

The Global Future of Retirement

June 14-16, 2015 | New York | The Waldorf Astoria

Does ESG Have a Place Within Defined Benefit & Defined Contribution Plans?

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Prof. Christopher Geczy, Ph.D.

Dept. of Finance

The Wharton School

ESG Criteria: Popular and (Soon to Be) Pervasive

Some stats to digest ...

- Global *sustainable investment market* (ESG + negative social screens, aka Socially Responsible Investing) topped \$20 trillion by beginning of last year*
 - ESG adoption alone reached \$13 trillion
 - U.S. has taken (asset-weighted) lead in ESG adoption, despite some of Europe's biggest plans signing up
 - Institutional investors now consider ESG factors in investment analysis & portfolio selection for \$4 trillion in assets
 - JPMorgan Chase forecasts Impact Investing (in the strict sense of the term) AUM will be \$1 trillion by 2020
- At YE 2013, \$6.57 trillion was professionally managed in "SRI" portfolios in the U.S.* (vs. \$36.8 trillion total AUM in U.S.)***

Thus, ~18% of all professionally managed assets in the U.S. are in SRI portfolios

* Global Sustainable Investment Alliance, "2014 Global Sustainable Investment Review."

** Cerulli Associates data cited in US SIF Foundation 2014 Trends Report.

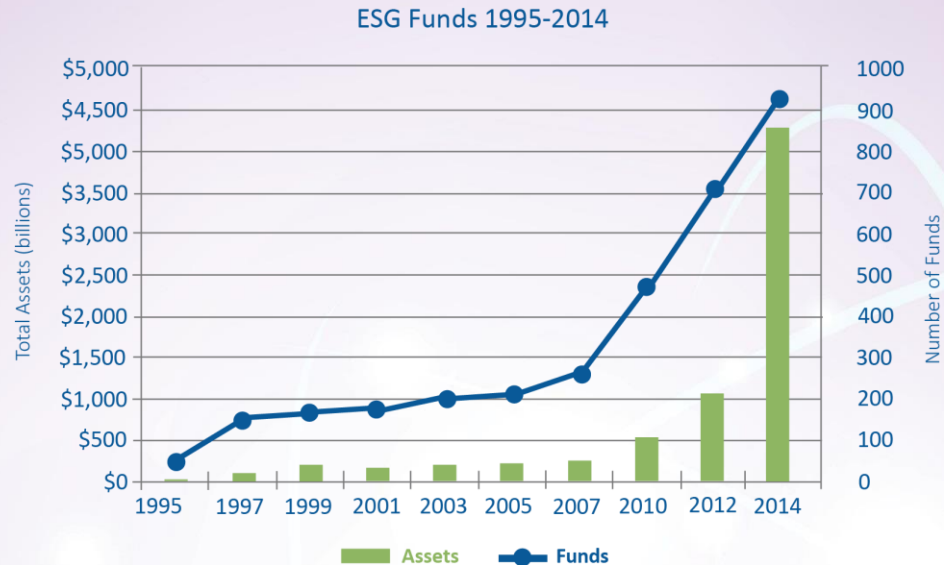
*** US SIF Foundation, "Report on US Sustainable, Responsible and Impact Investing Trends 2014."

