**DiMeo Schneider & Associates, Nonprofit Investment Stewards Podcast**
*Episode 10, January 27, 2020*

## ESG Investing for Stewards: Part 3 – with Kaitlin Bergan

[00:00:00] Welcome to Nonprofit Investments Stewards with Bob DiMeo and Devon Francis from DiMeo Schneider and Associates, Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment foundation or retirement plan investments, this podcast exists to help stewards, improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:27] Now on to the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo as always joined by co-host Devon Francis. Today's episode marks the third and final in our ESG miniseries, where we discuss environmental, social and governance investing. It's an important and growing topic for so many nonprofits and their investment committees.

[00:00:52] Let's jump right in and turn things to Devon to launch today's episode. Hi, Bob. So, it really has been so [00:01:00] rewarding to create this miniseries focused on ESG investing. In the first episode of the miniseries, we heard from Shreya who's one of our colleagues and she sits on DiMeo Schneider's mission aligned investing committee.

[00:01:15] She also works with a number of clients who incorporate ESG investing into their portfolio construction process. So, in that episode, Shreya Canakapalli, provided us with a broad overview of the ESG landscape, and she also talked about our firm's approach to helping our clients align their mission and values with their portfolio investments.

[00:01:35] The guest of our second episode was a client who utilizes a hybrid approach to ESG investing. So that particular client incorporates both exclusionary screens, as well as an integrated ESG approach. If you haven't yet listened to those episodes, we suggest you go back and do so after you finish up today's great episode.

[00:01:54] It's definitely not necessary to listen to the miniseries in order. So today [00:02:00] in our final episode of this ESG miniseries, we are thrilled to be joined by Kaitlin Bergan. Kaitlin is a director at BlackRock where she's a member of BlackRock's global product group, and she spends a lot of her time focusing on sustainable investment solutions across asset classes.

[00:02:17] So Caitlin, welcome to the show. Thank you so much, Devon and Bob, it's great to be here with you today. Caitlin. We're thrilled to have you. And before we dive into the ESG discussion, it would be great to hear your story. And specifically, what path led you to the investment world. And what is your role at BlackRock?

[00:02:35] I feel very lucky. I work in sustainable investing, which is such a growing area globally for, I think the investment community at large. And also certainly for BlackRock. I started out, I was a history major in college. Wasn't originally a finance person, but I got my first job out of college in finance.

[00:02:53] Kind of fell in love. And the rest is history. When I arrived at BlackRock two and a half years ago, I'd come from a hedge [00:03:00] fund. And I actually didn't have much experience with sustainable investing specifically, but because there was such a focus and, and I've always worked with institutional clients in the US and Canada across my career.

[00:03:12] In investment management. And because we saw such an increasing focus in this area of sustainable investing that by a sort of evolution became more and more of my job, I discovered a real passion for it and was fortunate enough to join the BlackRock sustainable investing team earlier this year in a more official capacity though, I've been working on these issues really since joining the firm.

[00:03:33] That's my story. And as I said, I feel very lucky. I feel like I sort of walked into something I'm passionate about, really excited to be in this line of work, the stars aligned. Yes, that's great Kaitlin. In January of 2020, Larry Fink, who is the CEO of BlackRock released a letter indicating that BlackRock would be putting sustainability at the center of the firm's investment approach.

[00:03:56] So can you talk about that in a bit more detail? [00:04:00] What was the driving force behind that shift? How has. Have some of the stakeholders reacted to that focus. I think the, an important point to make about BlackRock's public stance on this that came out with Larry's letter back in January was that this wasn't a new position for us as a business.

[00:04:18] It was very much an evolution, as I mentioned. Since I joined BlackRock, this had been of increasing importance. And because we are a global firm, you know, we saw in Europe, especially more and more emphasis where sustainability and environmental, social, and governance factors and incorporating those effectively into investing or becoming less, a nice to have and more table stakes and more something.

[00:04:42] Our investors and our clients expected us to be able to incorporate effectively throughout our business. When you ask the, kind of the, why now question. So, I said, this is an evolution we've taken as a business. So why in 2020, did we make the decision to sort of plant a flag in the sand and say, we're going [00:05:00] out really public on this?

[00:05:01] And I think there's three key catalysts. The first is the just mounting normally of climate change and the implications on that for the financial world more broadly, the number of extreme weather events we've seen in the last decade has grown exponentially that has resulted in a billion dollars or more a cost associated with them. Within a decade.

