Sun Life Global Investments
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ESG Integration

A deeper look with Portfolio Manager Kathrin Forrest, M.A., CFA

In 2005, the United Nations (UN) asked some of the world's largest institutional investors to help develop the Principles for Responsible Investment (PRI). Since then, the number of signatories has grown from 100 to over 3,000, managing almost US$80 trillion in assets.

Our involvement with PRI began when Sun Life signed on to the Principles in 2014. As an affiliate, Sun Life Global Investments has also embraced the UN's PRI goals. In doing so, we constantly strive to incorporate environmental, social and governance (ESG) factors into every element of our investment process.

We recently sat down with Portfolio Manager Kathrin Forrest to highlight in more detail how Sun Life Global Investments strives to incorporate ESG factors into its investment process and engages with its sub-advisors on their ESG approach.

Q: What drives Sun Life Global Investments to consider ESG factors in its investment process?

A: We have a fiduciary duty to our Clients who trust us to act honestly, in good faith and in their best interests at all times. This fiduciary duty is the foundation underlying all our investment activities. Because issues such as regulatory change, climate risk, and corporate responsibility can have a material impact on an investment's performance, we consider ESG issues across our investment process. It's part of sound risk management, and may help create opportunities for growth and alpha generation. As an important part of that, we rigorously analyze how our sub-advisors incorporate ESG issues into investment decisions.

Q: How do you analyze a sub-advisor's ESG integration?

A: For us, the overarching principle with regard to manager selection is to assess our confidence in each manager's ability to deliver on the mandate on a forward-looking basis. At the heart of this is the assessment of the breadth, consistency and sustainability of underlying alpha sources.

It includes the effective integration of ESG considerations in the context of each respective investment process. To support our analysis, we include ESG considerations in our initial due diligence, as well as in our ongoing monitoring activities. With regard to the latter, responses to detailed annual questionnaires, provide an initial road map for our engagement activities for the year. We then facilitate these through quarterly and ad hoc review meetings, as well as by internal assessments, using both qualitative and quantitative data.

While we do not base our decisions on external quantitative data sources, we find these helpful in comparing across peers, styles and geographies. As well, they may flag potential engagement opportunities. We are cognizant though, of the often backward-looking nature and the potential for style biases that this data may suggest.

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Q: Do you rate your sub-advisor or individual investment strategies?

A: We have not found ratings to be helpful to our investment process. Instead of focusing on an aggregate assessment, we look across a broad range of metrics independently, and escalate and engage as needed. This is consistent with our approach to manager research more generally, and reflects our belief that ESG considerations need to be implemented in the context of each individual investment process to help sustain and enhance the investment value proposition.

For example, we have engaged with managers to become signatories to the Principles for Responsible Investment; to provide rationale for specific proxy votes and investments in the context of ESG; to explain quantitative ESG scores below peers or benchmark, and to include ESG considerations in the rationale for certain change requests to investment guidelines.

Since ESG practices, regulations, data etc. are changing so rapidly, we put strong emphasis on continuously advancing our practices, and we hold our sub-advisors to the same standard. We're all on a journey with regard to ESG; the tricky part is that I'm not sure we're all taking the same route, or are heading to the exact same destination. Our open architecture model provides lots of insight in this regard. It allows us to observe evolving practices across sub-advisors, geographies and asset classes, and engage where we see opportunities for improvements.

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Q: Ratings aside, do you have expectations for your sub-advisors?

A: Yes, we do. Among the core pillars of our investment process, is to have a well-defined ESG philosophy and governance framework, which recognizes the potential impact that ESG factors can have on individual securities and overall portfolio outcomes.

We also look for a formal and effective governance framework around proxy voting and engagement, including ESG considerations. This in the context of supporting overall investment objectives of respective portfolios. And we value adoption of normative codes, such as PRI, which can help support alignment, transparency and the ongoing evolution of activities around ESG.

As I mentioned, we have encouraged our sub-advisors to become signatories to PRI, and expect the last one to do so early this year. And, at this point, all our equity sub-advisors have ESG and proxy voting policies in place and we monitor and encourage ongoing evolution. As part of this, we look beyond top down, firm-wide ESG initiatives and marketing – putting emphasis on consistent implementation of ESG policies in day-to-day investment decisions.

This last point is really important. In fact, through our research across investment managers globally, we've found that the link between a firm's objectives and portfolio level activities is not always as strong as perhaps we'd like to see. So we often probe individual investment decisions to reinforce that point.

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Q: How does ESG apply to your investment process more broadly?

