The integration game

With its acquisition of RiskMetrics in 2010, investment giant MSCI instantly became a major force in ESG indexes and research – and it promises to take ESG integration to the next level. Mark Nicholls reports

Those looking for evidence of the integration of environmental, social and governance (ESG) issues into the investment mainstream need look no further than MSCI. Until 2010, the investment analysis and indexes giant – which reported revenues of $900 million last year – had almost no ESG capacity.

Remy Briand, MSCI's Geneva-based head of ESG, says that "for many years" MSCI's advisory board of chief investment officers "had been advising us to get into the ESG space".

So, when New York-based MSCI began eyeing RiskMetrics – primarily, Briand says, for the latter's risk management capability – "we saw the ESG [business] as an extremely interesting additional benefit in the acquisition."

In 2010, MSCI bought RiskMetrics for $1.55 billion in cash and shares, absorbing with it two of the latter's recent ESG acquisitions – Innovest Strategic Value Advisors and KLD Research & Analytics. The former, founded in 1995, was best known for its Intangible Value Assessment product, which rated companies on their environmental and social performance.

KLD, meanwhile, was even older – founded in 1988 – and launched its KLD 400 Social Index in 1990. It subsequently developed a range of sustainability and climate change indexes.

Since the acquisition, Briand says that MSCI has made a significant investment in the ESG business. Specifically, MSCI has been working to integrate its ESG research products into a single platform.

And rather than retaining the legacy branding, "we made the decision to bring it under the MSCI brand, the core brand of the company," says Briand. "It was a statement that ESG is a very critical dimension of what we do."

In contrast to many acquisitions, the incorporation of the RiskMetrics ESG business into MSCI has led to more, rather than fewer, staff. The business now employs around 130 people around the world, 20–30% more than at the time of the acquisition. "And most of the new staff are in analyst positions," Briand says.

Remy Briand, MSCI: "ESG is a very critical dimension of what we do"

Since the acquisition, there have been some incremental additions to the ESG product offering – for example, MSCI has launched its MSCI World Socially Responsible Investment indexes, which apply negative screens to the company's best-in-class ESG indexes, and it has added an index family which screens out controversial weapons.

Meanwhile, the company has also branched out of equities, with the launch of ESG sovereign debt ratings last month. The company assesses the ESG exposures of 90 countries, which account for some 99% of sovereign bond issuance, providing an ESG rating from AAA to CCC.

But perhaps the most significant development in terms of ESG integration is the news that MSCI is to incorporate ESG data and reporting into its BarraOne investment risk management system, which is used by most of the world's largest pension and sovereign wealth funds, Briand says.

"When we looked at the state of the industry in terms of how ESG is integrated within asset managers and asset owners … what was very clear is that there are a lot of initiatives, a lot of desire for integration, but there was a lack of monitoring and reporting tools.

"People are ready to make investments in terms of having specialist ESG teams, and looking at integration, but there's still very little measurement of the return on that investment," he says. "One of the missing components was the ability of the asset owner to measure the [ESG] risk and how that risk is being managed over time."

MSCI's solution is in providing, via BarraOne, "an aggregated view of where environmental, social and governance risk lies" in a portfolio, alongside the ability to monitor and report on that risk on a periodic basis "in a similar fashion as you measure other risks".

Briand says that MSCI has trialled the system with a few pension funds. "They've used the portfolio to engage in a dialogue with their own managers … and used it to assess how strong the integration of ESG is by their managers."

"And we've seen it within asset managers," he adds. One manager, which Briand says had a "reasonably robust" process for ESG assessment, nonetheless found that its portfolio actually had a worse ESG score than the broader market. "That triggered a rethinking of the process within the asset management house.

"If you don't know you have a problem, there's no way to improve."

This should help asset owners differentiate between those managers taking a superficial 'box-ticking' approach to ESG risk assessment, and those with more sophisticated approaches, Briand says.

"The view of the firm is that ESG will be integrated into portfolios. We don't know how quickly, but it will be integrated eventually," Briand says.

"Whenever we do something, we want to make sure it makes sense in terms of the investment process … we want to ensure that we add value in terms of the investment process."

"ESG gives a lot of insight into those fundamental changes" that are transforming the global economy

Marc Brammer, MSCI

According to Marc Brammer, a former head of research at Innovest who is now a vice president with MSCI, the approach is finding resonance in the marketplace. "Given the situation, financially, demand has been pretty robust," he says. "What it tells us is that ESG is now being seen very much as part of fiduciary duty. It's also seen as quite an interesting new angle to get at financial value."

What clearly excites Brammer is the transition from an innovative, well-regarded but essentially marginal boutique to a firm squarely within the investment mainstream – at a company with the resources and the relationships to take those ESG insights and act upon them.

"ESG gives a lot of insight into those fundamental changes" that are transforming the global economy, "because it's trying to get at the fundamentals, it's not just trying to ask what the last three quarters tell us about the next quarter.

Combining these ESG insights with the portfolio management tools that MSCI employs makes them "much more usable, more tangible to a portfolio manager," Brammer says. **EF**