

# INVESTMENT INSIGHTS

PERSPECTIVES ON INVESTMENT STRATEGIES

*The 24-hour news cycle and rise of social media have made environmental, social and governance (ESG) topics more broadly visible to society at large and investors in particular. As a result, ESG factors have more potential to impact stock and bond prices than they did even a decade ago, say MFS's Colin Sinclair, managing director, institutional sales, Western Canada, and Darren Patrick, director, relationship management, Western Canada, when asked by Investment Insights how ESG analysis is integrated into their firm's investment process. That has led to a sharper focus on ESG issues as MFS continues to strive to identify companies that can sustainably add value for investors over the long term.*

## HOW HAS MFS'S APPROACH TO SUSTAINABLE INVESTMENT PRACTICES EVOLVED SINCE YOU ESTABLISHED A RESPONSIBLE INVESTING COMMITTEE IN 2009?

**CS:** Extra financial factors – like management quality, product quality, product safety and labour relations – have always had a place in our fundamental, bottom-up research process. That said, forming the responsible investment committee and establishing the MFS policy on responsible investing put a stake in the ground that helped focus our efforts and accelerate our thought process

around sustainable investing. In 2010, we became a signatory to both the CDP [formerly the Carbon Disclosure Project] and the Principles for Responsible Investment, and in 2013 we hired our first research analyst completely dedicated to ESG analysis.

Fast-forward to today and MFS has two experienced ESG-dedicated research analysts embedded within our investment team – one in Boston and one in Singapore – along with our three proxy voting analysts, and an ESG specialist on the client side of our operation.

It has always been our intent to avoid building out a separate investment team for ESG research. Our entire investment team is engaged in equity and fixed-income ESG analysis. Our ESG-dedicated analysts are there to support and enable the rest of the team rather than offer them an outsourcing opportunity. They are focused on collaborating with and facilitating our investment team around the world to ensure we are constantly evaluating ESG factors.

## HOW HAS AN ESG LENS HELPED MFS IDENTIFY PROMISING OPPORTUNITIES AND SIDESTEP POOR INVESTMENT CHOICES?

**CS:** It's important for us – as active, fundamental investors – to have an investment process that seeks to identify and anticipate ESG risks and opportunities with the potential to impact securities we invest in for our clients. These issues have become essential in understanding the overall investment case for a company.

As an example of how ESG analysis informs our decision-making process, our investment research team became concerned about governance practices at a Japanese energy company we owned

in some of our funds. The company had some poor fundamental performance metrics, such as poor capital allocation and operational difficulties, and the industry analyst who covered the company contacted our ESG research analyst to add a layer of additional research. The ESG analyst uncovered environmental risk factors, social issues around worker safety, and governance and ownership structure risks. Putting those elements together through our collaborative research process led to the industry analyst downgrading the stock, and we removed it from the portfolios.

Another example: our analyst responsible for covering Chinese consumer discretionary companies noticed a Chinese restaurant chain was moving to offer a series of healthier eating options. This increased our confidence in the quality of this management team and their ability to respond to industry trends and make sure their business model remained sustainable. That supported the positive view we had on that stock in our portfolios.

## HOW DOES MFS ENGAGE WITH COMPANIES GLOBALLY ON ESG-RELATED TOPICS?

**DP:** Open communication with the companies we invest in is an integral aspect of our ownership responsibilities. We strive to exchange thoughts on ESG topics that may represent material risks or opportunities for those companies and to effect positive change. There are four ways in which we typically engage with companies. Formal proxy voting-led engagement typically involves members of a proxy voting committee engaging with a company or other stakeholders to better understand the company's proxy statement. Informal investment team-led engagement occurs when, in the course of regular conversations and company

management meetings, our investment team asks ESG-related questions to better understand the risk-return profile of the company's securities. Formal investment team-led engagement happens annually when our investment teams either request ESG-focused meetings or write formal letters with the intent of engaging companies' boards on these topics. Finally, through collective and other forms of engagement, we interact with sponsors of shareholder initiatives and participate in industry working groups and with organizations that seek to develop thought leadership on emerging proxy voting issues. For example, in 2017, we entered into a collective engagement on methane emissions with over 30 other institutional investors from around the world that targeted 50 companies including one of the world's largest oil and gas companies.

## WHAT IMPACT DOES MFS PROXY VOTING HAVE ON THE COMPANIES IN WHICH YOU INVEST?

**DP:** Proxy voting decisions are made in what we believe to be the best long-term interests of our clients. We believe robust ownership practices can help protect and enhance long-term shareholder value, and that can include effectively exercising our voting rights as well as engaging with our portfolio companies on proxy topics. It can sometimes be difficult to measure the exact impact of our voting decisions and engagement activities on a particular company, but we have certainly seen positive change in line with our views and how we voted. For example, we engaged with a U.S. headquartered pharmaceutical distributor in advance of its July 2017 annual general meeting concerning our proxy votes on issues related to board composition, risk oversight and executive compensation. We re-engaged with the company in advance of the 2018 annual general meeting and discovered that it had elected a new independent director, launched a number of new initiatives

to help fight the opioid crisis as we had urged, and committed to separating the roles of Chair and CEO when the current combined Chair/CEO steps down or is replaced.

## HOW DOES MFS INTERPRET CARBON FOOTPRINT DATA TO INFORM ITS INVESTMENT DECISIONS?

**DP:** Carbon intensity and other ESG factors are integrated into our equity research at the individual stock level, but these factors on a standalone basis do not drive our investment decisions. Our view is that carbon footprint data is backward-looking and struggles to account for the investments many of the most carbon-intense companies are making to expand renewable capacity and advance renewable technology. All of our portfolio companies are thoroughly evaluated using both traditional metrics and ESG metrics such as carbon intensity, and have been selected because we believe their valuations are supported by that research. Generally speaking, our belief is that well-managed companies recognize the need to position their businesses for future success. In the case of companies with higher carbon intensity, such as energy companies, that often means proactively managing for the risks and opportunities associated with rising carbon prices, climate change-related regulations, and disruptive renewable energy technologies.



**COLIN SINCLARE**

MANAGING DIRECTOR, INSTITUTIONAL SALES, WESTERN CANADA



**DARREN PATRICK**

DIRECTOR, RELATIONSHIP MANAGEMENT, WESTERN CANADA



**MFS**<sup>®</sup>  
Investment Management

*Disclosures:  
The views expressed are those of the speaker(s) and are subject to change at any time.*