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Active ownership

Actively exercising your rights as a shareholder. The two main ways to do this are voting at shareholder meetings and engaging – taking part in a dialogue – with investee companies.

Active shareholders discuss environmental, social or corporate governance concerns with the companies in which they invest in order to preserve long-term shareholder value and enhance long-term returns. They can be very effective in influencing companies' behavior, especially when they cooperate with other shareholders.

Voting and engagement are two tools that, when combined, can strengthen each other. A long-standing relationship resulting from a multi-year engagement process inspires trust. Voting then becomes much more than simply casting a vote, and evolves into an important element in an ongoing mutual exchange of views.

There is not as much academic literature on active ownership as there is for other sustainable investment topics because there isn't much historical voting information yet, and data on engagement are often confidential. However, there are studies that have investigated the relationship between active ownership and financial performance, demonstrating that it can lead to higher returns.

In 'Active Ownership' (2013), Dimson, Karakaș and Li analyze a proprietary database of engagements with US public companies between 1999-2009. During the year after an initial engagement with a company, they observe that a company's stock returns an average of 180bp more than would have been expected had no engagement taken place. For successful engagements this figure rises to 440bp, while there is no market reaction to unsuccessful engagements. After successful engagements, companies experience improvements in operating performance, profitability, efficiency and governance.

Best in class

The best-in-class approach to sustainability investing involves investing in companies that are leaders in their sector in terms of meeting environmental, social and governance criteria.

An investor who follows the best-in-class principle does not exclude sectors or industries, such as tobacco or mining, but instead invests in the companies that make the most effort to meet the environmental, social and governance criteria that are relevant for their respective industries. A next step is to engage with these companies to help them improve their sustainability performance.

The most sustainable companies in a sector – also referred to as those adopting best practice – are used as a benchmark to be equaled or surpassed.

The Dow Jones Sustainability Indices follow the best-in-class principle: out of the 2,500 corporations listed in the Dow Jones Global Index, every year the 10% of companies in a given sector that best meet certain ESG criteria are selected for inclusion. No industries are excluded from this process. This best-in-class approach helps stimulate competition among companies for inclusion in the indices. To be

included or remain in the index, companies have to continually intensify their sustainability initiatives to the benefit of investors, employees, customers, and ultimately society as a whole.

Corporate governance

The set of rules, practices and processes by which a company is managed (governed) and its management is supervised.

Corporate governance relates to good governing practices and covers the basic principles, rights, responsibilities and expectations of an organization's board of directors. A well-structured corporate governance system aligns the various interests of all the stakeholders in a company, such as shareholders, management, clients, suppliers, financiers, government and the community. It supports the company's long-term strategy.

The principles of the International Corporate Governance Network (ICGN) constitute an internationally recognized code for good corporate governance. The organization aims to improve corporate governance, risk management, remuneration policy, shareholders' rights and transparency.

Corporate Responsibility (CR)

Taking responsibility for a company's impact on the environment and society.

Companies that integrate corporate responsibility into their business models actively monitor the impact of their operations on the environment and social well-being. They can try to minimize any negative impact or go a step further and take proactive measures to compensate for their impact or take actions that have a positive social or environmental effect.

Decarbonization

The reduction in the carbon intensity of global energy use. Similarly, investment portfolios can also be decarbonized.

The 21st United Nations Conference of the Parties (COP21), held in Paris in December 2015, came up with concrete targets to limit further global warming. Minimizing global warming involves reducing the world's reliance on fossil fuels. This will require some large companies, such as the oil majors and utilities, to fundamentally change their business models. However, moving towards a global energy system based on renewable sources creates another problem: stranded assets. These are the vast reserves of coal and oil that probably cannot be used if the world is to limit global warming to 2°C or less above pre-industrial temperatures.

In line with this trend, investors are also adjusting their portfolios. The simplest way to do this would appear to be by divesting fossil fuel companies from their portfolios. However, as there is a buyer on the other side of every sell transaction, this would simply mean transferring the problem to someone else. An effective alternative is to engage with carbon-intensive companies to try to cut emissions at source. Another way to reduce the carbon footprint of the portfolios is through impact investing. This can be achieved by, for example, underweighting the industry groups that account for over 80% of the global environmental footprint, i.e. energy, materials, utilities and transportation.

The Carbon Disclosure Project (CDP) encourages companies to disclose their greenhouse gas emissions and climate change strategies in order to set reduction targets and improve their environmental impact.

Engagement

A long-term dialogue between investors and companies on environmental, social and governance factors.