Trends



As Demand (from Institutions) Goes, So Does Supply

Hockey-stick growth in number & assets of ESG funds through last year



SOURCE: US SIF Foundation

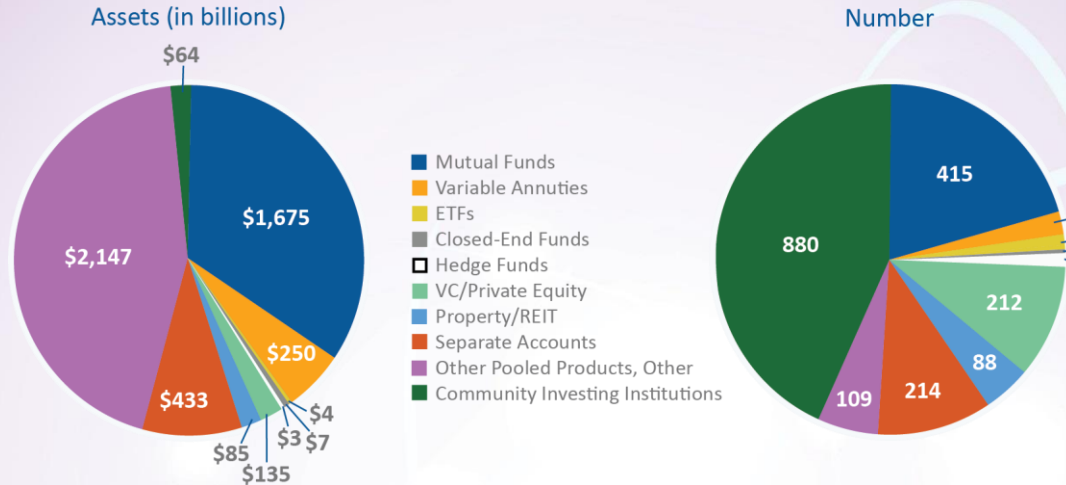
NOTE: Excludes separate account vehicles and community investing institutions.

Source: US Social Investment Foundation, 2014 Trends Report (Fig. 2.3, p. 29)

A Broad Spectrum of ESG Investment Vehicles

Note the number and variety of products that can be accessed by both retail & institutional investors

Types and Assets of Investment Vehicles and Financial Institutions Incorporating ESG Criteria 2014



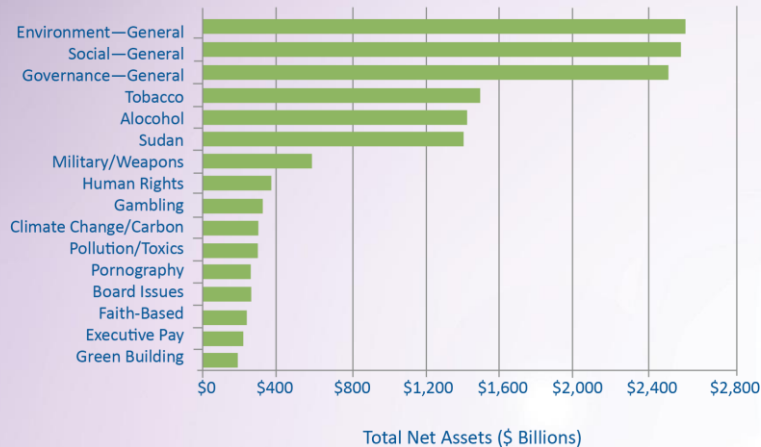
SOURCE: US SIF Foundation.

NOTE: For the purpose of this figure, community development venture capital funds are grouped with community investing institutions.

ESG Criteria Are Heterogeneous

Which ESG criteria an institution, or individual, may choose depends on many elements – financial, political, and even “keeping up with the Joneses”

Leading ESG Criteria, by Assets, for Investment Vehicles 2014



Source: US Social Investment Foundation, 2014 Trends Report (Fig. 2.5, p. 30)

Leading ESG Criteria for Mutual Funds 2014

	Number	Assets (in Billions)
Governance—General	211	\$1,555.1
Sudan	255	\$1,375.5
Social—General	70	\$1,133.0
Environment—General	75	\$1,127.4
Military/Weapons	104	\$588.1
Tobacco	184	\$477.2
Alcohol	154	\$410.2
Human Rights	93	\$363.9
Labor	99	\$340.0
Gambling	143	\$302.5
Climate Change/Carbon	84	\$275.6

SOURCE: US SIF Foundation

NOTE: Analysis based on assets of mutual funds, including those underlying variable annuity products.

Source: US Social Investment Foundation, 2014 Trends Report (Fig. 2.15, p. 39)

ESG Criteria: Doing Well By Doing Good?

