

Active is: The Future of ESG Investing

Dr Steffen Hoerter
Global Head of ESG
Allianz Global Investors
London, May 21st 2019

For professional investors only

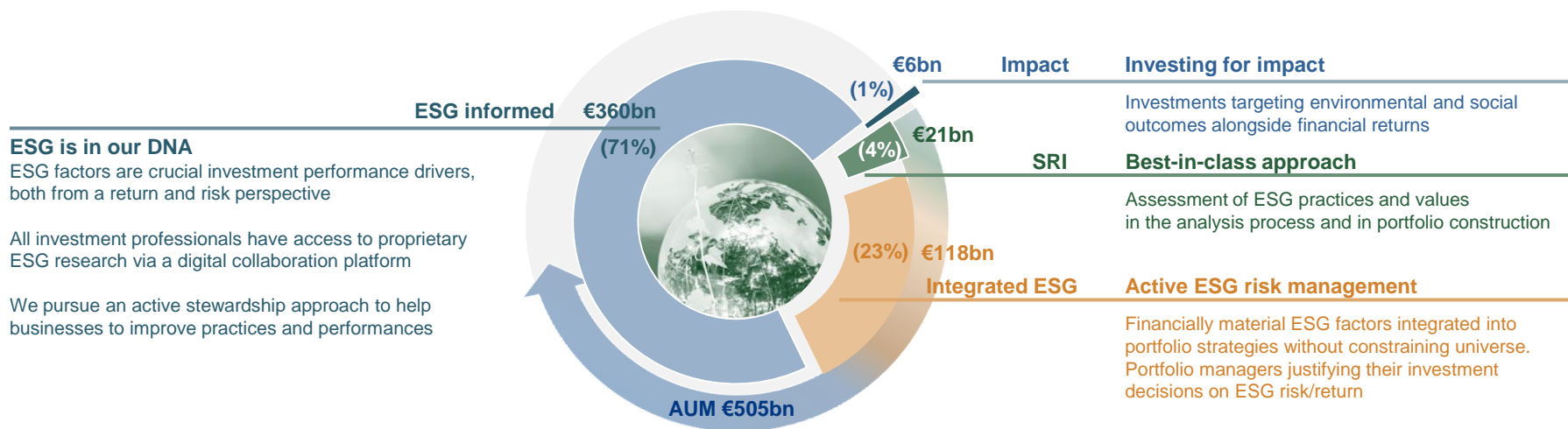
Value. Shared.

OUR HEART
BEATS FOR
ACTIVE ASSET
MANAGEMENT



Pioneering ESG

We are committed to integrating ESG factors into all investment decisions and across all asset classes



Active is: Unlocking the potential of ESG



An ESG pioneer since 2000

PRI top score A+ on ESG strategy and governance

Allianz SE sustainability leader and within DJSI

Data as at 31 December 2018. Source: Allianz Global Investors. Any differences in totals are due to rounding. Impact comprises different strategies targeting climate transition, environmental projects and renewable energy. Environmental, social and governance (ESG); Sustainable & responsible investing (SRI); Dow Jones Sustainability Index (DJSI); Principles for responsible investing (PRI). Sustainability leadership and inclusion in the DJSI are based on the research of and an evaluation of questionnaires submitted to RobecoSAM. The PRI assessment report is based on information reported directly by signatories. Moreover, the underlying information has not been audited by the PRI or any other party acting on its behalf.

Agenda

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Drivers of ESG

02

Alpha of ESG

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The Next Level

01

Drivers of ESG



Drivers of ESG: Client demand, regulations, investment alpha

ESG Client Demand

Long duration, liability-matching clients:

- Public Pension Funds
- Corporate Pension Funds
- Insurance-linked Investors

ESG Affine clients:

- High Net-Worth Individuals
- Family Offices
- Endowments
- Younger Generations

Global ESG Regulation



10 points of the EU Action Plan Sustainable Finance



FCA and PRA



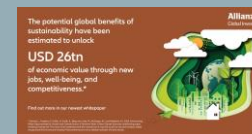
China Green Finance Regulation

ESG Alpha

ESG Risk Management



Sustainability Impact



The new world: more ESG feedback-loops to society

Hang on what is sustainability about: intergenerational fairness?