An active dialogue offers investors the opportunity to discuss sustainability risks and opportunities with companies and provides these firms with insights into investors' expectations of corporate behavior. This way, investors encourage companies to adopt more sustainable practices. Companies with sustainable business practices can create a competitive advantage and are more likely to be successful over the long run, ultimately improving the risk/return profile of their securities. Effective engagement can therefore benefit companies, investors and society at large.

Robeco applies an integrated approach to engagement based on close collaboration with analysts and portfolio managers at both Robeco and RobecoSAM. Analysts in RobecoSAM's Sustainability Investing research team identify long-term, financially material factors that can affect companies' ability to create value. This helps the engagement specialists to set SMART (Specific, Measurable, Attainable, Relevant and Timely) engagement objectives for companies. The outcome of the engagement efforts is communicated to analysts, portfolio managers and clients, enabling them to incorporate this information into their investment decisions.

Engagements typically run over a three-year period, during which the engagement specialists are in regular contact with company representatives and track progress against engagement objectives. They often combine their efforts in collaborative engagement initiatives with other institutional investors.

Environment

The 'E' in ESG: one of the three key factors to consider in sustainability investing, together with social and governance matters.

Institutional investors are increasingly working to better understand the potential financial impact of environmental issues on companies in their portfolios. They are calling for companies to pay greater attention to areas such as climate change, energy- and energy-extraction-related risks (such as coal combustion and hydraulic fracturing), energy efficiency, recycling and environmental hazards in the air, water and soil. Investors play an important role in environmental topics by drawing attention to the relevant issue and influencing disclosure.

The potential negative effects for companies that do not manage environmental risks include increasing costs (such as the need to clean up oil spills or restore the landscape around exploration sites), reputational damage in the event of headline-grabbing polluting incidents, or litigation costs. Integrating environmental considerations into a corporate strategy can also present opportunities. For example, using resources efficiently will reduce costs, while companies offering innovative solutions, such as printer suppliers helping their customers to get by with fewer and more energy-efficient printers, can gain a competitive edge.

ESG integration

The structural integration of information on Environmental, Social and Governance (ESG) factors into the investment decision-making process.

Sustainable investors believe that sustainability can have a material impact on companies' performance, and that factoring in financially relevant sustainability information can therefore lead to better investment decisions.

As a wide variety of sustainability information is available, investors first determine which ESG information is financially relevant. The second step is to analyze the impact of these material factors on individual companies and any competitive advantages or disadvantages that arise. The final stage is to translate this impact into adjustments to the valuation models used for equities.

Robeco also integrates sustainability information into the analysis of government and corporate bonds. Robeco's credit analysis team focuses on a bond issuer's cash-generating ability and the quality of those cash flows. The team's model uses five different variables, one of which is ESG. The importance of the E, S and G factors differs for each sector. The credit crisis, for instance, revealed the importance of good corporate governance for financial corporate bonds.

Robeco uses RobecoSAM's Country Sustainability Ranking in the management of its government bond portfolios. This ranking is based on a comprehensive ESG database. It is updated twice a year and functions as an early-warning system that helps us to identify both the threats and the opportunities in a country before they are reflected in spreads or ratings.

Exclusion

The exclusion of sectors or companies from an investment portfolio if they do not comply with specific ESG criteria.

Investors can choose to exclude a list of controversial countries or companies that do not comply with international agreements or treaties, such as producers of controversial weapons.

Sustainable asset managers have the primary duty to obtain good performance for their clients, and want to achieve this in a sustainable way. Consequently, they tend to focus less on exclusion, preferring instead to have constructive dialogues with companies to encourage them to improve their sustainability performance.

Robeco engages with companies that systematically breach the UN Global Compact principles in terms of human rights, labor rights, the environment and corruption. If these companies are excluded from our investment universe from the outset, we cannot exert any influence on them. We therefore only exclude companies when engagement fails to have the desired effect. However, we do exclude controversial countries on the basis of international agreements, and companies on the basis of legislation, such as producers of controversial weapons.

Ethically driven funds can take this principle further and exclude companies that do not comply with their moral beliefs, such as tobacco companies or firms that are involved in deforestation or child labor.

Footprint

A country, company or person's impact on the earth's resources and on other people.

An ecological footprint is a way of measuring how a company or an investment portfolio of companies impacts the planet. There are various ways to determine a footprint. It can be an indicator of, for example, how much productive land, freshwater or seawater a company uses; how much greenhouse gas it emits; or how many trees it needs to cut down to produce a certain article. It can also show the emissions generated from the oil, coal and gas we burn, or how much land is required to absorb our waste.

A portfolio's footprint can be reduced by excluding or underweighting sectors or companies with a large footprint, or by engaging with them to reduce their footprint.