What effect has ESG adoption had on financial performance?

- ESG adoption can improve performance, but the effect isn't universal for all criteria or all investments
 - One study (Geczy, Stambaugh & Levin, 2005)* found SRI adoption by mutual funds does have a cost, negligible or significant, depending on circumstances
 - Other studies have shown companies adopting ESG criteria can outperform**
 - The question of ESG cost is critical for plan fiduciaries required to maximize returns for participants.
- For U.S. plans under ERISA, DoL has held since 1998 that SRI is consistent with fiduciary duty if expected risk/return is comparable to available non-SRI investments

* Christopher C. Geczy, Robert F. Stambaugh and David Levin, "Investing in Socially Responsible Mutual Funds" (2005).

** E.g., Societe Generale's report "SRI Beyond Integration" found on average and in one year, the share price of ESG leaders grew 3.1% more than that of ESG laggards.

The Way Ahead

Retirement plans will see ESG front and center for the foreseeable future ...

- Industry leaders (e.g., ABP, CalPERS) will refine their approach to ESG and social investing generally. They'll learn not only from success but from failures, such as CalPERS Cleantech private equity
- Academia can help, though enthusiasm for studying ESG has lagged its actual adoption
- Specific trends:
 - Low carbon/carbon indexing
 - Boardroom diversity (esp. correlation of female directors with improved company performance)
 - Infrastructure development to ameliorate (inevitable) effects of climate change
 - Alternative entity structures to promote corporate social impact (benefit corps., B Corps).
 - o Recent article in *Harvard Business Law Review* (Geczy, Jeffers, Musto & Tucker, 2015) shows these entity structures don't change investment behavior
 - And, of course, **government regulation**



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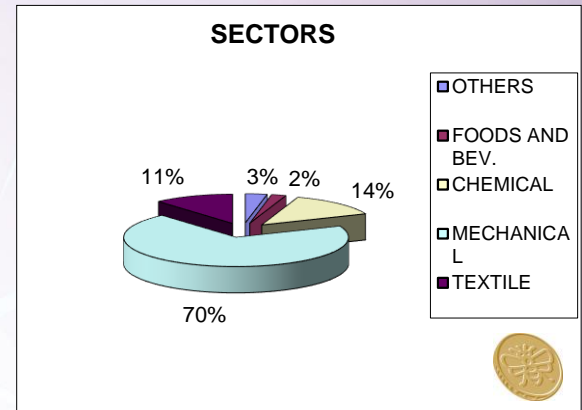
Mauro Bichelli

CIO

Fondapi - The Italian Small and Mid Cap Workers Pension Fund

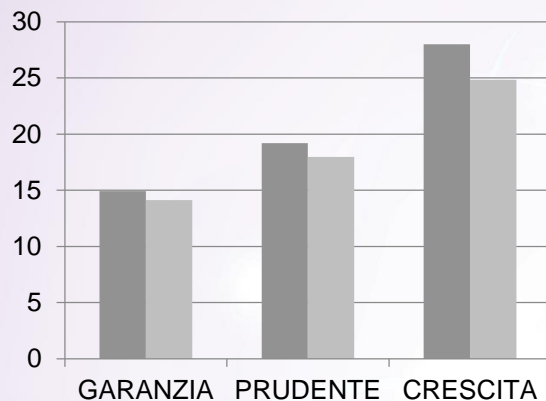
Performance April 2015

- **Founded in 98, started in 2001 after the approval of the new law on defined contribution Pension Funds in Italy.**
- **It is a closed Pension Fund for all the small and mid company's workers of all the sectors: mechanical, chemical, textile, commerce, graghs, real estate, foods and beverages.**
- **Fondapi counts 40,000 workers and around 6,000 companies that are, at the moment, only 8% of its potential.**
- **The asset under management is about 700 mln euros shared in three different profiles:**
 - **Guaranteed profile: 92% bonds + 8% equities**
 - **Prudent profile: 75% bonds +25% equities**
 - **Growth profile: 50% bonds + 50% equities**
- **It is concentrated in the Italian industrial regions and in the mechanical sector even if the real estate sector woud increase its percentage in the next future.**