London,
UK



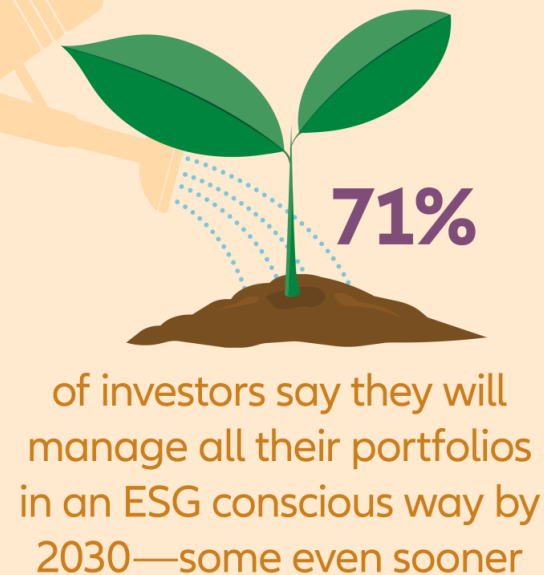
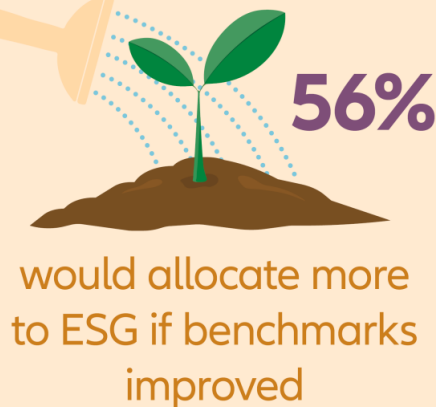
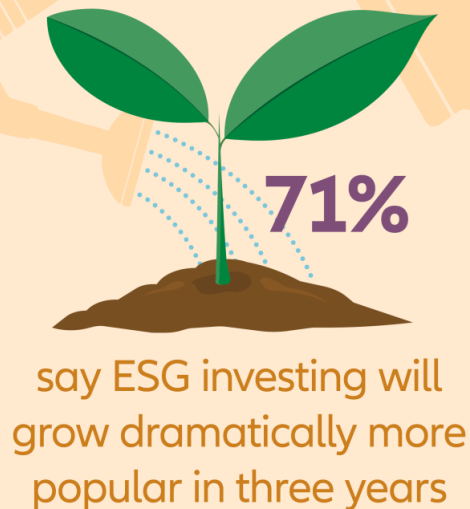
Jiangsu,
China

Munich,
Germany

Paris,
France

Investor Appetite for ESG is blooming

INVESTOR APPETITE FOR ESG IS BLOOMING



Clients want to have it all: ESG and financial performance



„I want to invest in something that respects the environment, that's morally responsible, socially active, aids the poor and the homeless and makes me a bundle.“

ESG risks moving to the top of the agenda

Top 5 Global Risks in Terms of Impact according to World Economic Forum surveys 2009 – 2019

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1 st	Asset price collapse	Asset price collapse	Fiscal crisis	Major systemic financial failure	Major systemic financial failure	Fiscal crises	Water crises	Failure of climate change mitigation and adaption	Weapons of mass destruction	Weapons of mass destruction	Weapons of mass destruction
2 nd	Retrenchment from globalization (developed)	Retrenchment from globalization (developed)	Climate change	Water supply crises	Water supply crises	Climate change	Rapid and massive spread of infectious diseases	Weapons of mass destruction	Extreme weather events	Extreme weather events	Failure of climate change mitigation and adaption
3 rd	Oil and gas price spike	Oil and gas price spike	Geopolitical conflict	Food shortage crises	Chronic fiscal imbalances	Water crises	Weapons of mass destruction	Water crises	Water crises	Natural disasters	Extreme weather events
4 th	Chronic disease	Chronic disease	Fiscal crises	Chronic fiscal imbalances	Diffusion of weapons of mass destruction	Unemployment and under-employment	Interstate conflict with regional consequences	Large-scale Involuntary migration	Major natural disasters	Failure of climate change mitigation and adaption	Water crises
5 th	Fiscal crises	Fiscal crises	Extreme energy price volatility	Extreme volatility in energy and agriculture prices	Failure of climate change adaption	Critical information infrastructure breakdown	Failure of climate change adaption	Severe energy price shock	Failure of climate change mitigation and adaption	Water crises	Natural disasters
	Economic	Economic	Environmental	Environmental	Geopolitical	Geopolitical	Social	Social	Environmental	Environmental	Environmental

Source: World Economic Forum 2019, The Global Risks Report 2019, 14th edition, p.6. Global risks may not be strictly comparable across years, as definitions and the set of global risks have evolved with new issues emerging on the 10-year horizon. For example, cyberattacks, income disparity and unemployment entered the set of global risks in 2012. Some global risks were reclassified: water crises and rising income disparity were re-categorized first as societal risks and then as a trend in the 2015 and 2016 Global Risks Reports, respectively.

The EU Case for Sustainable Finance

The EU committed to **three ambitious climate and energy targets for 2030** in line with the UN 2030 Agenda, the SDGs and the Paris Agreement. In its **long-term strategy**, the EU strives for **net-zero GHG emissions by 2050**.



Minimum **40%** cut
in greenhouse gas
emissions compared
to 1990 levels



At least **32,5%**
energy savings
compared with the
business-as-usual
scenario



At least a **32%**
share of renewables
in final energy
consumption

Public money

The yearly investment gap to
meet these targets is
estimated to be between
€ 175 to 270bn

Private money

Public supporting schemes
alone will not be sufficient to
meet those investment needs.
The private sector will have to
play a huge role and a smart
policy framework is needed to
incentivise private investment.

The global sustainability opportunity for economies and investors

How to finance the estimated

USD 6tn p.a.

to reach the **17 Sustainable Development Goals** until 2030?



The potential global benefits of sustainability have been estimated to unlock

USD 26tn

of economic value through new jobs, well-being, and competitiveness.¹



European Commission estimates an annual finance need of

EUR 270 bn

for Climate, Energy and Water alone.²



¹ Garrido, L., Fazekas, D., Pollitt, H., Smith, A., Berg von Linde, M., McGregor, M., and Wesphal, M., 2018. Forthcoming. Major Opportunities for Growth and Climate Action: A Technical Note. A New Climate Economy contributing paper. ² European Commission, Reflection Paper Towards Sustainable Europe, 2019. Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors might not get back the full amount invested. Past performance is not a reliable indicator of future results.