Impact investing

Targeted investments that produce both an attractive return and a measurable positive social or environmental impact.

Starting with a specific impact objective, impact investors require their investments to produce quantifiable socioeconomic or environmental benefits.

Traditionally, impact investors have focused on smaller, private allocations to social enterprises and project-type investments, for example through microfinance instruments. However, this has remained a niche activity due to liquidity constraints and limited scalability. But today, impact investing is increasingly being taken from the margin to the mainstream as the concept is being introduced to major asset classes such as listed equities and fixed income.

Focused impact investing portfolios allocate to companies that provide products and services that make a positive impact. The impact objectives of these portfolios are often linked to resource efficiency in areas such as climate, energy, water, health and food. These portfolios can invest in companies in areas such as alternative energy, water treatment technologies or energy efficiency equipment. Companies providing resource efficiency solutions not only enjoy competitive advantages relative to other firms, but also have a greater positive social and environmental impact.

Integrated reporting

Communicating both sustainability and financial targets and results in one report, linking them to each other.

The concept of providing a comprehensive report integrating the two separate streams of information most companies currently provide – sustainability data in a corporate responsibility report and financial information in an annual report – is rapidly gaining ground.

Whereas a corporate responsibility report does not speak the language of financial analysts, and an annual report only provides financial data, an integrated report links traditional sustainability data to the company's strategy and its financial results. It translates sustainability targets into Key Performance Indicators and value creation.

The International Integrated Reporting Council (IIRC), a global coalition of regulators, investors, companies, accountants and NGOs, promotes integrated reporting and thinking in both the public and private sectors.

Materiality

The relevance of a sustainability factor to a company's financial performance.

Financially material ESG factors are factors that could have a significant impact – either positive or negative – on a company's business model and value drivers, such as revenue growth, margins, required capital and risk. The material factors differ from one sector to another. Examples of factors that can be material include supply chain management, environmental policy, worker health and safety, and corporate governance.

For sustainability to translate into financial performance, it must have an impact on either the cash flow generated by the company, or its cost of external financing (the weighted average cost of capital). Free cash flow is a function of revenues and expenses, as well as taxes and reinvestment rates. The weighted average cost of capital is a function of short-term interest rates and the risk premiums a company must pay for acquiring equity, debt financing and cash.

Negative screening

Excluding companies that engage in activities that are deemed objectionable.

Negative screening involves excluding from an investment universe companies that do not comply with specific pre-set social or environmental criteria. For example, some mutual funds screen out companies involved in the production of alcohol, tobacco or gambling products, also referred to as 'sin stocks'. Other negative screens frequently applied are on weapons manufacturers, nuclear power producers or companies that use child labor.

Negative screening can be a first step for investors to invest sustainably. The downside is that it has no net impact, as there is always someone who is willing to buy the relevant shares in their place.

Positive screening

Investing in companies that show leadership in social and environmental issues, such as employee policies, environmental protection or human rights.

Positive (or affirmative) screening means that rather than excluding companies, investors select companies that set good examples in terms of their, for example, environmentally friendly products or socially responsible business practices. Unlike negative screens, which are generally more black and white, positive screens require analysis of complex issues such as pollution, workplace practices, diversity and product safety.

Part of a positively screened investment portfolio may consist of smaller companies that have come up with innovative products that enhance the world's sustainability. Examples include firms generating renewable energy, such as solar power, wind power or hydrogen fuel cells; manufacturers of natural food and healthy living products; and companies involved in environmental clean-up and recycling.

A well-diversified portfolio also needs to invest in large and medium-sized companies. Larger companies, and the problems they face, are more complex. Positive screening can help determine which are heading in a positive direction. Mutual funds and other institutions often use a 'best-in-class' approach to positively screen companies. This means that they can include a tobacco company that is showing leadership in its industry, despite the overall record of that particular industry.

PRI

The Principles for Responsible Investment, a global initiative supported by the United Nations. Also referred to as UN PRI.

The United Nations-supported Principles for Responsible Investment (PRI) initiative is an international network of investors working together to put the group's six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories in incorporating these issues into their investment decision-making and ownership practices.

In implementing the Principles, the signatories contribute to the development of a more sustainable global financial system. They have a duty to act in the best long-term interests of their beneficiaries. In this fiduciary role, they believe that environmental, social, and corporate governance issues can affect the performance of investment portfolios. They also recognize that applying these Principles may better align investors with the broader objectives of society.

The six principles are:
Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
Principle 6: We will each report on our activities and progress towards implementing the Principles.

Robeco and RobecoSAM have been signatories of the PRI since 2006.