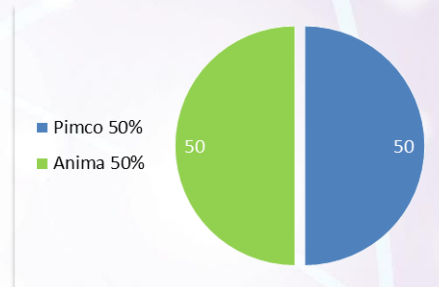
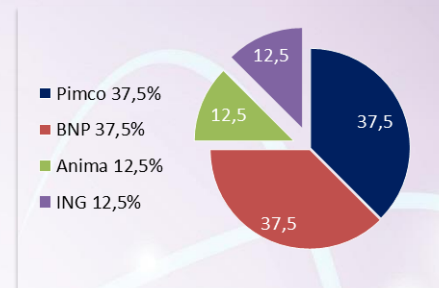


Performance April 2015

	FONDAPI	BENCHMARK	12 MONTH
GARANTY 07/12	14,92%	14,12%	+ 5,07%
PRUDENT 05/13	19,20%	17,97%	+ 14,66%
GROWTH 05/13	27,99%	24,84%	+ 20,66%



	BOND	EQUITY
GARANTY	92%	8%
PRUDENT	75%	25%
GROWTH	50%	50%

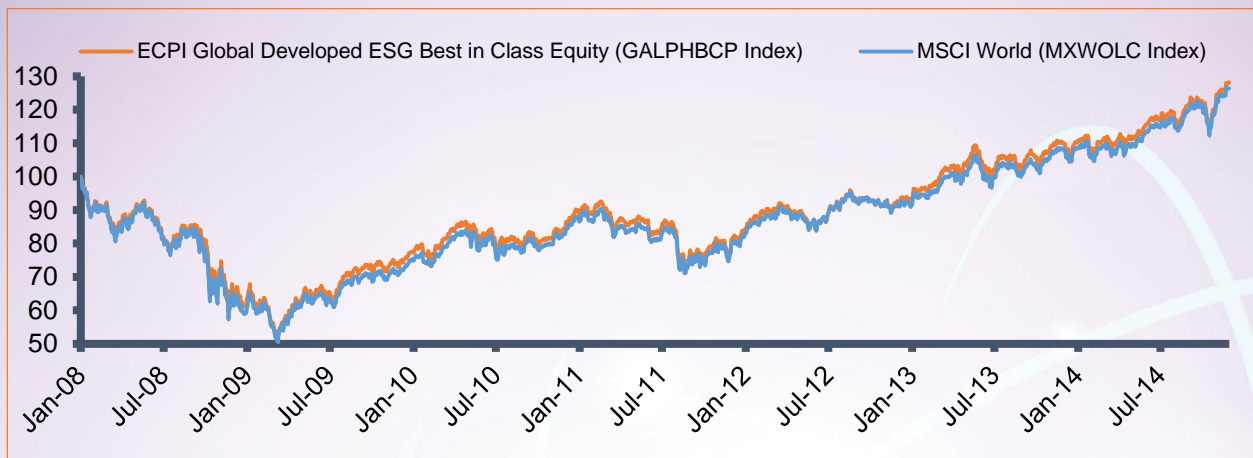


The ESG Approach: where we are

- Constant improvement of ESG investments (environmental social and governance) characterized by a significant attention to the environment, the social impact, all the good economic rules of behaviour and governance .
- A lot of different studies on medium and long horizon perspective have shown – using the positive principle approach without sector exclusions – that the investor could add a social filter to their choices of investing without compromising performances .



