Executive Summary

- Environmental, social, and governance investing is no longer considered a niche strategy.

- The ESG data landscape is still developing, particularly for small-cap and mid-cap stocks.

- Significant opportunities exist for company engagement to prioritize ESG considerations.

- Eagle SMID Cap ESG Select uses an integrated approach, rather than exclusionary screens and sustainability ratings, to invest in and active engage with sustainable enterprises.
BACKGROUND

Sustainable and responsible investing (SRI) has grown significantly over the past several decades. Once considered a niche investment strategy of exclusions (e.g., no alcohol, tobacco, firearms, gambling, etc.), sustainable investing is becoming a mainstream approach that takes into account a wide array of environmental, social and governance (ESG) factors in the investment process.

The total U.S.-domiciled assets under management using SRI strategies grew from $8.7 trillion at the start of 2016 to $12.0 trillion at the start of 2018, an increase of 38 percent. This represents 26 percent — or 1 in 4 dollars — of the $46.6 trillion in total US assets under professional management.

Despite growth in the field of sustainable investment, development of useful tools, including reliable data, performance metrics, and reporting standards for companies, has not kept pace. While ESG data challenges exist for companies of all sizes, they are most notable in the small- and mid-cap universe, where resources for reporting may be constrained. This has made sustainable and responsible investing particularly challenging for small-and mid-cap investors. However, there is progress on this front as well as opportunity.

ESG DATA LANDSCAPE: CURRENT STATE

Efforts to improve ESG data quality and company sustainability reporting have been gaining momentum globally over the past several years: “For high-quality ESG research to provide maximum added value for investors, comprehensive reporting and availability of ESG data is required.”

Corporate responsibility or sustainability reporting is now a standard practice for large and mid-cap companies around the world, with three-quarters of the companies covered by the KPMG survey using the GRI [Global Reporting Initiative] standards.

While there is not yet a universally adopted set of standards or even a universally accepted definition of materiality, the idea that ESG factors are important considerations in investment decisions is now widely accepted. Consensus is growing around the work of several organizations that have developed useful reporting frameworks and guidelines. These include the Global Reporting Initiative (GRI), the Sustainable Accounting Standards Board (SASB), the International Corporate responsibility or sustainability reporting is now a standard practice for large and mid-cap companies around the world, with three-quarters of the companies covered by the KPMG survey using the GRI [Global Reporting Initiative] standards.

In 2018, “78 percent of the S&P 500 issued a sustainability report for the most recent reporting period, most with environmental and social performance metrics.”

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**Sustainable and responsible investing,” “socially responsible investing,” “SRI,” “responsible investing,” “impact investing,” etc. are all related and are often used interchangeably.**


**Kristina Julie Rueter, “Materiality in ESG,” ISS-Oekom, October 2018, p. 16**


**Sol Kwon, “State of Integrated and Sustainability Reporting 2018,” Sustainable Investments Institute (SII) and Investor Responsibility Research Center Institute (IRRCI), December 2018, p. 3**
The ESG Data Challenge

The brief descriptions below provide a glimpse into the focus of each of these organizations.

GRI: Established in 1997, GRI is an independent international organization. The GRI Sustainability Reporting Standards, which cover a broad range of ESG content areas, have evolved over the years through a multi-stakeholder process. [www.globalreporting.org](http://www.globalreporting.org)

SASB: Founded in 2011, SASB “sets sustainability disclosure standards that are industry-specific and tied to the concept of materiality to investors. The standards are intended to capture sustainability matters that are financially material—reasonably likely to have a material impact on financial performance or condition. Standard-setting is accomplished through a rigorous process that includes evidence-based research and broad, balanced stakeholder participation.” [www.sasb.org](http://www.sasb.org)

IIRC: This is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. As its name suggests, the coalition promotes the integration of financial data and business-relevant ESG data into a single report. With input from coalition members and other stakeholders, the IIRC published its most recent principles-based international reporting framework in 2013. [www.integratedreporting.org](http://www.integratedreporting.org)

CDP: Since 2002, CDP has collected self-reported environmental data from companies, cities and regions, including information on greenhouse gas emissions, water use, and responsible forest management. [www.cdp.net](http://www.cdp.net)

TCFD: Created in 2015 by the Financial Stability Board (“FSB”), which is comprised primarily of G-20 finance ministries and central banks, the TCFD was charged with developing “voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders.” ([www.fsb-tcfd.org](http://www.fsb-tcfd.org)) The TCFD’s final report with its recommendations was released in June 2018.

