as board structure, and if you look at their sustainable building efforts, they focus on what we call green building certification, such as LEED (Leadership in Energy and Environmental Design). We also have British Land in the UK; they have won Gold Awards from GRESB three years in a row. They recently published their 2020 sustainability goals, and one of their buildings, 201 Bishopsgate in London, received an 'Excellent' grade on green building. We also see opportunities in certain parts of Singapore and Australia – so it's increasing, but these companies are definitely pioneers.

Edwin: As a global portfolio manager, time is our biggest constraint. In our search for interesting investments, we sometimes focus too much on the hard financial data instead of the ESG criteria, which, in general, are more difficult to measure or quantify. As the centralised ESG team in Paris becomes even better at providing us with the necessary data, this will help us implement ESG criteria into our investment processes in a more efficient way. Within our team, this is still work in progress, but we will get there.



WHAT MOTIVATED YOU TO IMPLEMENT ESG CRITERIA IN YOUR PORTFOLIO?

Edwin: I think it is very important to be aware of how you manage your client's money. Of course, our first priority will always be the financial performance of the fund, but we have to realise that financial performance and ESG criteria are not conflicting factors. Moreover, I am quite convinced that in the medium-to-long term, ESG criteria can even contribute to performance.

One can easily notice that our clients find it important that we have a clear ESG policy in place. Therefore, you always have to think of the next step to take, as this is an ongoing process.

Dirk: Having worked with ESG in my previous position, it was an easy choice for me to stay involved when the opportunity arose to begin incorporating it in my current role. I think it's an endlessly fascinating and increasingly important part of investment portfolios, and there's a growing focus on it throughout BNP Paribas Investment Partners.

ANYTHING ELSE YOU WOULD LIKE TO ADD?

Dirk: For all the challenges we face, things are clearly changing. We've noticed that many companies are increasingly paying attention to the costs/benefits situation with ESG-related investment. So, for example, many real estate developers are installing lighting systems that may incur a significant initial cost but reduce longer-term operational costs. Also, certain corporate tenants may be forced by their shareholders to invest in or rent buildings with green certification, while attaining the right level of "greenness" can make it easier for building companies to get construction permits from local government. There is so much more we can do with ESG.


BIOGRAPHIES


Edwin Simon
Portfolio Manager
Netherlands-based Global Equities Team

Edwin has been a portfolio manager with the Netherlands-based global equities team since 2009. In this position Edwin has global responsibility for the Energy and Materials sectors.

Prior to his current role, Edwin was an Associate with the firm. He has been with BNP Paribas Investment Partners and/or one of our predecessor firms since 2007.

Edwin has a master's degree in Economics and a bachelor's degree in Business Economics both from the University of Amsterdam.



Dirk Molenaar
Senior Portfolio Manager
Global Real Estate

Dirk joined BNP Paribas Investment Partners in 2011. He is responsible for managing the North American Listed Real Estate portfolios.

Prior to joining BNP Paribas Investment Partners, Dirk was a senior portfolio manager Global Real Estate at Unilever pension fund 'Progress' where he was responsible for both listed and Unlisted Real Estate portfolios. Between 2001 and 2009, Dirk was a senior portfolio manager and subsequently Head of Global Real Estate Securities at F&C Investments Netherlands, having previously been an investment manager of Global Real Estate securities at ING Investment Management. He began his career in 1995 at Kolpron Consultants before joining SFB Vermogensbeheer as a Direct Real Estate market analyst in 1996.

Dirk has a master's degree in Economics with a focus on Real Estate Investments from the University of Amsterdam and is a Certified Investment Analyst.



DISCLAIMER

Opinions expressed are current as of the date appearing in this document only.

This material is issued and has been prepared by BNP Paribas Asset Management Inc. ("BNPP AM INC")* a member of BNP Paribas Investment Partners (BNPP IP)**. This document is confidential and may not be reproduced or redistributed, in any form and by any means, without BNPP AM INC's prior written consent.

This material is produced for information purposes only and does not constitute:

1. an offer to buy nor a solicitation to sell, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever or
2. any investment advice.

Opinions included in this material constitute the judgment of BNPP AM at the time specified and may be subject to change without notice. BNPP AM is not obliged to update or alter the information or opinions contained within this material. Investors should consult their own legal and tax advisors in respect of legal, accounting, domicile and tax advice prior to investing in the Financial Instrument(s) in order to make an independent determination of the suitability and consequences of an investment therein, if permitted. Please note that different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for a client or prospective client's investment portfolio.

Given the economic and market risks, there can be no assurance that any investment strategy or strategies mentioned herein will achieve its/their investment objectives. Returns may be affected by, amongst other things, investment strategies or objectives of the Financial Instrument(s) and material market and economic conditions, including interest rates, market terms and general market conditions. The different strategies applied to the Financial Instruments may have a significant effect on the results portrayed in this material. The value of an investment account may decline as well as rise. Investors may not get back the amount they originally invested.

The information contained herein includes estimates and assumptions and involves significant elements of subjective judgment and analysis. No representations are made as to the accuracy of such estimates and assumptions, and there can be no assurance that actual events will not differ materially from those estimated or assumed. In the event that any of the estimates or assumptions used in this presentation prove to be untrue, results are likely to vary from those discussed herein.

* BNPP AM INC is registered with the US Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940, as amended.

** BNPP IP is the global brand name of the BNP Paribas group's asset management services of which these three entities are members. The individual asset management entities within BNP Paribas Investment Partners specified herein, are specified for information only and do not necessarily carry on business in your jurisdiction. For further information, please contact your locally licensed Investment Partner.