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Weekly Commentary

Issue **No. 45** | **October 26, 2020**

By Charles Marleau CIM® and William Mitchell CIM®

ESG and Responsible Investing
Part 5: ESG - Standards, Reporting and Transparency

Investor interest in ESG (environment, social, and governance) is growing rapidly, however further progress remains challenged by a lack of standardization, transparency and the absence of a unified regulatory framework. If the ESG movement is to have a measurable impact on the climate change solutions and serve as a catalyst for the betterment of our society as a whole, it's critical that all parties work cohesively on improving the availability, credibility, and transparency of ESG data.

Among the major issues is the absence of a standardized set of rules and disclosure requirements. For instance, while more and more companies are pressured to include ESG performance in their annual reporting, the act of reporting on ESG is largely voluntary and subjective. For companies that choose to report on ESG performance, they do so without standardized requirements or universally accepted guidelines. Without a clear-cut framework, how can company specific performance be viewed with credibility and further, how can investors perform an 'apples to apples' comparative assessment on ESG performance when the rules are vague?

Some progress is being made. Earlier this year, the CFA Institute (CFAI) began working towards the development of a standards framework designed to provide greater transparency in reporting. The objective is to create a standardized framework of ESG disclosure requirements. The CFAI initiative would result in a broadened understanding of reporting requirements and greatly improve the comparability of ESG-related investment products. As investors can hold a variety of motivations that support their appetite for ESG conscious products, a reliable toolkit for analysis and comparability will be welcomed. However, the CFAI initiative is currently in the consultation and submission stage and a formal proposal is not expected before the spring of 2021.

Other challenges persist: the creation, acceptance, and adoption of an authoritative ESG governing body, that has a global reach, may prove difficult to achieve. Progress is certain to be hampered by jurisdictional differences related to legal processes, regulatory powers, enforcement, political motivations, and a society's consensus on demanding change. To date, the European Union (EU) has demonstrated a strong willingness to act. One initiative involves defining what qualifies as a 'green investment'. We're seeing rapid growth in sustainable investment products like green bonds and transition bonds. A clear set of rules that defines what constitutes a 'green' investment will assist the process of evaluating the merits of any ESG claim.

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With a growing investor appetite for sustainable investing, so too is the desire for companies to portray themselves as 'green'. This has led to an increased incidence of 'greenwashing' which is the practice of making exaggerated or misleading claims regarding a company's ESG profile. In January four of the world's largest accounting firms proposed that a universal set of disclosure rules be formalized. Their objective is to create a definitive set of standards that will raise transparency and take the ESG assessment process to the next level. The implications for the investment industry are significant. Ultimately, greater onus will be placed on regulators to adopt and enforce the 'rules' and onboard level executives to take action. For investment professionals, a heightened level of diligence will be required when evaluating the ESG merits and managing the ESG risks of portfolios.

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Upcoming Special Event:

The Department of Economics and the Faculty of Social Sciences at the University of Ottawa invite you to the Marleau Lecture Series on Economic and Monetary Policy. Please join our virtual workshop "Digital Currency and Monetary Policy" to discuss the design and consequences of a central bank digital currency. The keynote speaker will be Professor Fernández-Villaverde (University of Pennsylvania, NBER and CEPR). In his presentation, Professor Fernández-Villaverde will build on his recent research, which is featured in *Cryptocurrencies: A Crash Course in Digital Monetary Economics* and *Central Bank Digital Currency: Central Banking for All?*

http://secure.campaigner.com/csb/Public/show/ch5q-2bbbz2--rxk3c-5ke7znj7#

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$7.82	0.42%
Palos Equity Income Fund - RRSP	PAL101	$5.70	1.35%
Palos Merchant Fund L.P. (Dec 31, 2019) [2]	PAL500	$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	$10.34	35.10%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.74	-6.12%
S&P TSX Composite (Total Return with dividends reinvested)			-1.81%
S&P 500 (Total Return with dividends reinvested)			8.88%
S&P TSX Venture (Total Return with dividends reinvested)			24.64%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			0.84%
Canadian Government 10-Year			0.64%
Crude Oil Spot			US $39.85
Gold Spot			US $1902.00
US Gov't10-Year/Moody BAA Corp. Spread			262 bps
USD/CAD Exchange Rate Spot			US $0.7619

[1] *Period ending October 23, 2020. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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