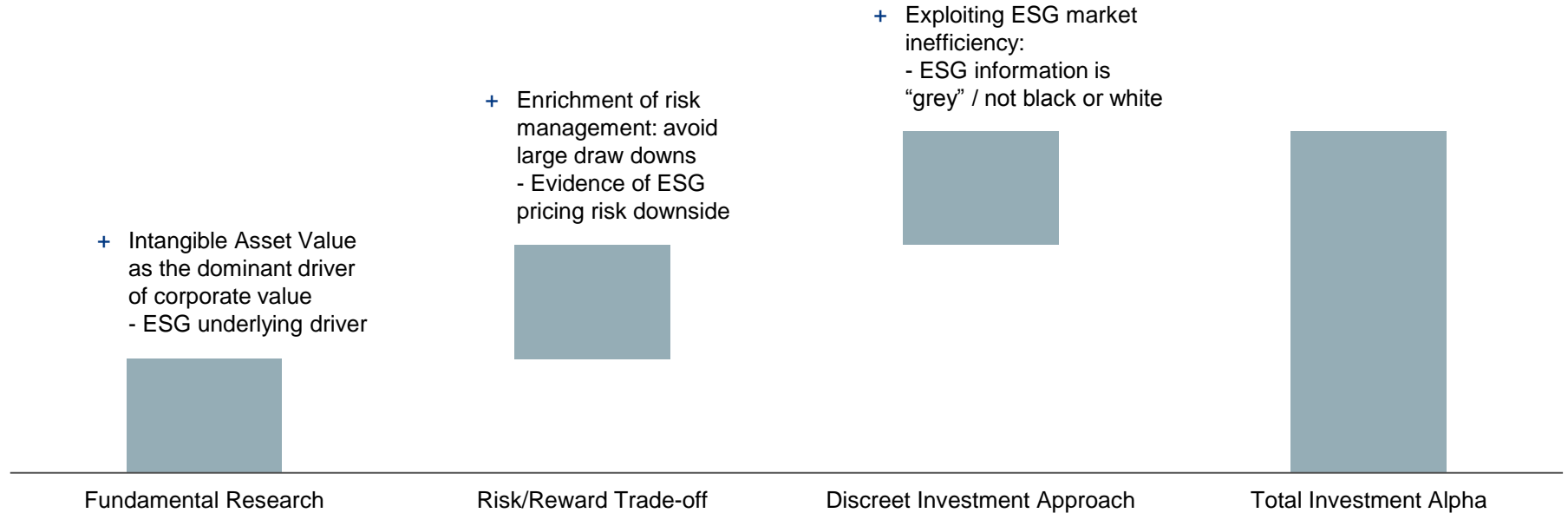
02

Alpha of ESG



Alpha relevance of ESG for Investors

Financial materiality of ESG



Explaining Intrinsic ESG Value of corporates

Material ESG Factors are important value drivers

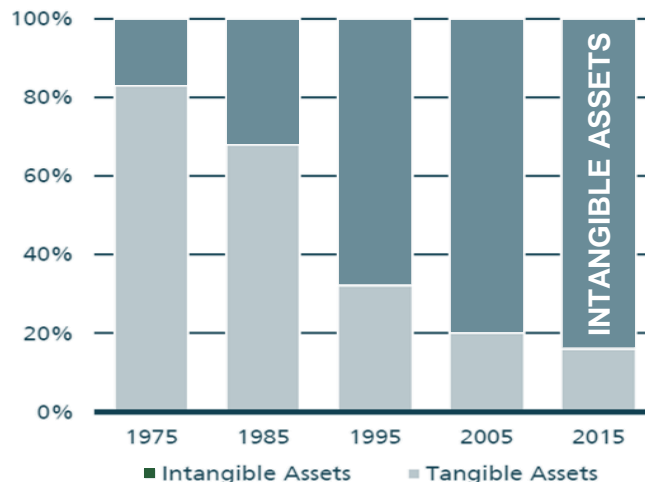
Intangible Assets meanwhile determine
80-100% of S&P 500 market capitalization*

ESG in Tangible Assets

- Stranded Assets

Examples:

- Depreciation oil + gas reserves
- Flooded real estate



ESG in Intangible Assets

- Reputation risk on client trust and retention

Examples:

- Brand damage impairing goodwill

Enterprise Value

=

Tangible Value

+

Intangible Value

* Source: Ocean Tomo, "Ocean Tomo's Intangible Asset Market Value Study," 2015. R&D = Research & Development.
Allianz Global Investors, 2019. For illustration only. No Investment Advice.

Framing ESG Risk

ESG Risk	Macro	Sector	Portfolio	Idiosyncratic
Financial Impact	Loss of Gross Domestic Product	Sector devaluation	Portfolio Tail Risk	EPS revision Credit downgrades
Modelling	ESG extended econometric models ESG Integrated assessment models	Sector ESG materiality framework (SASB/proprietary)	ESG (tail) risk portfolio modelling and stress testing	ESG extended DCF models ESG in Credit Ratings
Real-life examples	GDP at risk due to physical climate change	Coal sector devaluing	Carbon price stress testing	PG&E Credit Default
Regulatory ESG Risk (i.e. ESG litigation, CO₂ Tax and Trade)				
Applies to nearly all asset classes				

Macro ESG risk: Climate change

3-5 °C

Global
temperature
increase
by 2100

Source: IPCC's projection "business as usual" Scenario: RCP8.5; 2018

0.9 °C

Normalized
actual global
warming at 2018

Source: NASA / Goddard
Institute for Space Studies

-23%

Global GDP
loss due to
climate change
until 2100

Source: By Stanford University's
estimates, Burke M., Hsiang S.M., Miguel E.

