

The US SIF, ESG indexes and Responsible Investing

By: Anthony Eames | July 31, 2020

Washington - The US SIF Foundation this week released its latest report, "The Rise of ESG in Passive Investments," which explores the growth of passive environmental, social and governance (ESG) investing and the debate on the effectiveness of passive versus active ESG mutual funds. Calvert Research and Management was among the asset managers that contributed to the report, which also drew on publicly available data and insights from the US SIF Foundation research advisory committee.

The vast majority of sustainably invested assets remain in actively managed ESG funds, but net flows into passively managed ESG funds have outpaced net flows into their actively managed counterparts in four of the past five years, according to Morningstar data. This continued early in 2020; while the S&P 500 dropped by 20 percent in Q1, passively managed ESG funds within the US equity segment saw inflows of \$4.8 billion.¹

That said, ESG indexes receive some criticism, in part because some strategies may lead to overconcentrations of certain types of companies, and some passive managers lack the resources or incentives to engage with the companies held in their funds. Calvert's Responsible Index series does not suffer from these issues, thanks to our rigorous research and engagement processes.

Active work on a passive index

While an "index" is passively implemented, there's a tremendous amount of active work that Calvert does to identify the companies we include in our Responsible Research Index series. A parent index provides the initial investment universe of constituent companies, at which point our research process takes over to determine which companies meet the Calvert Principles and merit inclusion in our index series. This is something we have a lot of experience with - Calvert has offered a suite of proprietary research indexes for years, with the flagship CALCOR research index incepted over 20 years ago. By identifying companies adequately managing their material ESG risks and opportunities, we build our indexes with the potential to meet or beat the performance of common broad-market benchmarks. We maintain our indexes over time with annual reconstitutions and rebalancing.

Engagement likewise is a central tenet of the Calvert approach. As a complement to our research, structured engagement in pursuit of improving environmental and social outcomes — as well as long-term shareholder value — is a core feature of our investment approach. To accomplish this, our dedicated team of engagement professionals uses our proprietary ESG research to uncover financially material opportunities where a change in a company's ESG performance could help mitigate risk or take advantage of opportunities more effectively. This gives investors in Calvert Research indexes a unique opportunity to have their investment capital engage for positive change. Additionally, Calvert votes proxies in alignment with the Calvert Principles, which ensures that fund votes support the increasing number of ESG-related proposals filed with operating companies.

Measuring impact

Indexes also have the opportunity to clearly illustrate to investors their exposures to key areas of ESG risk, such as toxic or carbon emissions, otherwise known as impact measurement and reporting. Impact reporting has the opportunity to show investors how a particular ESG index is different than the traditional approach, that investors are exposed to less ESG risk than they otherwise would be. Surprisingly, many of the industry's largest ESG index funds do not provide reporting that indicates exposures to areas such as tobacco production and fossil fuel reserves.

For years, Calvert has reported our ESG impact exposures to investors on our fund fact sheets and also via the [Know Your Impact Tool](#) on calvert.com. This allows investors to see the exposure our funds have in the following areas compared to a traditional benchmark: carbon emissions, landfill waste, tobacco, toxic emissions and water usage. Most recently, Calvert launched the Calvert Transparency Tool, which allows financial advisors to evaluate mutual funds and ETFs on a broad range of traditional portfolio characteristics and ESG metrics.

Bottom line: This US SIF report is a great window into the growth of passive investing in the ESG space, as well as best practices and common critiques. Calvert's Responsible Index series provides the research, engagement and impact metrics that provide investors assurance that a lot of active effort goes into these passive products.

1. Jon Hale, "Despite the Downturn, U.S. Sustainable Funds Notch a Record Quarter for Flows," Morningstar, April 9, 2020, <https://www.morningstar.com/articles/977328/despite-the-downturn-us-sustainable-funds-notch-a-record-quarter-for-flows>.

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