Insights
ESG

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Accessing ESG Exposure with State Street Global Advisors & SPDR ETFs

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State Street Global Advisors has managed ESG index investment since 1985 and shown commitment to sustainability through its asset stewardship. As a global asset manager, we leverage our size, voice and vote to actively engage with portfolio companies on ESG factors.

State Street Global Advisors & Sustainability

SPDR ETFs are a part of State Street Global Advisors, the asset management arm of State Street. This structure affords SPDR a heritage of sustainability and significant resource to respond to client needs.

As a well-established provider of financial services to global institutional investors, State Street is dedicated to long-term value creation. Across our leading investment servicing, management, research and analytics capabilities, State Street is committed to helping investors understand the Environmental, Social and Governance (ESG) issues that affect the value of their portfolios. We further show our commitment to sustainability as a signatory to the UN's Sustainable Development Goals, through global environmental goals and incorporation of ESG into the board charter at the corporate level.

As we witness the structural shift in our economies from tangible to intangible value drivers, we recognise that ESG considerations are becoming more important factors for companies and the way they are valued as well as for investors. At State Street Global Advisors, we are committed to combining our financial data and analytics capabilities with our investment practitioner perspective to create a new generation of ESG solutions. We provide leading research, analytics and advisory for investors' ESG needs across asset classes and investment styles.

We believe our asset stewardship activities and ESG scoring model (described below) are differentiating activities in the financial world.

Our asset stewardship activities and new ESG scoring model (described below) are differentiated activities in the financial world. Our commitment to sustainability is further illustrated by the following activities undertaken by State Street:

Stewardship & Active Ownership

State Street Global Advisors increased its commitment to active ownership at the start of 2020. In this year's proxy season, we have taken appropriate voting action against board members at companies in many of the leading developed markets (including S&P 500, FTSE 350, ASX 100, TOPIX 100). We have focused our voting on those companies that have lagged based on our proprietary ESG metrics and that cannot articulate how they plan to improve their score. In 2022, we will expand this voting action to include companies that have consistently underperformed their peers on their R-Factor® scores for multiple years, unless we see meaningful change.

As discussed in our paper, *Using ETFs to Gain ESG Exposure*, asset managers providing ETFs are increasingly aware of their fiduciary duties and the rewards of corporate governance activities. Unlike active managers, index managers cannot sell a stock based on heightened risk (including ESG factors) and, therefore, engagement is perhaps more important. State Street Global Advisors is increasingly active in its stewardship of assets across our range of funds.

Our Asset Stewardship team engages with and provides clear expectations of company performance on material ESG factors. The team screens companies for voting and proactive discussion based on their scores. During engagements, we disclose companies' scores on State Street Global Advisors' proprietary ESG measure, R-Factor™ (see page 3 for further explanation), as well as the underlying basis for those scores. This gives boards and management teams a guide for the specific dimensions that investors are evaluating to assess their sustainability efforts. It also helps companies identify which metrics to disclose and manage to improve future scores, creating a positive feedback loop in the market.

State Street Global Advisors voted at more than 17,000 corporate meetings in 2019, and 14% of the votes were against company management. We undertook 1,950 engagement activities in 73 countries, more than one third of which were management meetings; the remaining were R-Factor® engagements or written communications. Such activity is carried out for company holdings across the State Street Global Advisors range of products, including ETFs and index funds as well as active funds.

Thought leadership is the third leg of the State Street Global Advisors engagement process. The Fearless Girl campaign, sponsored and led by State Street Global Advisors, has helped promote gender diversity and women in leadership. In the three years since the campaign's launch, 681 women have been added to previously male-only boards.[1]

Communications with boards of directors became even more important during the COVID-19 crisis, especially on issues of human capital and workforce management. Among specific campaigns this year, board accountability has seen engagement on effective independent board leadership.

1 Source: State Street Global Advisors, as of May 2020.

R-Factor™

At State Street Global Advisors, we firmly believe that ESG investing and fiduciary responsibilities are not contradictory. Rather, the consideration of material ESG factors in the investment process is an integral part of honoring our fiduciary duty. Through our stewardship and investment expertise, we built R-Factor® as a solution.

Research shows that ESG factors can affect a company's long-term performance. However, despite a sizeable universe of ESG data coverage, the lack of transparency into ESG materiality considerations and opaque scoring systems have created challenges in the past. Our proprietary ESG scoring system was designed to overcome the paucity of consistent data. The R-Factor® leverages data sources from four best-in-class data providers (Sustainalytics, ISS-Oekom, Vigeo-EIRIS and ISS-Governance) and is aligned with a financial materiality framework drawn from the Sustainability Accounting Standards Board (SASB).

The R-Factor® is used to support development of sustainable capital markets, allowing managers to integrate financially material ESG data into ESG solutions. It is also used by State Street Global Advisors to incentivise listed companies to improve their practices by making comparisons on a regional and industry basis. The adoption by Bloomberg of SASB and R-Factor® for its Bloomberg SASB ESG indices has validated the scoring system.

While the R-Factor® does not feature in SPDR's ESG exclusion ETFs, work surrounding the system was important to understanding the environment and testing our offering.

SPDR ESG ETFs

SPDR ETFs provide investors with the choice to invest based on their own values and preferences. ETFs have democratised investing, offering a straightforward, cost-effective* and transparent access. They are a perfect match for ESG investing. ESG ETFs open up investment themes that were once out of reach to all but the largest of investors.

SPDR created the world's first US-listed ETF in 1993 and has been listening to clients and meeting their needs ever since. A European investor survey undertaken in 2019 allowed us to understand investor demands for standardisation and less complexity in ESG processes. In terms of exclusion, the prevalent requirements of respondents were controversial weapons, including nuclear weapons and non-compliance with United Nations Global Compact principles.

For our first two ESG ETFs, we partnered with two of the largest index providers, STOXX and S&P Dow Jones, to launch SPDR STOXX Europe 600 ESG Screened UCITS ETF and SPDR S&P 500 ESG Screened UCITS ETF, which both incorporate the above investor needs in a simple and transparent way.

Creating exclusionary funds has allowed us to remain engaged with companies in an index that are in approved activities. Our strategies do not directly employ ESG scoring methodology but do benefit from the State Street Global Advisors R-Factor® framework, specifically through engagement with the fund's holdings with a goal of improving corporate behaviour.

* Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

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