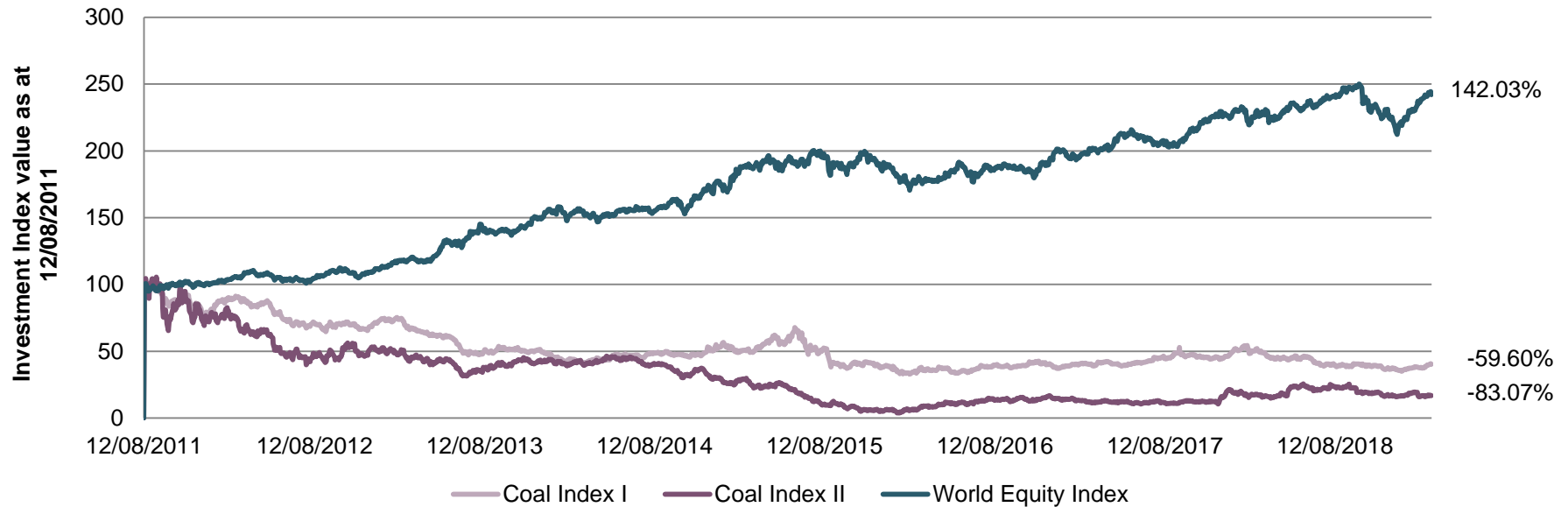
\$ 505bn

Physical
climate change
insurance
losses for the
last 2Y

Source: Swiss Re Institute;
worldwide 2017/2018 damages aggregated

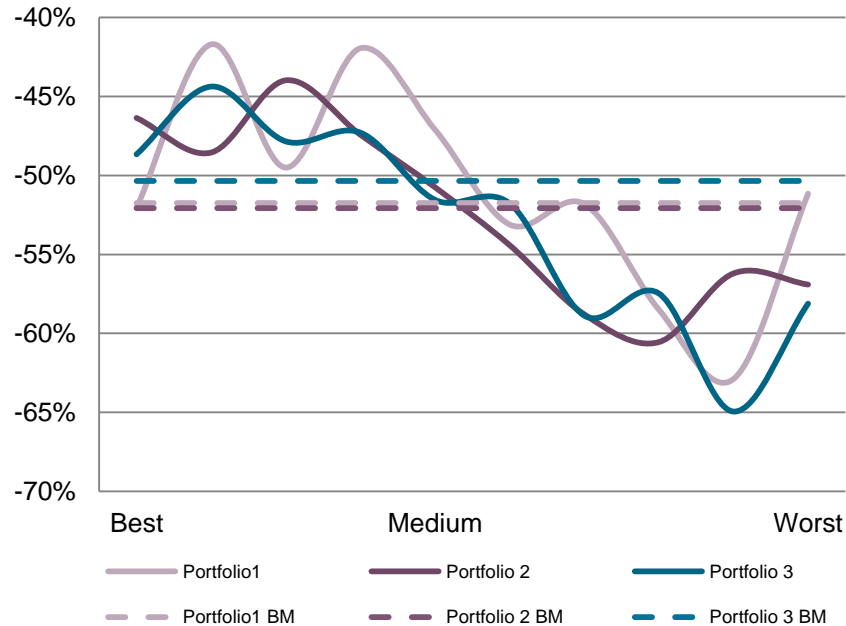
Sector ESG risk: Coal sector heavily underperforming