ECPI ESG Benchmark vs MSCI World

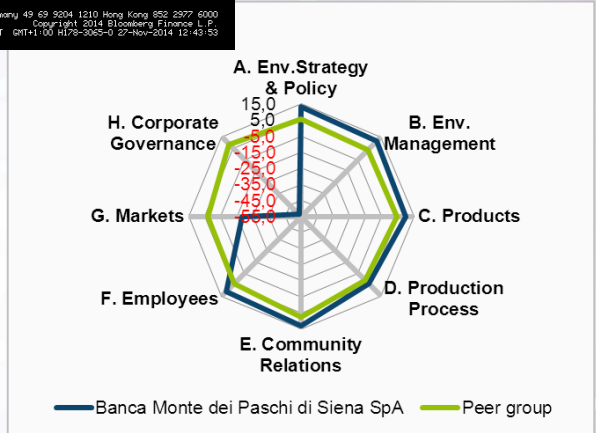


BB TICKER	GALPHBCP	MXWOLC
RETURN		
YTD	15.76%	16.21%
SINCE 2008	28.24%	26.37%
Comp. annual gr. rate	3.66%	3.44%
RISK		
ANN. VOLATILITY	17.05%	17.19%

BB TICKER	GALPHBCP	MXWOLC
RELATIVE ANALYSIS		
ALPHA wrt COMPARABLE	0.39%	
BETA wrt COMPARABLE	0.96	
DATA FROM/TO	1-Jan-08	28-Nov-14

ESG Filter effect: Montepaschi Bank (MPS)

- In March 2013 ECPI downgraded to F (not eligible) MPS: **starting from now Fondapi's financial managers cannot invest in this security.**
- The main important reasons are accusations and violations about **customer relations, corruption, money laundering, insider trading**
- From January 2013 to date, Montepaschi lost **56,89%** (considering FTSEMIB performance of **+21,57%**, **with a relative return of -78.46%**).
- Different ESG risky signals could have important effects on economic performances.



Selection of criteria: Governance

- **CORPORATE GOVERNANCE**
- **Disclosure on Corporate Governance**
- **February 2013:** The chairman of Consob stated that as a result of an anonymous notification received in August 2011, controls have been undertaken on the Company's capital market operations. The notification included a detailed description of the operations, with numbers, names of intermediaries, brokers, employees who had been returned commissions. The charge explicitly accuses managers to have approved capital market operations on the basis of the amount of returned commissions. It is highlighted the fact that capital market operations procedures have not been followed. Moreover, controls by the audit function had not been effective.
- **February 2013:** Gianluca Baldassari, ex director of the Finance Department, and its partners have been seized an amount of about € 40 mln for the illicit capital market operations which they concluded. The amount is considered to be a part of the paybacks they received from counterparties.
- **January 2013:** The Company faces losses up to € 700 mln in derivative contracts, which have not been disclosed in a transparent way and were not accounted for in previous annual reports.
- **January 2013:** Giuseppe Mussari, head of Italy's banks lobby ABI, resigned following a media report that showed how, under his helm back in 2009, Banca Monte dei Paschi di Siena carried out a derivative transaction likely to cost the bank 220 million euros in losses, to be posted in 2012 accounts. Bank of Italy states to have never received information about the "Alexandria" derivative contract.
- **November 2011:** Francesco Gaetano Caltagirone, ex member of the BoD, has been condemned for the acquisition of a percentage greater than 15% (violating banking regulations) of the shares of BNL, in collaboration with other partners.
- **January 2011:** the prosecutor of Florence assumes the issuance of false invoices for fictitious consultancy, in relation with the financing of 150 million euro granted to the group BTP. Andrea Pisaneschi, lawyer and president of Antonveneta, is involved in the investigation. Bank Antonveneta is now part of the BMPS Group, after the acquisition carried out in 2008.
- **Transparency of operations with related Companies**
- **August 2012:** the Company is under investigation for the tax effects resulting from an extraordinary operation (sale of a sharing) carried out in 2006.