Integrated Reporting Council (IIRC), CDP (formerly known as the Carbon Disclosure Project), and most recently the Task Force on Climate-Related Financial Disclosures (TCFD). Despite the fact there is no single unifying reporting standard, each approach provides an important piece of the reporting puzzle, and in concert may provide a clear and comprehensive picture of a company’s ESG profile.

Although not directly involved in standards setting, it is important to note the work of the UN-sponsored Sustainable Stock Exchanges Initiative (SSE), in which the New York Stock Exchange, its parent company Intercontinental Exchange, and Nasdaq are partners. Established in 2009 by the UN Secretary General, the mission of the SSE is:

To build the capacity of stock exchanges and securities market regulators to promote responsible investment in sustainable development and advance corporate performance on environmental, social, and governance issues.6

It, too, sees the need for reliable, consistent and comparable data, and is supporting efforts of its stock exchange partners to encourage listed companies to provide meaningful ESG data.

Progress, but . . .

The main challenge is the voluntary nature of sustainability reporting. The SSE acknowledges progress but also recognizes the deficiencies in the current state of reporting:

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6 www.sseinitiative.org, accessed 12/11/2018
Despite the increase in the number of companies issuing reports and the improvements in the quality of the data and information being provided, reporting practice continues to fall short of what is needed to deliver the potential benefits.\(^7\)

This is especially true in the small- and mid-cap space.

Only 4.23 percent of the Russell 2500\(^\text{TM}\) report GHG emissions through CDP.\(^8\)

Although the U.S. Securities and Exchange Commission does require public companies to address risks related specifically to climate change in their filings, “U.S. companies have largely stuck to vague language in disclosing the impact of climate change and haven’t faced any pressure from the SEC to be more specific.”\(^9\) Beyond limited climate change risk reporting, there are currently no regulatory requirements regarding sustainability reporting.

Absent regulation and stock exchange listing requirements, it is up to individual companies to adopt their own approach to sustainability management and reporting. Given the voluntary nature of such practices, it often falls to shareholders and other stakeholders to encourage companies that may be lagging to step up their efforts. This is where corporate engagement and shareholder advocacy through proxy voting come into play.

**CORPORATE ENGAGEMENT AND PROXY VOTING**

Shareholders can make a difference by engaging with companies on issues that matter to them. Engagement can take many forms, ranging from direct dialogue to the filing of shareholder resolutions.

Requests related to climate change action as well as a host of other corporate responsibility issues have been raised over the years in investor requests for sustainability disclosures and reports. This is an issue where investors have frequently been able to obtain withdrawal agreements when the target companies agree to expand their disclosures.\(^10\)

During the 2018 U.S. proxy season, there were 36 shareholder resolutions filed regarding sustainability reporting. Ten of those were voted, and those voted received an average vote of 32.4 percent. This represented the highest average vote of such resolutions in three years.\(^11\) The numbers may seem small, but they represent progress nonetheless.

**FROM THEORY TO PRACTICE: EAGLE ASSET MANAGEMENT’S APPROACH**

How do we as investors move from the theory of responsible investment to practice? Like most investment disciplines, there is not a “one size fits all” approach to sustainable and responsible investment. Because we do not rely on outside sustainability ratings, we must delve into each investment opportunity to find the unique qualities of a company that would lead to long-term growth. We start by determining the drivers of success for any given company in any given industry. We work to identify the risks and the opportunities, sifting through data points where available, separating the relevant information from mere noise. Through this process, we home in on material ESG factors and actual sustainability performance of each company under consideration.

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\(^8\) Data source: Bloomberg, CDP. Company responses categorized as follows: 105 - answered questionnaire/ submitted responses; 1 - signaled it would consider responding; 79 - declined to participate; 160 - sent no response; 3 - logged in and began the process, but have yet to submit a response; 2173 – no data provided by CDP or status could not be determined.