A: While manager selection and oversight is a core aspect of our ongoing ESG integration work, we consider ESG broadly across our investment process. For example, as part of our strategic asset allocation decisions, we added a renewable resources sleeve, seeking structural growth opportunities in a number of sectors, including water, agriculture and renewable energy. This investment decision was based on analysis, which suggested stronger expected-risk-adjusted returns and a broader set of alpha opportunities, with a tailwind from evolving regulation, technology and consumer preferences.

ESG considerations may also influence how we define or constrain investment opportunity sets, or where we express a strong preference for active management. We are generally agnostic between active and passive. However, we believe that active management can help support effective ESG implementation in our portfolios, such as in regard to longer-term investments in emerging markets, smaller-cap equity and higher-yielding fixed income.

Q: You mentioned probing individual investment decisions. Can you give examples?

A: Given our manager-of-manager structure, the day-to-day investment and proxy voting decisions with regard to individual securities, resides with the various sub-advisors that we select.

As we discussed earlier, we fully integrate ESG considerations into our analysis. One of the ways we aim to validate effective ESG implementation is by looking through to underlying holdings. In particular, we may request explanations or case studies for specific proxy votes or individual holdings. Our goal here is not to override our sub-advisors, but to reinforce and validate consistent implementation of ESG considerations in the context of respective investment strategies and policy frameworks.

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Some recent inquiries around proxy votes included votes against additional climate risk disclosure and mandated board diversity. And with regard to individual securities, a recent inquiry highlighted how the investment team considered the compelling valuation on a corporate bond alongside a range of potentially material non-financial factors. These included risks arising from energy transition and stranded asset risk, and the company's investment in renewable technologies. Ultimately, the sub-advisor formed a favourable view.

Q: How do you think about engagement with sub-advisors?

A: Engagement is typically the first step when we identify a perceived gap. Through our recent research activities, we identified a number of areas where, for example, we felt information was less robust, where processes appeared less mature, or where there may be interest in enhanced disclosures to our Clients. We incorporated these issues into our annual ESG questionnaire, and we are in the process of analyzing responses. Our findings will determine engagement activities for each individual sub-advisor and investment strategy. These may ultimately include ESG integration in portfolio construction and risk reviews, client reporting and application of social factors.

Looking back, governance and, more recently environmental factors have generally received significant attention. As we look ahead, social factors, including mitigation of controversy and consideration of UN Global Compact Principles[1] may increasingly move into focus.

[1]unglobalcompact.org

Q: Would you consider divestment? Have you divested from certain areas in the past?

A: Yes, absolutely, and we have demonstrated this in the continuous evolution of our portfolios through time. These include changes to our strategic asset allocation and underlying investment managers and strategies.

I'd also highlight that our processes are designed to identify potential issues up front, before making investment decisions. Aside from any initial due diligence, and generally in reference to governance concerns, we have declined various sub-advisors' requests to broaden investment guidelines and opportunity sets into specific markets.

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Q: Do you engage with the industry more broadly?

A: We do, including participating in cross-business committees and quarterly ESG roundtables hosted by the Sun Life corporate sustainability team. This allows us to exchange information as well as updates on initiatives, challenges and collaboration opportunities. Through the broader organization, we can also be more impactful as we engage externally on environmental, social or governance-focused initiatives.

Nonetheless, we do engage directly in areas where we can be impactful ourselves, and help improve outcomes for our unitholders. Most recently, we participated in the IFIC Responsible Investing Task Force. Its mandate was to respond to two public consultations establishing ESG classification and disclosure standards. One key area that we raised was the use of a "best-in-class" label as a feature category for certain funds. In its public response, the task force noted that "best-in-class" is a problematic term that suggests subjectivity and may be prone to misinterpretations. And it recommended alternative labelling.[2]

[2]ific.ca

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Q: Who is responsible for ESG integration at Sun Life Global Investments?

A: The Investment Oversight Committee, which includes our CIO, oversees activities under our ESG Policies and Procedures. Various functional areas are accountable for ongoing implementation. In particular, this includes members of our Portfolio Management Team, working in consultation with Sun Life's International Investment Centre, to incorporate ESG considerations in our manager research and monitoring activities. They report their findings on a quarterly basis.

For those responsible for the integration and monitoring of ESG factors, it forms an important component of annual employee goals and performance reviews. In this way, a portion of their remuneration is directly dependant on the successful integration of ESG factors.

Q: How do you report publicly on ESG?

A: Reporting is a key area of focus for us, including details of our ESG philosophy, policy and procedures. We are also developing periodic reporting on broad ESG metrics across our platform and providing commentaries to support ongoing dialogue and engagement on this evolving topic.

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All proxy-voting records are available on our website. Further, we report on our ESG integration, both through the annual Sun Life Sustainability Report and through the UN's PRI program.

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