Nuveen: The Innovator in ESG/SRI Investing

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by Robert Huebscher

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Prior to joining Nuveen in 2015, Martin managed the ETF build-out at Deutsche Bank, where he launched and oversaw products in the commodities, currency, equity (international and domestic) and fixed income space. Prior to Deutsche Bank, Martin worked in risk management at JPMorgan Chase.

Martin earned his B.A. from the University of Leeds.

I spoke with Martin on October 30 at the Schwab IMPACT conference in Washington, DC.

Tell me a little bit about your role at Nuveen and your focus within the world of financial advisors.

I have two main focuses. I have the retirement products business – our target-date funds, the life-cycle funds, and the life-cycle index funds. I also have the exchange-traded fund business, which is a new build. We've been going for about two years, and have approximately $550 million in assets under management across 11 products.

Let's talk about ESG/SRI investing. What is the overall appetite for advisors for those products, and what do you think is driving that right now?

The appetite among financial advisors for responsible investing is pretty strong, and continues to grow stronger. The majority of our ETFs are ESG. Of the 11 ETFs in our product suite, eight of them are ESG, and about $400 million of our $550 million or so in assets are in ESG assets.

We are seeing appetite from clients across the board. The traditional surveys tell you that it's women and millennials that are more interested in values-based and responsible investing, but we are starting to see it with baby boomers and across the market.

There are a couple of things driving advisor interest. First of all, there's client demand. How do you incorporate responsible or values-based investing into your investment process? More and more financial advisors are having the question put to them by their clients, and by their clients' children when they do succession planning, and they need to have a good, solid answer.

The other thing that's really helping to drive it is the fact that for a long time, the knock on ESG has been that it underperforms. We're showing that now it doesn't. In fact, we can present it as a way to add value.

We come across this a lot with the research that we've done into ESG/SRI investing. Clearly one of the biggest concerns among advisors is whether there's a sacrifice in diversification, and related to that a sacrifice in performance. The academic theory would suggest that there has to be. But what is the best way that you've found to counter that concern?

The products that we've built are designed to be asset-class building blocks for portfolio construction. Among ESG ETFs, we have large-cap growth, large-cap value, mid-cap growth, mid-cap value, small caps, developed markets, emerging markets and core fixed income. They're all designed to perform in line with the asset class that they are representing.

When we look at how we construct the ESG portfolios, we go through the factors that we score companies on. Under "E," it's resource wastage, climate change, water usage and pollution. Looking at it another way is whether or not a company manages its material inputs efficiently. If it does, it's going to get a higher score under "E". You can look at "E" as efficiency rather than environmental.

Under "S," we look at whether companies are doing well on labor relations, customer relations and regulation issues. Do they get on with the regulators? Do they get on with their workers and their customers? These, again, are just more signs of a well-run company.

Under “G”, we find that's the one that people most intuitively get. Most financial advisors understand a company with good governance is generally a better run company. You take all of those together and you can say, "Look. This is another way of looking for quality without going into the balance sheet. It's another way of looking for well-run companies."

Then you have controversy scoring. If a company has a significant controversy, it can materially reduce its ESG score. For investors and financial advisors, this is a risk-management overlay. I say to people, "Even if you're not an ESG investor, you should look at all the single stocks in your portfolios. What are their ESG scores?” If they move dramatically downwards, it may be an indication of trouble to come.

Can you give me an example?

Equifax was downgraded by all the ESG data providers at least a year before its major data privacy scandal. It had a smaller data privacy scandal and it didn't fix it. Facebook was not in our large-cap growth portfolio, nor has it ever been in our large-cap growth ETF (NULG), because it has a relatively poor score for technology companies because of the 2014 data security and data privacy issue that forced it to sign an agreement with the Federal Trade Commission. It didn't fix that, and in Q2 this year it suffered a major sell off. Its earnings forecasts were bad, partly because of the extended cost and steps taken around data privacy.

From that perspective, you can look at the controversy screening as a risk-management overlay. It's a way of filtering for companies actually fixing the problems they have. Instead, they may be just doing a calculation where it says, "You know what? It's cheaper just to pay the fine when it happens." Because of this, we can position ESG as a way of looking for better-run companies with a risk-management overlay.

One of the other concerns or misconceptions about ESG investing is that there's limited exposures to the size and style with various market capitalization strategies with respect to value and growth. What is your response to that?

Our response was the products we launched. We give investors size and style, because you're right, that was a huge problem. The majority of ESG funds are large-cap growth-skewed. Large cap because they report more, so you've got more ESG stats to score them on, and growth because once you've removed energy and utilities, which is what a lot of managers did, that's a growth-skewed portfolio. We wanted large growth and large value, as well as mid growth, mid value, small caps, developed markets, emerging markets and core fixed income. They all have a consistent ESG overlay.