[00:05:19] We'll see more than 15% of the current S and P national muni bond index with issues in Metro statistical areas that will have economic losses of up to 1% of GDP. Because of climate issues. So more and more from an investment perspective, we saw climate risk. Number one, and I'll go into the S and the G more, a bit later.

[00:05:40] Secondly, demographic shifts, 64% of millennials believe these issues are important. And we're currently in the midst of the largest transfer of wealth in human history. With millennials set to inherit 30 to $40 trillion globally in the coming years. That will be increasingly important as they are kind of the prime stakeholders in investment [00:06:00] management.

[00:06:00] Ultimately though, for our business, we come at this from a fiduciary first perspective. We have a range of clients across the globe with different philosophies and objectives, especially when it comes to sustainability. And so, the most important catalyst is our growing investment conviction that incorporating environmental, social and governance factors.

[00:06:19] Not only doesn't forgo return but can actually enhance return over the long term. And so that's sort of the three-pronged approach to why we made the decision to be so public this year. And when it comes to ESG investing, you've got nonprofit organizations and endowment and foundation investment committees sort of across the spectrum, right from, let me learn more too.

[00:06:41] Implementation to impact and so on. Where do we stand in the US relative to other parts of the world on this topic? We felt lucky as a firm that we saw this happen in your first, but we very much see it in the process of happening in the US so I would say a couple of things. [00:07:00] The first is we see differing regulatory regimes in the US versus many other parts of the world.

[00:07:05] So where Europe is getting much stricter and more strict is probably the wrong word, more rigorous about having ESG reporting metrics and. Regulatory regimes in each country, or like overseeing things like pension investments, et cetera, that has really accelerated the momentum in Europe of what was already a growing area of investing in the U.S. at the federal level.

[00:07:28] I think we're probably about to see a shift as we undergo a shift of administrations to much more proactive focus on this at the federal level, but what's been interesting in the U.S. is, from a regulatory perspective, we've seen States from Illinois to California, to New York, to others take very proactive stances in this area that almost matched some of what we've seen in Europe and has accelerated the growth in the U.S. so it's a more nuanced picture in the U S I would say from just a client perspective, particularly on the nonprofit side, it's really two [00:08:00] prongs.

[00:08:00] The first is increasing conviction from our client base in the U.S. that, that our belief that ESG factors do play a role in risk and return and should be incorporated in a holistic way to any investment process. And then secondly, as you mentioned, Bob, on the impact or mission aligned investing, we're seeing much, I'd say more sophisticated, interesting investment opportunities across different themes, environmental, social, and governance.

[00:08:25] And I think the endowment and foundation community for one is one of the leading in the US on those sorts of investment opportunities. So that's what I've seen in my seat. So as you've seen a more sophisticated approach to considering ESG investing, has that been mimicked in fund flows? The longstanding belief of ESG investing has been that you can.

[00:08:50] Really only achieve it through exclusionary screens. And I think that over time, we've seen an evolution into a more integrated approach [00:09:00] where managers are incorporating ESG criteria into the process. Has that been exhibited in fund flows? Have you seen a difference in flows into exclusionary strategies versus inclusionary strategies?

[00:09:14] That's a great question, Devon. So you're absolutely right. That historically exclusionary screens were sort of first manifestation of ESG investing. And to this day across the industry and within our own business, we do see the bulk of assets in exclusionary strategies that said. We really, and this is sort of our view at BlackRock, and we've done a lot of research on this.

[00:09:37] We believe we're at the beginning of a tectonic shift of assets into this area into much more inclusionary type strategies, and that's become a huge focus for us. And I think part of the reason for that shift is that exclusionary screens are very important from a value perspective. So screening out.

[00:09:56] Areas say around physical climate risk, where you may see [00:10:00] stranded assets going forward, using those exclusionary screens to get out of the investments that may become financially, not viable going forward, but also from a values-oriented perspective so that a client or investor can be confident that their capital is not going towards a cause that they don't want to put capital towards.

[00:10:18] So, so that will remain important. I think on the inclusionary side though, the really exciting developments are because you're not only now screening out risks. You can really take advantage of the increasing opportunity so you can invest. Not only say we want to screen out, you know, stranded assets like thermal coal, for instance, but you're saying, but let's actually invest in clean tech or on the social side, less let's invest in those companies that do much better with inclusion and diversity because we've seen real quantitative financial.