Coal index performance versus a broad market index

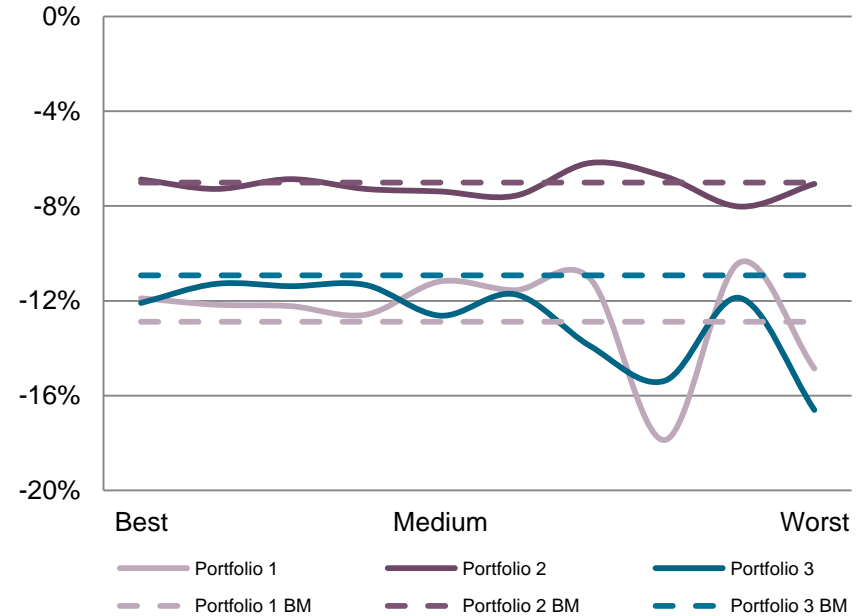


Portfolio ESG risk: Maximum Drawdown and Value-at-Risk 1% display this

European Universe – Maximum Drawdown



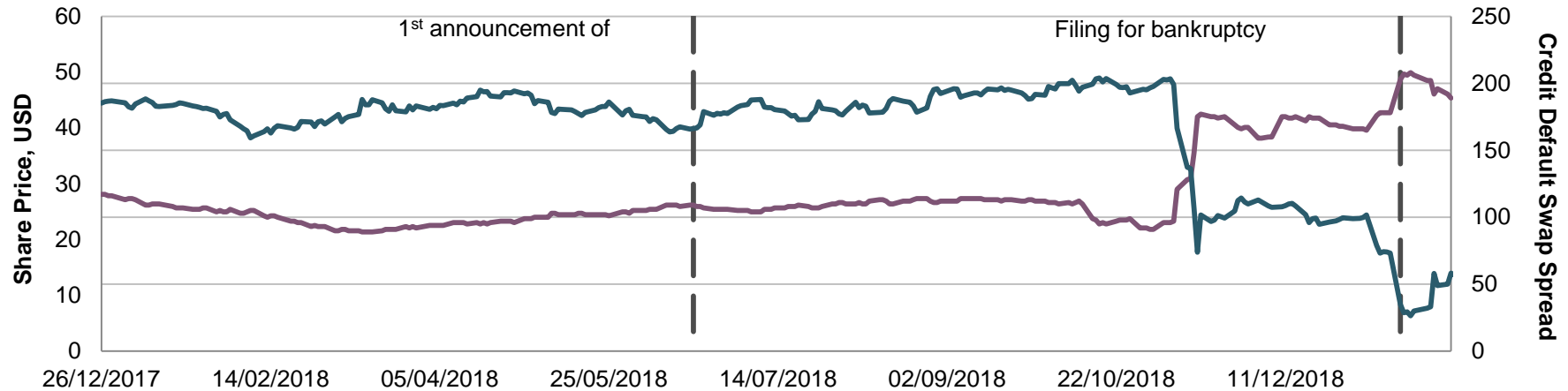
Global Universe – 1% VaR Worst Loss¹



¹ Solid line – Decile Portfolios, Dashed line – Parent Benchmark
Source: Allianz Global Investors, 2019

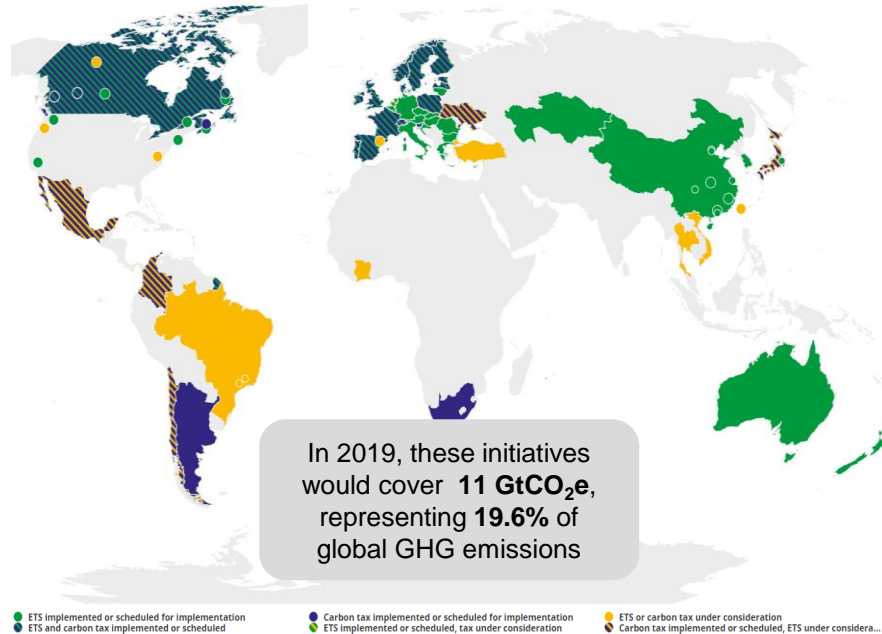
Idiosyncratic ESG risk: PG&E bankruptcy due to physical climate risk – who is next?

