

Mercer to Rate All Managers with New Metric

By [Billy Nauman](#) August 9, 2012, FundFire

For any managers dismissing the potential importance of environmental, social and governance (ESG) investing criteria, it's time to sit up and pay attention. You're now being graded.

[Mercer](#) announced that by the end of the year, all of its performance reviews and manager searches will include ESG ratings, whether or not its clients specifically request them. Executives at the consulting giant say they are convinced - and point back to mounting evidence, [as reported](#) - that adherence to ESG standards improves investment performance and should be incorporated when selecting managers. Saving the world may just be a fortuitous side effect.

"We think that ESG issues are relevant for long-term investors," says **Craig Metrick**, principal and U.S. head of responsible investment for Mercer. "We've developed methodology to look at how [managers] view these issues in terms of risk and opportunity, and how those views impact the portfolio."

The firm is not just screening against investments in sin stocks and the Sudan, either. According to Metrick, an increasing number of Mercer's clients are becoming more interested in how their managers approach ESG from "an investment perspective, not an activist perspective."

"For managers that have an investment strategy and philosophy, we want to see them integrating ESG in a way that enhances value for clients," Metrick explains. "We don't want this to turn into a box ticking exercise. We want [managers] to have a view they can articulate and to demonstrate that [ESG standards] are part of the decision-making process."

Consultants like Mercer aren't the only ones emphasizing these types of investments, either. According to a fund spokesperson, the \$233 billion [California Public Employees' Retirement System](#) (Calpers) recently adopted a process for integrating ESG issues as a strategic priority.

"Regarding environmental risk ... we recognize that rising demand for food and resources globally, coupled with the likely effects of climate change, will have a potential impact on risk-adjusted returns," says the spokesperson. The pension has gone so far as to appoint a "global governance team," which "works across all asset classes to ensure Calpers investments are as sustainable as possible within the boundaries of fiduciary duty."

Managers must be careful to incorporate ESG standards properly, however. “If you build portfolios to get ESG exposure to look good in the Mercer rankings, you may give up performance,” warns **Andre Bertolotti**, CIO of **Quotient Investors** – one of the original managers selected by Calpers to start its ESG initiative. “The crux is in looking at ESG as a source of returns. That’s been the key for us.”

Bertolotti is a true believer in the value of ESG investing – when it’s implemented correctly. “I am 100% convinced we can add alpha through ESG,” he says. “In December, we will have a three-year track record [on our ESG product], and it’s our best-performing strategy.”

In addition to environmental risks and liabilities, Mercer is evaluating asset manager assessments of corporate governance standards, although Metrick notes that there’s great variety in what managers think is important for their asset class and timeframe.

On the governance side, Mercer wants to understand how a manager determines the “management quality” of the companies it invests in as well as its level of engagement with those firms and the circumstances surrounding its proxy voting. “With proxy voting, we’re not taking opinions on how firms should have voted,” Metrick explains. “[We] want to see if they have a structure and process in place.”

So far Mercer has evaluated more than 5,000 separate investment strategies on these ESG criteria, and while only roughly 10% have achieved its highest marks, Metrick says that there are signs of improvement in the lower reaches. “We set the bar intentionally high,” says Metrick, explaining that restricting the upper echelon to a select few helps to recognize the “firms out there that have been doing this for a long time.”

Even with these developments, ESG is still far from the mainstream. “It’s still new to a lot of people despite the research out there,” Metrick explains. “Most people didn’t go to school and learn about this stuff growing up. There’s still education to be done.”