Sin stocks

Shares in companies involved in activities that are considered unethical, such as alcohol, tobacco, gambling, adult entertainment or weapons.

Ethical investors tend to exclude sin stocks, as the companies involved are thought to be making money from exploiting human weaknesses and vices. It is a relative concept, though, as different cultures have different opinions on what constitutes a sin. Although sin stocks usually include alcohol, for example, brewing bear or making a fine wine can be considered a noble tradition in various regions or countries in the world. And whereas some investors exclude weapons manufacturers on moral grounds, serving in the military can be considered an act of patriotism by others.

Various studies show that sin stocks deliver better returns than stocks in general. There are several explanations for this. One of them is that sin stocks are undervalued because many investors avoid them. Another one is that sin industries pose increased litigation risk or reputation risk, for which investors are compensated with a risk premium.

A more recent explanation is offered by David Blitz, Head of Quantitative Research

at Robeco, and Frank Fabozzi, Professor of Finance at EDHEC Business School, in their article 'Sin Stocks Revisited: Resolving the Sin Stock Anomaly' published in the Journal of Portfolio Management. They show that the outperformance of sin stocks can be explained by two Fama-French quality factors, 'profitability' and 'investment'. The profitability factor maintains that high-profitability stocks perform better, while the investment factor suggests that stocks in firms with high total asset growth perform worse. Sin stocks tend to have high exposure to both factors; cigarette makers, for example, enjoy high margins due to relative price inelasticity, and are restricted in how they can grow their assets.

Social

The 'S' in ESG: one of the three key factors to consider in sustainability investing, together with environmental and governance matters.

Social issues relate to the rights, well-being and interests of people and communities. These issues include human rights, labor standards in the supply chain, child and forced labor, workplace health and safety, and relations with local communities.

A company that manages social issues well and takes the interests of its various local stakeholders into account will obtain a 'social license to operate'. This refers to a level of acceptance or approval by local communities and stakeholders. This will facilitate the obtaining of government permits and 'social permission' to conduct its business. Increasingly, a social license to operate is an essential part of operating within democratic jurisdictions as without sufficient popular support, government agencies are unlikely to grant operational permits or licenses.

A company that does not address social issues risks reputational damage, increased costs and lawsuits.

Socially Responsible Investing

An investment strategy that seeks to consider both financial returns and social good.

Sometimes also referred to as sustainability investing, although this term is considered to be broader (see Sustainability Investing).

An investment is considered socially responsible based on the nature of the business the company conducts. Common themes for socially responsible investments include avoiding investment in companies that produce, sell or are involved in addictive substances or activities (like alcohol, gambling and tobacco) and seeking out companies engaged in social justice, environmental sustainability and alternative energy/clean technology. Socially responsible investments can be made in individual companies or through a socially conscious mutual fund or exchange-traded fund (ETF).

One example of socially responsible investing is community investing, which goes directly toward organizations that have a track record of social responsibility by helping a community, but have been unable to garner funds from other sources, such as banks and financial institutions. The funds enable these organizations to provide services, such as affordable housing and loans, to their communities. Their goal is to improve the quality of the community by reducing its dependency on government assistance such as welfare, which in turn has a positive impact on the community's economy.

Stewardship code

A code requiring institutional investors to be transparent about their investment processes, engage with investee companies and vote at shareholders' meetings.

The first stewardship code was introduced in the United Kingdom in 2010, with the objective of enhancing the quality of engagement between asset managers and companies to help improve long-term risk-adjusted returns for shareholders. In early 2015, Japan was the first country in Asia to introduce a stewardship code. The International Corporate Governance Network has launched a Global Stewardship Code.

Although stewardship codes are not compulsory, they are increasingly viewed as a condition if companies wish to retain business. For example, Japan's largest pension fund, GPIF, requires its asset managers to be signatories of the Japanese Stewardship Code.

Robeco is a signatory of the UK, Japanese and Taiwanese Stewardship Codes and has its own Stewardship Policy, which explains how Robeco fulfills its duties as a good steward by engaging, voting and reporting about its sustainability investing strategy in a transparent way. Through this policy, Robeco also complies with all existing codes.

Stranded assets

Assets on corporate balance sheets that rapidly lose their value as a result of forced write-offs.

Stranded assets currently mainly refer to utilities and exploration companies, whose traditional activities of finding and generating energy from fossil fuels have come under pressure as a result of climate protection regulations.

Research by Nature magazine published in January 2015 suggests that a third of oil reserves, half of gas reserves and 80% of coal reserves should remain unused from 2010 to 2050. The research identified the largest risks areas as coal reserves in China, India and the former Soviet Union, and oil and gas reserves in the Middle East.