Credit Default Swap Spread and Share Price of PG & E



Regulatory ESG risk: Corporate P/L prepared for higher carbon emissions pricing?

Initiative(s) Implemented or Scheduled¹



EU CO-2 Emissions Rights²



¹ Source: World Bank accessed at 17/04/2019

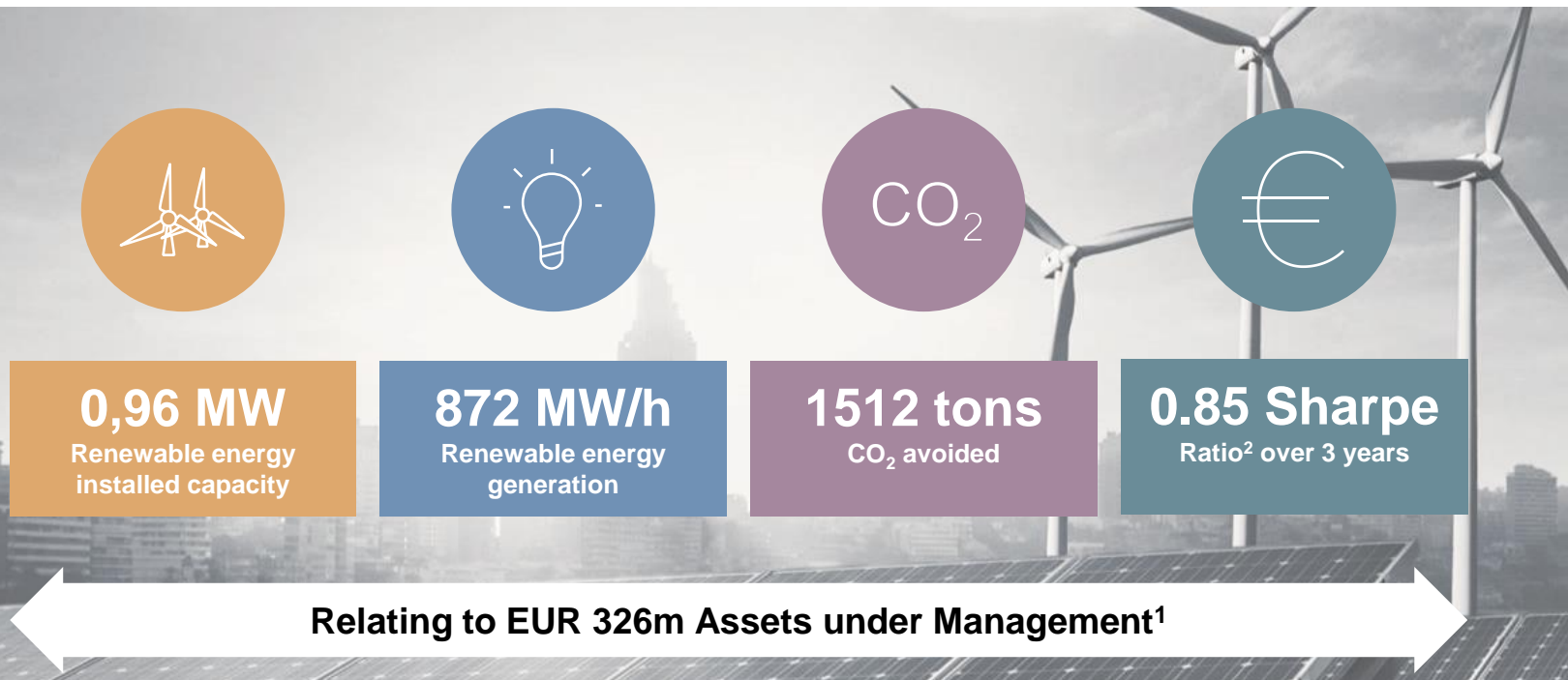
² Source: Bloomberg accessed at 08/04/2019

How to invest for climate impact

AllianzGI Green Bond Strategy



Allianz Green Bond Impact report



¹ As at April 2019; ² The Sharpe ratio states the relationship between the return generated by the fund and the investment risk. The fund's excess return versus the risk-free market rate is compared to volatility. Negative values are not meaningful.

Impact figures are calculated for EUR 1 mn investment in Allianz Green Bond. Data is calculated for green bonds included in the portfolio as of 31/12/16 with available reportings or impact expectations disclosed by the issuer (68% of the green bond bucket). Bonds without any available reporting or impact expectation disclosure from issuer are not included. Impact figures are approximates and do not necessarily reflect the exact impact of the fund.

Source: Allianz Global Investors, 2019. This is for illustrative purposes only, it should not be considered a recommendation to buy or sell any particular security or strategy or investment advice.

AllianzGI Corporate Engagement Case Study: Luxembourg-based steel producer

In-depth ESG risk analysis, informed by combined sector & ESG expertise and direct company contact

Portfolio Manager

E
MSCI **2.0**

MSCI overly punishes the company on account of exposure to EU carbon regulatory environment, without taking into account compliance and risk-mitigation capacity. Moreover, use of misleading metrics and peer group that negatively impact rating.

ESG Research Analyst

E 
AllianzGI **4.0**

Management lead important efforts to improve energy efficiency and invest in low-carbon technologies to de-carbonize operations. These and a prevalent low-price carbon environment, help diffuse tail risks. A higher E rating is warranted, yet remains capped due to EU policy uncertainty.