The other thing is that if you're trying to mix and match different managers, a financial advisor then ends up having to explain, "What is this manager's ESG methodology? What is this one? What is this one?" Then they've wasted the whole meeting with the client talking about different ESG methodologies. We aim to give them asset allocation tools, as that is clearly the driver for performance, so they use their own asset allocation with a single consistent ESG methodology.

What about the fact that, particularly in the ETF world, many of the strategies rely on an exclusionary approach?

You're right. Just a straight exclusion portfolio has actually been one of the biggest drivers of underperformance and lack of diversification value over time, so we didn't want to have that.

That's the old SRI. With our products, we do have the traditional “sin stock” exclusion – alcohol, tobacco, firearms, nuclear power. For emerging markets, we added one around doing business with Sudan. In the U.S. and developed markets, that was covered by OFAC and similar regulations. In the emerging markets, we had to add that in.

The only other exclusion we have is within energy, as part of our low-carbon overlay. We exclude companies with fossil-fuel reserves. But beyond that, we're using best-in-class, not straight exclusionary tactics. It enables us to have an energy segment in all of our large growth, large value, mid growth and mid value. We have energy and utilities in them. We're not just going to remove them because they make your ESG scores look bad. We're trying to give you asset-class performance, and so we have them in there.

What do you find now is the hot button issue for advisors when they think of ESG/SRI? Is there one issue that jumps out, like climate change or gender diversity?

When we talk to advisors, the biggest question we get once we've gone through the products is around implementation. "How do you actually deploy these?" They ask, "Great, you've given me building blocks. How do you actually put them together in a portfolio?" So we built a series of target-risk models with our solutions team. Advisors don't have to copy them religiously, but it gives a guide as to how advisors can build various allocation models.

We included a low-carbon overlay, which we've been doing for a long time as an institution. We've been running client money in this space for nearly 30 years, but as an asset manager we've been doing this for nearly 50 years, including managing our own money. Our responsible investing team said to us, "Look, you actually need to have a specific low-carbon overlay, because a standard ESG methodology will not necessarily reduce carbon footprint, materially."

We've found that even if the client or the advisor is not focused on climate change, the reduction in carbon intensity is the one ESG stat that resonates. You can say, "All right, we've improved the ESG score versus the benchmark by 20%." But what does that mean? If you say, "All right, we've actually reduced the carbon footprint by 60%," that resonates. That is one of the stats that survives that game of telephone between the issuer, salesperson, advisor and client.

Have advisors been asking you for ESG/SRI-specific reporting on how your funds and ETFs are doing? Not just how they've performed, but what is the actual end result of, say, carbon reduction relative to an appropriate benchmark?

They have. One thing that's been missing a little bit is the measurement part of ESG/SRI investing. It's like, "All right, you said it's ESG, but prove it to me." So we show the ESG score versus the benchmark, and we show the carbon reduction versus a benchmark. On a portfolio level, we can do that as well. We can show them, "All right. You put the portfolio together. This is what your ESG pickup and carbon-intensity reduction have been through employing this portfolio."

Long term, when we go to someone who's using active managers in the ESG space, we will say, "Fine. If you're happy with that manager, that's great. But please benchmark them to our products, and make sure you find the right manager. Make sure they're earning that extra fee through performance through ESG pickup and also through carbon-intensity reduction." If they're not, then we can have a conversation with them.

What sets Nuveen apart? How do you differentiate yourselves from your competition?

In a few different ways. The first one is our track record on credibility in the space. We are the asset management arm of TIAA. We're one of the original drafters of the UN's Principles for Responsible Investing. We run two-thirds of our trillion dollars in assets according to the UN PRI. We've been running client money in the space since 1990 and mutual funds since 1999. We've been doing this for a long time. It shows in the fact that we are the only ESG ETF this year that has brought low carbon into core ESG. There are low carbon ETFs and there are ESG ETFs. We've brought it together because we understand that's actually a key component.

We understand how investors are using ESG/SRI. We're the first people to bring out that full portfolio of building blocks. We're the first people to bring out ESG ETF portfolios. We understand the actual construction and implementation because of our position within TIAA.

What are the ways that you find advisors are using these ETFs to build sustainable impact portfolios for their clients?

There are two main ways we come across them. One is if they are a traditional ESG investor, who has been using various different active managers. They use our products to bring the style or the size back to where they want it to be in their portfolio. They bring the skew away from large and away from growth back to value or somewhere in between.

The other one is financial advisors who haven't been using ESG, but are starting to get questions from their clients. They're using our products to mimic their asset allocation, but with an ESG overlay across it.

How big do you expect the ESG/SRI asset universe to become?

One of our competitors has said that the ESG ETF market is going to be $400 billion within 10 years. I can see that. Once you've explained that underperformance is no longer an issue, then it's a way for a financial advisor to deepen and strengthen the relationship with their client, which ultimately helps with client retention