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Rob Wilson

Research Analyst

MFS Investment Management®

ESG Research at MFS: A Historical Perspective

Emphasis on ESG is a reflection of our investment process

- Long-term ownership
- Deep fundamental analysis
- Global collaboration

MFS' commitment to ESG research demonstrated by:

- The founding of MFS' Responsible Investing Committee
- Our signing of the PRI in February 2010
- The ongoing development of transparent, ESG-aware proxy voting policies
- The procurement of multiple ESG research providers
- The hiring of a dedicated ESG investment analyst

ESG Integration at MFS

Analysts

Analysts &
Portfolio Managers

Portfolio
Managers

Ongoing
Analysis
of Current
&
Emerging
ESG
Topics

One-on-
One:
Industry
Initiations
& Ad Hoc
Support

Sector
Team
Lead
Meetings

Low
Rating &
Rating
Change
Alerts

Sector
Tapeouts

Cross
Sector
Research

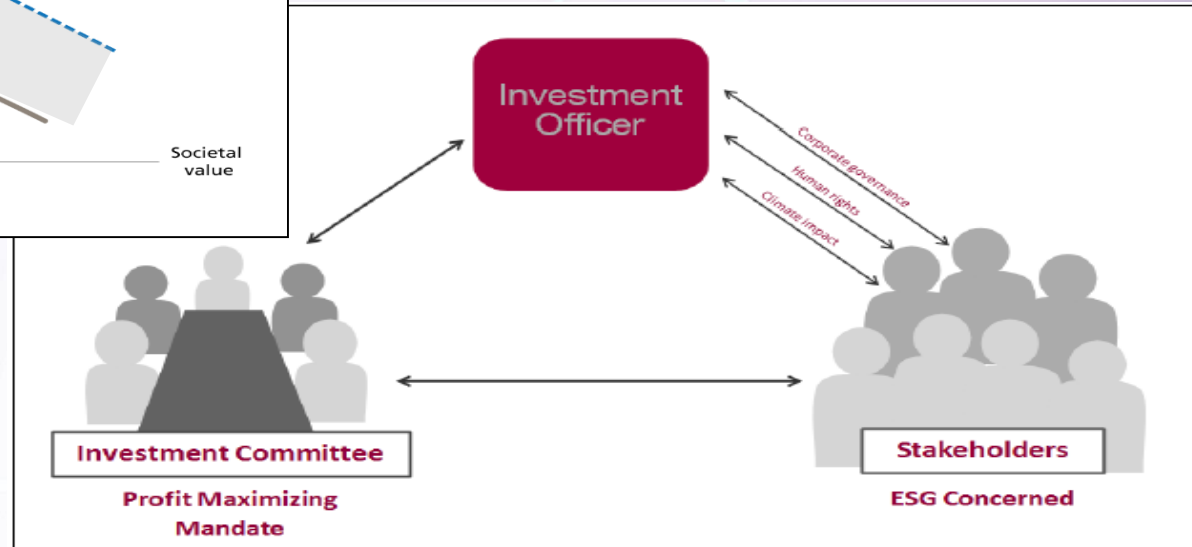
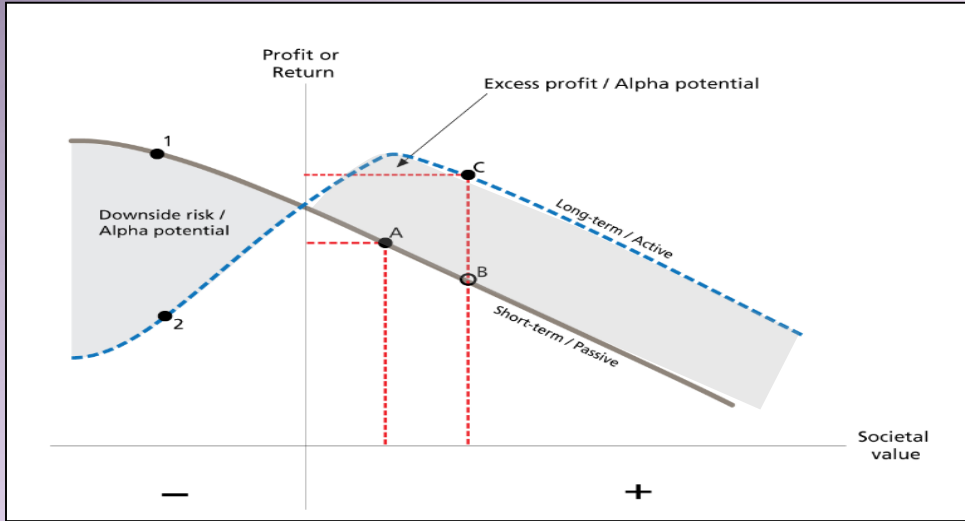
ESG
Dash-
boards

