Gravity Exists

APPROACHING A NEW BREED OF ESG ALLOCATOR

Robert Brown Founder, Atlas Impact Partners Atlas Impact Partners was among the first asset managers to apply an ESG methodology within a hedge fund strategy.

Atlas Impact Partners was among the first of a new breed of absolute return managers to apply an ESG methodology within a hedge fund strategy. Prior to founding Atlas, Robert Brown was a senior portfolio manager at Alliance Bernstein and the Chair of the Research Advisory Council of Just Capital. We spoke with Brown about the evolving ESG landscape as allocator demand and expectations for values-based managers grow exponentially.

ESG labeled funds are estimated to have owned over $8 billion in Russian assets before the invasion of Ukraine. The fallout from the war has caused many allocators to reexamine their portfolios. What is your thinking on how values-based investors should approach opportunities in non-democratic/compromised economies?

"I would begin my answer to that question with a generalized statement: As an investor, you are always facing ethical decisions at some level. We can call it a values-based decision, and some funds are labeled that way. Ultimately, every decision you make — every allocation of capital — is in some way an ethical decision.

For example, we manage a long/short equity portfolio of companies we believe are either materially and measurably improving the planet or materially and measurably harming the planet. We would never be long shares of a diesel engine manufacturer, which many investors might expect based on our mandate. But we would also never be long a corn syrup manufacturer either, which surprises some people. In our view, corn syrup producers and food products that include it ultimately contribute to the spread of diabetes.

In both of those examples, some might argue the companies have a strong ESG profile or are improving their ESG profile, which may be true. Our opinion is the products they sell are the dominant impact they have on the world. You could go on and on identifying different ethical questions facing investors. What is essential is to be consistent with your values.

So, when it comes to operating inside a nation with a non-democratic or deeply flawed democratic government, the ethical decision is complex. For us, it is more important what the underlying company does and how they conduct business than what sort of government they operate under.

One example of this is the healthcare sector. There are good healthcare companies in certain emerging markets doing good work despite operating in countries ruled by bad regimes. The issue of government is seldom black and white no matter how badly people would like it to be."

A key criticism of ESG investing has been the lack of consensus on a standard definition of the factors. As a fund manager, how do you advise clients to approach their ESG process as they select allocations?

"We get asked that question a lot. Usually, I respond with three main points.

First, there is no need for you to recreate the wheel. There are some thoughtful frameworks for applying a values lens to an existing investment strategy. As an impact investor, you can start with the United Nations' Sustainable Development Goals or draw from the Impact Management Project. As an ESG investor, you can take direction from the SASB materiality framework. I don't judge any of these as better or worse. But it's worth

considering that thoughtful, informed people created them, and they can be used as a foundation by any investor regardless of their resources.

My second key point is simple: authenticity matters. And this is something allocators increasingly demand. You need to have a framework and apply it consistently across all your investments, and you need to hold yourself accountable to those standards across all timeframes. That requires a genuine commitment, an authenticity that can't be faked.

Finally, you must always ask yourself whether you are applying sufficient rigor. Are you developing a data set? Do you fact-check company assertions? Are you consistently monitoring those metrics to test your assumptions as the underlying fundamentals evolve?

My point here is not that one methodology is proper or another is wrong. But there are right and wrong ways to approach the application of your framework, and there are definitely reliable and unreliable sources of data. Bottom line: Process and integrity matter and allocators increasingly see greenwashing for what it is."

Currently, there is pushback from elected and appointed officials in some states to the attempt to define and measure ESG factors by market regulators. Proposed municipal bond guidelines have been controversial in some state capitals. How do you view the involvement of regulators/NGOs/credit rating agencies and other non-investors in the process? Your firm was active for many years when ESG was purely a private sector process. How do you react to public sector involvement now? Does it create new risks?

"I find some of the pushback on regulations in this space suspect because, to my knowledge, there's not a call for regulation, there's a call for disclosure, and those are very different things. Investors should welcome disclosure. Unfortunately, many people and organizations lobbying against so-called oversight are pushing back because they haven't carefully considered the agenda. It's like pundits critiquing a book after reading a review of it.

Despite what some people have argued, these proposed regulations didn't spring out of regulators unwanted and are not being imposed by political interest groups. Massive flows of AUM have demonstrated that this information — call it ESG— is important to allocators and to the investors who have entrusted those decision-makers with their capital.

The SEC has a responsibility to ensure that the information investors need to make their decisions is accurate, consistent, and publicly available. That leaves the investors in the position of being well informed and yet perfectly free to reject it. Having data available does not force anyone to adhere to any ESG standards whatsoever. It simply provides information for them to use or not use based on their decision-making process.

ESG has become particularly "fashionable" in some segments of the financial services industry that had previously ignored it until the recent explosion of interest in the institutional sector. Do you anticipate that these fresh entrants will remain in the space in the long run?

> "I wouldn't use the term 'fashionable.' Certainly, marketing teams are developing sellable products, but there are also earnest efforts by investment managers trying to meet the demands of their clients. Some recent entrants will fade, but there is no reason to believe the acceleration of investment into ESG managed funds over the last couple of years will slow because, ultimately, capital owners are demanding it.
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> I suspect there will be a change in how investors approach allocating in the space. They'll want more scrutiny. We already see increasing demand for managers who demonstrate a rigorous, analytical approach.
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> When we launched our fund three years ago, Albourne was one of the only major consultants with a fully realized ESG framework. And Redington in the UK comes to mind. Cambridge had their mission-related investing division, for instance. But few had a fully integrated process, and now it is almost universal, though with varying degrees of authenticity.
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> Today that has changed, and we know that because we are subjected to increasingly rigorous due diligence by consultants and advisors who are meeting the demands of their customers for a fully realized ESG methodology. These professionals understand how to define impact, understand what an impact metric should look like, and can accurately measure whether the managers they invest with are delivering consistently across their entire portfolio.
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> To our method of thinking, this is a great development that is sweeping away much of the 'greenwashing' prevalent in years past."

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