[00:10:51] Evidence that those companies actually perform better in the long-term. So there's a real financial opportunity there that also aligns very [00:11:00] proactively with a mission. So I think screening will always be a part of this world, but I think more and more, we're seeing an uptake in flows and an interest and appetite, for, for inclusionary strategies, whether the Matic strategies or impact strategies.

[00:11:16] And one final thing I'll say on that is. One of the public commitments we made as a business was back in January, was that by 2030, we, we hope to have 1 trillion in assets in our dedicated, sustainable strategies today that numbers around 150 billion, that is inclusionary strategies. So that is separate from our screened assets.

[00:11:38] So we're really putting a big bet ourselves on this area of invest in growing. That's an impressive goal. When you talk about the inclusionary, can you think of a story or an example that might be of interest? Perhaps even a fun thought in terms of a specific client pursuing a certain type of inclusionary strategy.

[00:12:00] Absolutely. So one of my favorite examples of this, because I think it really highlights the innovation that is going on in this area, across the industry. We had a client come to us a couple of years ago and say, you know, we want it. We're really big believers in the shift to a transition, a low carbon, the transition to a low carbon economy, excuse me.

[00:12:21] And they said, you know, what we see in the market right now is either as sort of these very heavy, high stakes, often private markets impact investments in say renewables or on the other side of the spectrum screen strategies that screen out certain, you know, high carbon emitters, et cetera. And they said we really want a strategy that takes a liquid approach to both taking out those poor performers.

[00:12:46] But also overweighting those companies that are. Best placed over the long term to really benefit from the transition to a low carbon economy that we believe is occurring over the next few decades. [00:13:00] And that really wasn't on the market. So, we worked with them. We have a proprietary research team of quantitative and fundamental ESG specialists, researchers that worked with this client to develop a methodology around this.

[00:13:12] That we were able to launch with them initially. And now we've seen huge amount of uptick across our client base. And we've actually now been able to translate that methodology, which was originally focused on E to social and governance elements as well. Thanks Kaitlin. It's always interesting to hear specific stories about client experiences.

[00:13:35] You've already alluded to this, but I'd like to dig a bit more deeply into the issue of performance. There has been a long-standing belief that in order to invest responsibly, you need to sacrifice returns. And you already mentioned that you don't. I think that's the case and that BlackRock does not think that's the case.

[00:13:54] So why don't you and how might you address an investor who is somewhat [00:14:00] skeptical? It's a great question. And one that we get all the time, the why don't we is that we have seen over the past several years, you know, we have an investment. We had an investment hypothesis that by better integrating ESG factors into investment that could only enhance returns.

[00:14:16] Over a long-term horizon. And part of the reason we have that is because traditional financial accounting standards, don't always provide investors with a complete picture of what is financially material from an ESG lens. So in order to capture the full set of risks and returns, we hypothesized that if we could do that effectively, it would enhance return.

[00:14:36] And what we've seen is evidence of that you look at this year 2020, for instance. 88 percent. And this is through, I believe September of 2020, 88 percent year to date through that time period of a globally represented selection of, of indices that we looked at outperform their parent benchmarks. We've seen similar statistics from big, industry-wide organizations like [00:15:00] Morningstar, and then within our own strategies on the active side, we've seen a real.

[00:15:05] Level of, of good outperformance during this period. Now I'll also say the caveat and the devil's advocate that people often bring up, which is a fair one is these strategies are relatively young. They have not, they don't all have very long track records. It's probably about five years that we have really solid.

[00:15:24] ESG track records across certain strategies, certain ESG indices, et cetera. 2020 was important because it was the first real market crisis test for many of these strategies that came to life, post the financial crisis. But what the evidence we've seen so far backs up our, our hypothesis that I kind of laid out at the beginning.

[00:15:44] And Kaitlin, what are some of the challenges that you see when it comes to an endowment, a foundation of the investment committee members implementing ESG or, or on the other hand, what are some of the best practices, or if you were [00:16:00] trying to recommend an appropriate approach for someone to enter on this continuum and path, what are some of your thoughts on that?

[00:16:08] I think one of the first questions we get across, I'd say the institutional spectrum, but definitely in the nonprofit sector is an interested in this area. It's such a broad area that where do I start? And so what I'd say is really, again, sort of a two-pronged approach for those investors that are really interested in getting broad ESG exposure, but they don't necessarily have a specific mission.