\(^11\) Ibid., p. 74

\(^12\) Kristina Julie Rueter, “Materiality in ESG,” ISS-Oekom, October 2018, p.21
Materiality
As noted above, there is not a “one size fits all” approach to sustainable investing, and this extends to key decision-useful or “material” ESG data. It is not about data for data’s sake, but rather what makes a difference for an individual company in the long run. In ESG investing, “the final materiality assessment will . . . depend on the individual company situation and sustainability performance.”

This approach is in complete alignment with Eagle’s process of fundamental research and analysis. Once material ESG factors have been identified for an individual company and/or industry, the next and perhaps more problematic step is gathering meaningful data.

Disclosure vs. Performance
For many companies, sustainability reporting in the form of glossy corporate social responsibility (CSR) reports check the box on sustainability. Even if companies provide meaningful information in such reports, it is just the beginning. Companies must follow through with performance. It is one thing to report GHG emissions and reduction targets, but quite another to actually reduce GHG emissions and meet or exceed stated reduction targets. At Eagle, it is important to know that companies are working to improve performance in the areas of sustainability that impact their business and overall corporate performance.

As evidenced above, an important element of active ESG investing is accurate and meaningful reporting. Here lies a major challenge, particularly in the small- and mid-cap space, but also a major opportunity: active ownership.

Active Ownership
Active ownership is a critical aspect of active management. For Eagle, active ownership means corporate engagement and proxy voting. For some of its holdings, Eagle is a major shareholder. By taking the long view and engaging companies on important issues that go beyond quarterly results, such as sustainability reporting or voting for shareholder resolutions that support longer term ESG efforts, Eagle can help effect real change. In the small- and mid-cap arena, the impact of active ownership can be significant.

CONCLUSION
Sound investment decisions are based on sound information. While progress has been and continues to be made in the field of sustainability reporting and ESG data quality, there is still a long way to go, particularly for small- and mid-cap companies. Through international partnerships, initiatives, and coalitions, guidelines, standards and frameworks, the work will continue to move forward, driven by regulators, academics, business leaders, and investors. Eagle Asset Management’s SMID Cap ESG Select team is committed to helping further this progress. We know it will take a lot to get it right, but we believe it is worth the effort.

Approach to ESG Investing
The Eagle SMID Cap ESG Select Team’s approach to small- and mid-cap ESG investing is centered on active management and active ownership rather than exclusionary screens and sustainability ratings. Grounded in fundamental analysis, the investment process we have developed over the years has grown to encompass ESG criteria, the backbone of sustainable and responsible investment. In addition to seeking companies with strong management teams, proven business models, and profitable operations, we also search for companies that are addressing important environmental and/or societal issues, are committed to being good corporate citizens, and have responsible governance practices.
About Carillon Tower Advisers
Carillon Tower Advisers is a global asset management company that combines the exceptional insight and agility of individual investment teams with the strength and stability of a full-service firm. Together with our partner affiliates – ClariVest Asset Management, Cougar Global Investments, Eagle Asset Management, Reams Asset Management (a division of Scout Investments) and Scout Investments – we offer a range of investment strategies and asset classes, each with a focus on risk-adjusted returns and alpha generation. Carillon Tower believes providing a lineup of institutional-class portfolio managers – spanning a wide range of disciplines and investing vehicles – is the best way to help investors seek their long-term financial goals.

About Eagle Asset Management
Eagle Asset Management provides a broad array of fundamental equity and fixed-income strategies designed to meet the long-term goals of institutional and individual investors. Eagle’s multiple independent investment teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.

Disclosure
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Risks Associated with SMID Cap ESG Select Investing
Investing in small- and mid-sized companies is based on the premise that relatively small companies will increase their earnings and grow into larger, more valuable companies. However, as with all equity investing, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. Historically, small- and mid-cap stocks have experienced greater volatility than other equity asset classes, and they may be less liquid than larger-cap stocks. Thus, relative to larger, more liquid stocks, investing in small- and mid-cap stocks involves potentially greater volatility and risk. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

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