Example of ESG at MFS

Cross Sector Analysis: Tax avoidance

- Many multinationals use various tax strategies to shift profits to low/no tax locations
- Has been a strong earnings tailwind for many companies
- Under scrutiny due to budget deficits and "fairness", which creates earnings risk
- Key metric: Gap between effective tax rate and "geographic weighted statutory rate"
- Outcomes:
 - Partial sale of multiple equity holdings
 - Several MFS analysts normalized (increased) tax rates for individual companies in future years to account for risk
 - Certain downside scenario analyses also modified to include tax reforms
 - Tax analysis a critical component of one analyst's rating upgrade (pass to buy)

Profit vs. Altruism: A Zero Sum Game?



Proxy voting

Importance of MFS' Ownership Practices

- Our proxy committee is chaired by our Executive Vice President & General Counsel and managed by our Vice President of Corporate Governance & Proxy Voting

Focus on Long-term, Economic Impact

- We believe that a portfolio company's ESG practices often have an impact on the company's long-term financial performance
- All of our proxy votes are cast in the best, long-term economic interest of our clients

Emphasis on Global ESG Engagement

- Since joining the PRI in 2010, MFS' proxy team has engaged with portfolio companies on over 1,000 ESG issues in over 20 markets around the world

Attention to ESG Transparency

- Publicly-available proxy voting & engagement reports
- Publicly-available proxy voting policies and procedures
- Publicly-available voting records of many of our pooled investment vehicles

Disclosure

The views expressed in this presentation are those of the speaker and are subject to change at any time. These views should not be relied upon as investment advice, as securities recommendations, or as an indication of trading intent on behalf of any other MFS investment product.

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Does ESG have a Place within DB & DC Plans?

Ajit Singh

Chief Risk Officer

United Nations Joint Staff Pension Fund

The UNJSPF is a joint pension fund in which 23 member organizations participate.