[00:16:31] In mind, they just want to capture companies or issuers as part of their portfolio that, that perform better across ESG metrics. That's where index replacement can be a great starting point for any investor that wants to think about this. There are now so many ESG indices that that overweight are optimized towards those better ESG performers.

[00:16:53] So that gets you some real broad exposure without really affecting the risk budget. And also often does it for a very comparable [00:17:00] pricing. For those investors, which I know is often the case with the nonprofit community that have real specific mission alignment, and really want to have that impact and be able to report on that impact.

[00:17:10] That's where we'd say sematic or impact strategies are really an excellent option. And we have them across the industry in both public and private markets, but these are really strategies that are giving you a very clear idea of the actual impact your capital is having. Often linked to things like the UN sustainable development goals or particular themes, whether it be the environment, social issues, educational opportunities, financial inclusion, et cetera.

[00:17:37] So I think those were the clear mission impact is worth looking at those who just want that broader exposure index replacement is often a good first step. So, can you discuss the concept of shareholder engagement? What that means, why it's meaningful, how BlackRock approaches shareholder engagement, and perhaps if you could share a few [00:18:00] success stories about your engagement efforts.

[00:18:03] Shareholder engagement is important, really, in two ways, I'm going to talk about it more on the index side. Although of course, on the active side, it's very important as well. On the index side, shareholder engagement is the main way that we are able to register sort of our thoughts in our index holdings on behalf of our clients around those issues.

[00:18:28] Both ESG issues and other issues, but often they do take an ESG bent that are going to be in our view, most impactful to the long-term performance of a company. One of the things we came out with in January was to have really increased transparency in how we were releasing statistics and also case studies around things like our proxy voting record, our actual number of engagements.

[00:18:51] Our philosophy on this is that we really need to take a long-term engagement view and work with these companies to say to them, here's our [00:19:00] expectations, which we're very transparent about and, and set out for them. Here's why we have these expectations here. Here's why we think it's best practices to think about your environment.

[00:19:10] Environmental, excuse me, practices this way, your index or human capital practices this way, your governance board management practices this way. And then we work with them to really hopefully improve. And then if we don't see that improvement, we will take voting action against them. That's really our main tool in the index space for registering our belief on what is going to be material to their performance on, on behalf of our underlying.

[00:19:38] Clients. And, and I would say in terms of anecdotes. So I think this year we've seen a 289 percent increase in our environmental engagements. We have several case studies, which are public, which we share on our website, which I'm happy to share after this, with anyone who's interested in specific company engagements.

[00:19:57] I think that engagement tool being such a large [00:20:00] shareholder of many of these public companies, it does give us that extra tool to make progress in a way that would be difficult to otherwise. Caitlin, you've talked a fair amount about the ESG with climate change being obvious and meaningful component.

[00:20:13] And you promise to circle back to the S and the G. And I, I love to have you share a bit on that front, whether it be with respect to recent events on social trends and, or just investor perspective, pertaining to the S and the G. I would say this year, we have seen a massive increase. This is anecdotal from my seat, but also we've seen it, I think, across the industry in a social issue.

[00:20:41] I think from the first lens of materiality, it's becoming increasingly clear how things like community relations, a broader set of stakeholders, community relations, labor relations, reputational issues are really key to a company's long-term performance. So more and [00:21:00] more we're seeing an interest in. I work clients wanting to put their capital to align with companies that perform better along those metrics.

[00:21:10] Secondly, I think particularly in the United States, both with COVID and then also many of the protests around racial injustice that we saw this summer, that's created a very clear interest in some sematic specific. Social oriented strategy. So we've actually put quite a bit of time and energy into developing more specific sematic strategies that hit on these social issues.

[00:21:35] And I think that that is a trend we will continue to see going forward. I think everything from human capital to DEI issues. It's very important. I think from governance, good governance has always been sort of an important factor in investment consideration, but more and more, what we're seeing is financial evidence of just how important governance is and that those companies that [00:22:00] score higher in governance.

[00:22:01] Issues actually perform over the long-term and we've actually seen a correlation between quality, the quality factor and those companies that score higher on governance. Again, I think that will be increasingly important as we see more and more evidence for how it affects and underlying companies. So Kaitlin, I'd love to hear your perspective on how companies have reacted to the focus on ESG investing.