Company Engagement

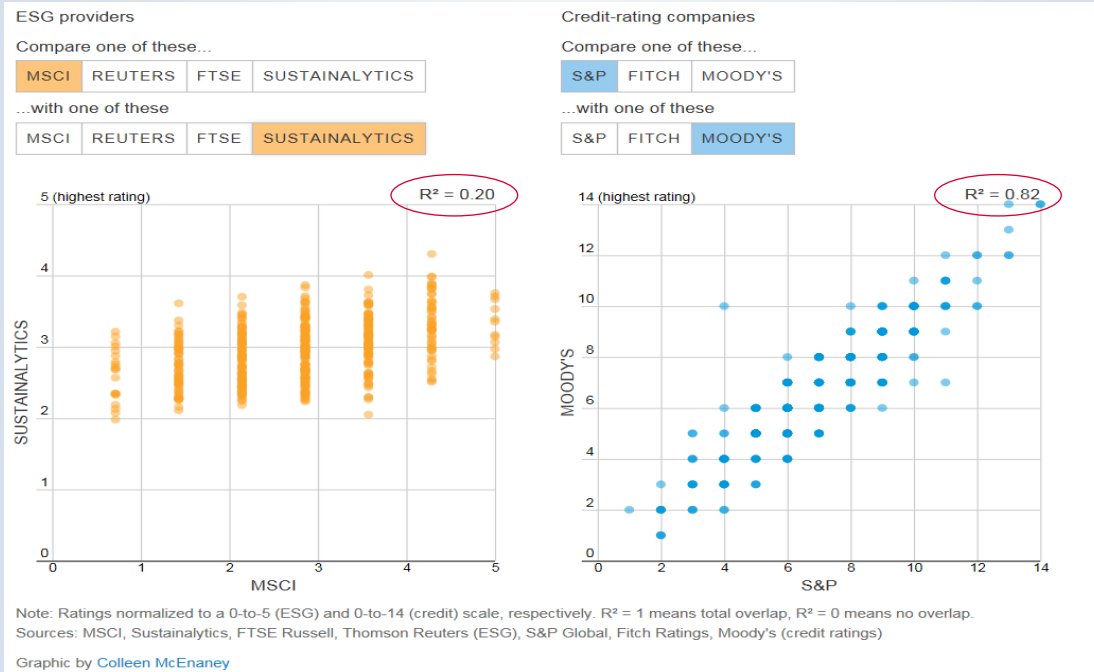
- Engaged with company on climate change risk. Expressed support of continued investments in low-carbon technologies to drive emissions' reductions. Encouraged the company to engage constructively with policymakers to reduce regulatory uncertainty.
- Participated in a steel roundtable convened by the Institutional Investors Group on Climate Change (IIGCC), which addressed investors' expectations regarding steelmakers' management of climate change risks. Steel producer's participation in roundtable discussions has provided insightful information on the technological and operational challenges companies face to improve energy efficiency and thus reduce carbon emissions.

03

The Next Level



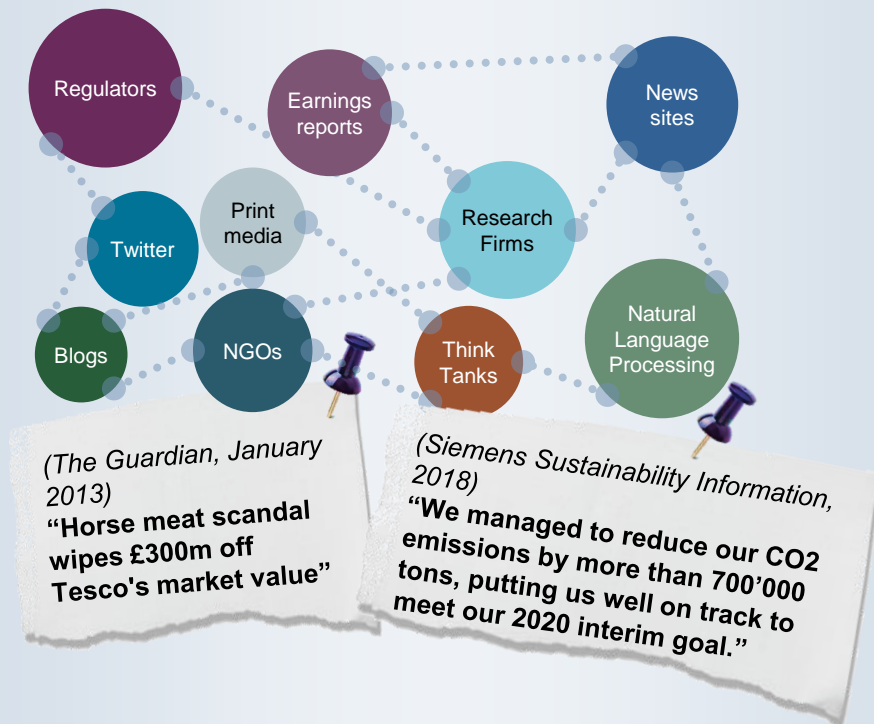
Third Party ESG Ratings Differ Due to Different Methods



Analysis across same investment universe

- Third party ESG research ratings from different providers are lowly correlated
- Unlike CRAs - where there is a high correlation of corporate credit ratings

