

Investing with ESG Integration Means Investing with Action: How Active Ownership is a Differentiator



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 Miller/Howard Investments

‘Active ownership’ goes beyond traditional active management to integrate ESG throughout your investment’s life.

—Nicole Lee

Nicole Lee, Director of ESG Research at Miller/Howard Investments, explains what is at the heart of the firm’s ESG integration and why ‘active ownership’ makes the difference. Since the launch of their first strategy in 1991, Miller/Howard Investments has integrated active environmental, social, and governance (ESG) analysis into their investment process that seeks to provide Sustainable Income Opportunities® to clients.

What does Miller/Howard mean by ‘active ownership’?

Independent research is part of the foundation for our ‘active ownership’ process, and it begins with getting to know the companies themselves. We use our integrated fundamental and ESG research to make more informed investment decisions, engage company management, actively vote proxies, and advocate for our clients. That is ‘active ownership’.

Some of our competitors choose to rely exclusively on third-party data providers and indices for their ESG evaluations. That’s not what we do. We dig deeper.

Our portfolio management team looks for financially strong companies with high current dividend yields and strong prospects for dividend growth, and our ESG team focuses on the environmental, social, and governance policies and practices of the investment candidates. This combined fundamental research helps us understand the totality of a company, and it helps to uncover risks and opportunities that might otherwise be hidden.

What roles can investors play to increase and improve ESG data?

Miller/Howard believes that we—and really all investors—have several important roles to play when it comes to ESG data: demand it, scrutinize it, and use it.

For example, we push companies to increase their disclosure around their management of many ESG issues and risks. But we don’t stop there. We use this information to assess trends in company management over time. For example, is the company getting better and more efficient in its resource management, or is its emission intensity increasing?

Then there is the issue of data providers, which function both as data gatherers and gatekeepers. We all view the world through our own unique lens. Data providers are no different. They curate their analyses and rankings through internal perspectives on materiality. Data providers also create sustainability-related signals for the market. Investors have to be sure they’re focusing on valid signals.

When using third-party data, we are critical consumers. We compare data from a variety of sources to make sure that we understand any potential biases and the framework each data provider brings. The dynamic between what companies choose to disclose publicly versus what data providers choose to feed their clients is a complicated one. It’s impacted by where information is disclosed, what language and framing is used, and whether the information is accessible, time-stamped, and clear.

Ensuring that we’re using relevant and accurate ESG data allows us to effectively respond to how a company is managing its ESG risks and opportunities, suitably reward good actors, and assess the potential costs of bad actors.

Ultimately, good ESG data enables more informed, strategic investment decisions—and that’s why investors need it, no matter whether they be from ESG, SRI, or traditional frameworks.

How do you get to know a company from the inside out?

We seek Sustainable Income Opportunities®—stocks that can provide high and rising income with strong ESG attributes.

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We have a data-driven culture, and our research process draws from a variety of sources.

As a dividend manager, our bottom-up fundamental analysis always starts with a company's yield and dividend history. Stock selection also includes an assessment of balance sheet strength, quality, and earnings stability. We like businesses that can generate attractive returns and continue to pay, and potentially grow, their dividends.

Our ESG research process is equally robust: We start with third-party ESG data, and then move on to company publications and filings, NGO and other benchmarking reports, and sustainability analyses and reports. We also triangulate: If we can only find information in one database and nowhere else, then we trace the information back to primary sources.

Once a candidate makes it into our portfolio, we engage directly with company management. Engagement can reveal more about a company's values than its published materials. The relationships between Miller/Howard and the company management teams function as another quality assessment check. We ask ourselves, "Is the company walking the talk?" In other words, do the data we see and the responses we receive jibe with our overall knowledge of the company?

What are the key parameters a company has to obey to make it into your selection? Is exclusion your only filter?

Miller/Howard offers a mix of engagement and divestment solutions for clients to suit the diversity of values and preferences, but our emphasis is on engagement more than divestment. All of our strategies are subject to shareholder advocacy. This is a great thing! It means that we communicate with company management teams on challenging topics, pushing for improvements. And, importantly, we actively vote all proxies according to our ESG-aligned proxy voting policy.

For our ESG-managed portfolios, a subset of our offerings, we apply some exclusionary screens—for clients who choose to divest or avoid exposure to certain activities or industries—depending on the portfolio mandate and philosophy. For example, while we've had great success engaging energy companies to improve their environmental disclosures and operations, we also offer a version of our flagship Income-Equity Strategy that excludes fossil fuel energy and utility companies.

For investment candidates, we also want to ensure that the level of risk that a company would bring to a portfolio is suitable. We use company-level risk ratings that are intended to represent the level of unmanaged ESG risk inherent in that company, and that could have a material financial impact. Before an investment candidate is added to a portfolio, our portfolio management and ESG teams weigh the potential risks relative to the company's overall business, versus its peers, and in the context of the portfolio as a whole.

It sounds like Miller/Howard views ESG as a key part of

risk management. How else can ESG analysis be used to identify risks?

Our number one goal is to provide our clients with equity portfolios that have the ability to pay and grow dividends. We incorporate ESG to fully understand these companies in an effort to protect the dividend.

Our process exposes nonfinancial risks, which often have a financial impact and can jeopardize shareholder value. We seek to identify potential tail risk events that manifest over periods longer than quarterly earnings, and we consider issues that are material at the company and sector levels. Our goals are to mitigate operational, regulatory, reputational/headline, environmental, and other business risks.

As part of our 'active ownership' and in service of risk mitigation, we engage companies through dialogue, proxy voting, and shareholder resolutions.

How do you think ESG is going to evolve within the investment industry?

In the past, ESG and socially responsible investing (SRI) had been considered rather niche. Now, it has become a norm! As we say around here, ESG investing is just...investing.

Yet many companies still fall into the trap of ignoring ESG risks. These risks may start out as non-financial, but eventually they may begin affecting profitability. Arguing that a company doesn't have to pay for its impact right now, doesn't mean it's never going to have to in the future.

For Miller/Howard, our current work is about translation. We translate these existing non-financial risks into the business case. This allows us to have a conversation with company management using terms and framing that makes sense to them.

We think that ESG is a necessary part of a robust risk assessment and management program. In time, it is going to become less and less of a translation issue as more companies recognize the materiality of sustainability.

At Miller/Howard, we also think that 'active ownership' goes well beyond constructing portfolios and managing investments. For us, 'active ownership' also offers insights into best market practices, good corporate citizenship, and sustainable profitability. We take those lessons and apply them to our own firm. They are reflected through our ownership structure, our gender-diverse board and executive team, our building and resource management, and the way we develop our employees—because we believe that is what's best for our clients and their investments. ■

This article originally appeared in CityWire's October 2019 ESG Supplement: The Future Is Green.



Nicole Lee, Director of ESG Research

Nicole Lee, Director of ESG Research, provides operational and strategic leadership to Miller/Howard's ESG team. Nicole's ESG research on portfolio holdings and candidates is integral to the firm's investment process. Prior to joining the firm in 2014, she worked for several years as a clinic coordinator and educator for a nonprofit health organization, during which time she also developed and conducted training programs at two local universities. Nicole received a BS in Sociology from Southern Utah University, after which she studied public health at Westminster College in Utah.

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