As of December 31 2014, the market value of assets stood at 53.297 Billion USD

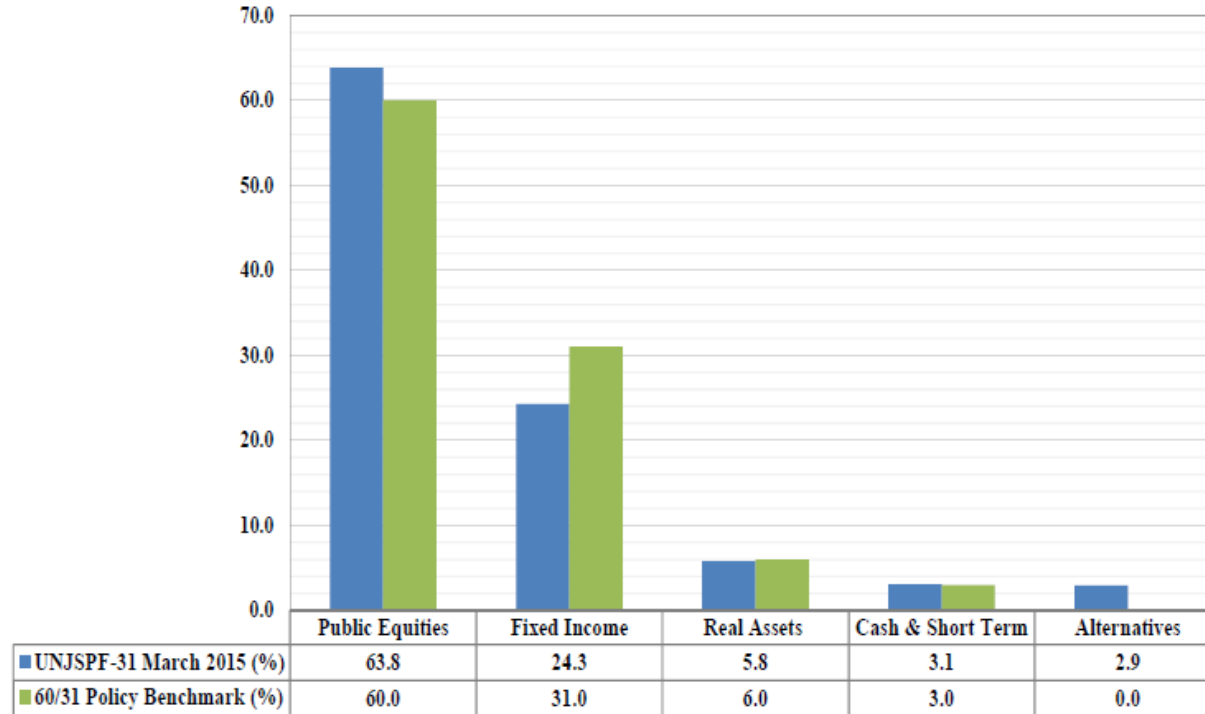
Widely considered a very complex pension fund because

- Its beneficiaries are around the world, in every member state
- It has multi currency liability structure, where pension payments are made in different currencies
- It pursues investments in all asset classes globally.
- Approximately 123k active participants making multi currency contribution.
- Approximately 73k beneficiaries, receiving benefits in different currencies.

The United Nations is committed to doing and promoting ESG investing and has taken leadership role in Creating low carbon index in 2014 and the investible products (ETFs).

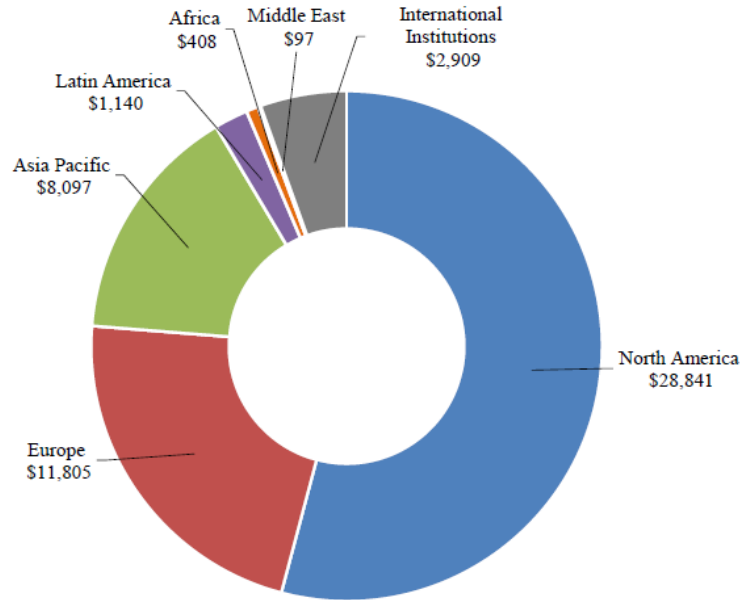
The Asset Allocation

The Fund has carved a dedicated allocation to Green Equities in its public equities allocation.



Regional Diversification

As of 31 March 2015, diversification by region in millions US dollars.



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