Key to ESG analysis: more data? Artificial Intelligence and Big Data



Harvest complex data for Alpha

Moving from Financial to ESG Integrated Financial analysis

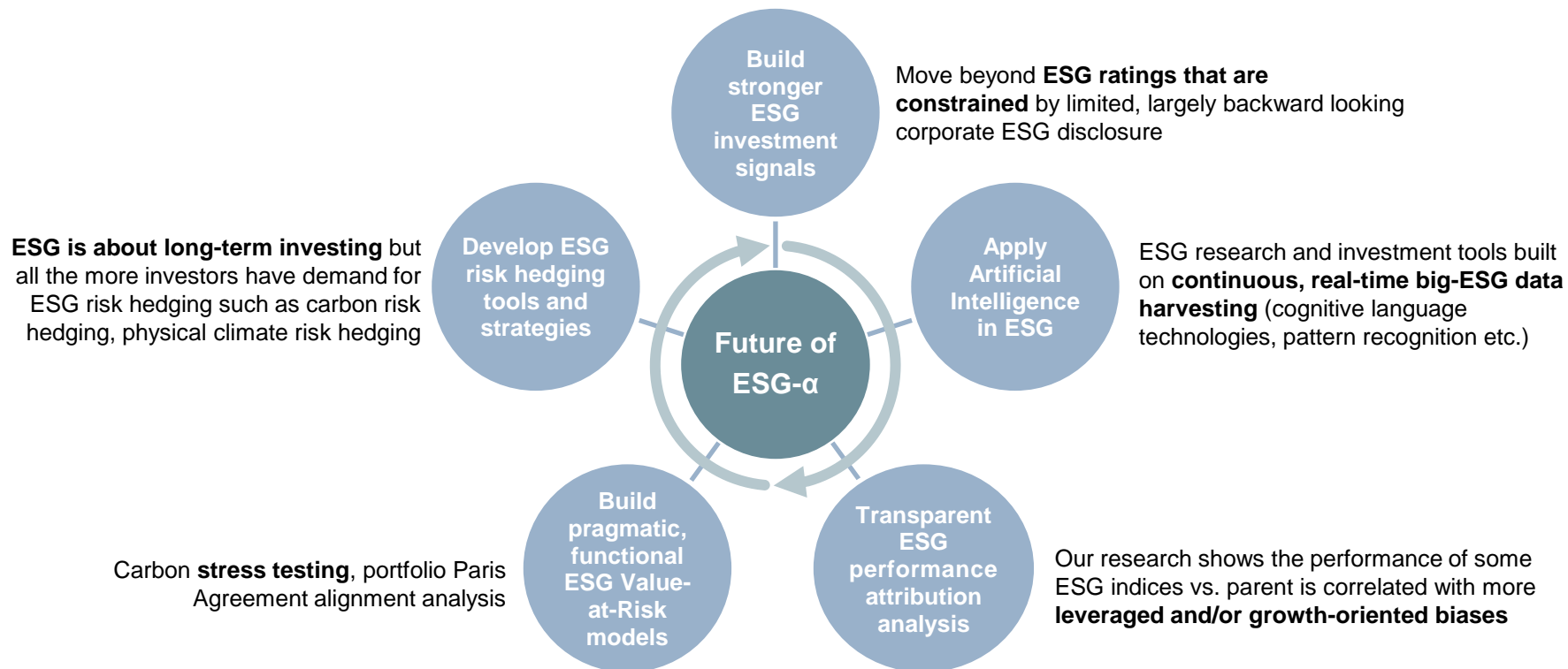
- ESG addresses multiple facets of a company's position
 - It can be past, present, and future-looking
 - Formal or informal disclosures, non-structured data, spill-over effects
 - Hard quantifiable metrics vs softer management ambition
- To fully capitalise on the investment power of ESG, all of these have to be reflected to one extent or another
 - Can a single rating be fit for purpose?
 - Is it feasible to monitor manually or is innovation required?

ESG Fuzzy Logic 

Develop stronger ESG
Investment signals

The next stage

Important tools to complete the future ESG investing puzzle



Q & A



Biography



Dr. Steffen Hoerter

Global Head of ESG

Steffen Hoerter is the Global Head of ESG at Allianz Global Investors which he joined in 2001. He is internationally responsible for AllianzGI's ESG investment integration strategy, ESG Policy and ESG Client Investment Solutions. Since July 2018, Steffen is also a member of the Technical Expert Group on Sustainable Finance which assists the European Commission in developing its legislative proposals.

Steffen is a regular conference speaker and has published various whitepapers and thought leader pieces on financial materiality of ESG in Equities, ESG in Corporate Fixed Income and ESG in Sovereign Bonds. An additional research focus is Climate Change and its integration into Strategic Asset Allocation and Portfolio Implementation. Between 2010 and 2016 he has been advising institutional investors, in particular pension funds in Europe on investment strategy, risk management and ESG integration.

Prior to joining Allianz Global Investors, Steffen worked as a Management Consultant for banks and risk management at an international consultancy firm. He studied Business Administration in Regensburg, Edinburgh and Ingolstadt/Eichstaett. He holds a doctorate from the Catholic University of Eichstaett-Ingolstadt, where he worked as a lecturer at the Department of Finance and Banking at WFI – Ingolstadt School of Management.

Steffen is a lecturer for Sustainable Responsible Investing with focus on insurance companies at European Business School/ Germany.

Disclaimer

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