Supply chain management

Integrating environmentally and socially viable practices into the entire supply chain life cycle.

There is a growing need for companies to ensure and monitor the sustainability of their supply chains. If a company's supplier resorts to, for example, child labor, this can result in reputational damage and costs for the company. Corporations therefore increasingly see sustainability in their entire supply chain as essential to their long-term profitability. A sustainable supply chain can offer value creation opportunities and competitive advantages.

Supply chain management affects the production process from product design and development, to material selection (including raw material extraction or agricultural production), manufacturing, packaging, transportation, warehousing, distribution, consumption, return and disposal. Environmentally sustainable supply chain management and practices can help organizations not only reduce their total carbon footprint, but also optimize their end-to-end operations to achieve greater cost savings and profitability.

Sustainable Development Goals

A set of sustainability goals released by the United Nations in 2015 as a successor to the Millennium Development Goals. Officially known as 'Transforming our world: the 2030 Agenda for Sustainable Development'.

193 countries have agreed to contribute to the realization of 17 Sustainability Development Goals (SDGs) by 2030. The goals aim to tackle social and environmental challenges such as climate change, the promotion of clean energy, extreme poverty, gender equality and sustainable agriculture.

SDGs differ from the Millennium Development Goals in that they call on the private and public sectors, together with the signatory governments, to cooperate closely in order to tackle the most serious issues facing people and the planet.

As a sustainable investor, Robeco embraces the SDGs. We already integrate Environmental, Social and Governance (ESG) factors into our investment processes in order to make better-informed investment decisions and improve the risk/return profile of our investments.

Robeco sees the SDGs as a business opportunity for listed companies, providing them with a future competitive advantage by being a source of innovation, process improvements and operational efficiencies. At the same time companies can have a positive impact on society and the environment. We believe that companies that embed the SDGs in their business strategy will be more likely to align with governmental policies and regulations and therefore avoid the risk of losing their license to operate or encountering high costs resulting from structural change.

Sustainability investing

An investment discipline that considers environmental, social and corporate governance criteria to generate long-term competitive financial returns and positive societal impact. Also referred to as responsible investing.

Sustainability investing is a broad concept, and there are many different rationales, approaches and definitions. The motives behind it vary from ethical principles to simply wanting to achieve better investment results. There are various methods to invest sustainably, such as through active share ownership (engagement & voting), integration of ESG factors, best-in-class approaches, thematic investing, impact investing and exclusion.

Responsible investing is a holistic approach that aims to include any information that could be material to investment performance. As a signatory of the Principles for Responsible Investment, Robeco uses this approach as well, but we use the term sustainability investing.

Thematic investing

Investing in themes contributing to the development of sustainability.

Sustainability-themed investments help address social or environmental challenges by investing in companies offering solutions to these problems. The most important issues tend to be population growth, rising wealth in the developing world, natural resource scarcity, energy security and climate change. Such investments generally focus on environmental themes, but can also cover social issues, such as health.

RobecoSAM offers a range of thematic strategies investing in companies that provide solutions to the most urgent sustainability challenges. Its range includes smart energy, healthy living, smart materials and sustainable water strategies.

UN Global Compact

A global corporate sustainability initiative, calling on companies, investors and other participants to align their strategies and operations with universal principles on human rights, labor, environment and anti-corruption.

The ten principles are:

Human Rights
Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
Principle 2: Make sure that they are not complicit in human rights abuses.

Labour
Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4: The elimination of all forms of forced and compulsory labor;
Principle 5: The effective abolition of child labor; and
Principle 6: The elimination of discrimination in respect of employment and occupation.

Environment
Principle 7: Businesses should support a precautionary approach to environmental challenges;
Principle 8: Undertake initiatives to promote greater environmental responsibility; and
Principle 9: Encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption
Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Robeco is a participant in the UN Global Compact and engages with companies that structurally and severely breach UN Global Compact principles.

Voting

Voting at Annual General Meetings of shareholders (AGMs), aiming to influence a company's governance or operations.

Voting is a way for active owners to influence companies. If there are important issues and a company is unwilling to listen to shareholders or other stakeholders, voting at its AGM can be a powerful tool. The results of decisions made at AGMs are made public. When shareholders vote against a proposal, a company has to address the issue.

Robeco has drawn up a voting policy on the basis of the principles of the International Corporate Governance Network. This is an internationally recognized set of best practices for good corporate governance. The principles aim to improve corporate governance, risk management, remuneration policy, shareholders' rights and transparency. Robeco assesses all voting decisions in light of its voting policy.