[00:22:24] When you are engaging in shareholder engagement and in conversations with these management teams, do they kind of begrudgingly accept the fact that they have to address these ESG issues, but they don't really want to, it's just kind of a headline risk type of thing that they're dealing with or are they happy to be faced with the kind of the impetus to.

[00:22:48] Make positive changes. What has your experience been and the, the experience of your research team been in interacting with company management about these topics? I [00:23:00] think it is highly dependent on how the company's internal culture works, what their other stakeholders are asking of them and what their beliefs are.

[00:23:10] One of the key things that we have said publicly that our CEO, Larry Fink has said several years now in his annual letter is that a company's purpose is really integral to its long-term performance. So those companies who we really see as having a clear, cut purpose, they are more and more extremely amenable.

[00:23:29] I would say to working with not just us, but, but industry leaders and third-party organizations, whether it's the task force on climate related financial disclosure, whether it's the sustainable accounting standards board, they're really eager. To get to a place where they're being as transparent as possible and bring their own businesses, practice business practices up to a level that is really going to be seen as not only seen, but, but really is better than peers, perhaps when we think about ESG issues and they [00:24:00] do that because they share a belief that this will actually, I think, over the long term enhance their, their performance.

[00:24:06] I think for those companies that you see struggle with this more. Again, that's where we will, if it comes to it, take certain actions to, to register our belief that if they aren't willing to be transparent, if they aren't willing to make changes in business practices that have been detrimental in these areas, we will have to think about how that affects their long-term performance.

[00:24:30] So you do see an array of, of responses. I'd say more and more though. We've seen increased alignment across the industry across companies and issuers that these issues are important and that if they want to perform well over the long-term, they're going to have to engage given the stakeholder basis.

[00:24:49] And you've provided so many meaningful insights for investment committee members and non-profit charitable organizations. And at large, any final points you'd like to share on this important [00:25:00] topic of ESG. I think the most important thing I'd want to share is this is a really exciting area. And so we've seen such growth in, as I mentioned the past five years, but I think the next.

[00:25:13] Five to 10 years or are going to be many times that growth. And I'm not just talking about assets. I'm talking about the innovation, the types of strategies available, the types of mission alignment and ways to put capital towards a particular. Investors key values while also taking a value-oriented approach and seeing enhanced performance when this is done correctly.

[00:25:38] So I would just say I'm very excited for what the future holds in this area. Yeah, I think you're right, Kaitlin. I think we've only seen the tip of the iceberg and there's a lot more to come, so it is exciting. We always like to ask our guests a few personal questions and get to know them a bit more. Let me just leave you with a couple of final questions.

[00:25:59] One [00:26:00] is what do you enjoy doing when you're not working? What kind of things are fun for you? What activities do you enjoy? And I know that this has been such a challenging year for so many people with COVID and folks not getting to. To do those things that they normally love to do. Have there been any silver linings that you've experienced given the COVID situation?

[00:26:25] First off in terms of what I like to do. I love to run, which is great. Cause I can do it outdoors. Even during these unusual times. I love normally going out to eat, which has been quite limited, but I have had fun. I love seeing friends and family and I have had a lot more connectivity, even if it's over video with friends and family who don't live as close to me.

[00:26:46] So that has been a definite silver line. That's great. Maintaining those connections is so important. Yeah, just, just so at if nothing else. So we don't go crazy by ourselves. We really appreciate you coming on [00:27:00] the show. You've provided so many great insights. If folks want to reach out and contact you, or if they want to learn more about what BlackRock is offering in the ESG space, where should they go or how can they reach out?

[00:27:14] They are welcome to email me. My email is Kaitlin.bergan@blackrock.com. More than happy to engage further. Kaitlin, thank you so much. Your insights have been absolutely wonderful. And as we wrap up, I think many of our listeners know that I serve on several nonprofit boards and that role.

[00:27:37] It's common. I think, especially at this time of the year for endowment and foundation committees to examine the effectiveness of their investment programs. And two thoughts on that. If you're thinking about your nonprofit's investments, number one, definitely download a copy of our six tips to managing endowment and foundations investments guide.

[00:27:56] You could find that in the show notes or at dimeoschneider.com. [00:28:00] And then number two, if you'd like to chat about your portfolio and how you might potentially think about improving things in 2021, reach out to me or Devon on LinkedIn or through dimeoschneider.com. So to all you good stewards, thanks for investing time to help your nonprofits prosper.

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