

ESG Viewpoint: BofA Securities

RepRisk interviews Savita Subramanian, Head of ESG Research at BofA Securities



BofA SECURITIES 

1. RepRisk: Could you please provide some insight into your role and the role of your department within BofA Securities?

Savita Subramanian: As the head of Global Environmental, Social, and Governance (ESG) Research within BofA Securities, I lead the development and marketing of the firm's global ESG research, which is used by institutional and individual clients. I also lead our U.S. Equity & Quantitative Strategy team, where I am responsible for determining forecasts for the S&P 500 and other major U.S. indices, recommending sector allocations for equities, and developing and marketing the firm's quantitative equity strategy.

2. RR: BofA Securities recently published a report featuring RepRisk data that evaluates the impact that ESG risk has on investment performance. What are the main findings of the report?

SS: Our recent report examined whether ESG controversy data can be an effective alpha signal for investors. And we found evidence that in the US, Europe, and Asia, stocks with low (less risky) RepRisk scores consistently outperformed those with high (more risky) RepRisk scores over the period studied, based on our backtesting methodology (see below for important disclosures).

3. RR: The research shows a strong correlation between RepRisk data and investment outperformance and reduced stock performance. With that in mind, what are the benefits of adopting a risk-focused approach to ESG for investors?

SS: ESG controversies can be especially costly and long-lived, and even highly regarded companies are subject to such reputational risk. In fact, we estimate more than \$600bn of market cap for S&P 500 companies has been lost to "ESG controversies," such as data privacy issues or governance failures, in the last seven years alone. And controversies are a long-lived overhang — the average stock doesn't recover from a controversy until almost a year has passed, based on our analysis of recent controversies for S&P 500 companies. So, we think investors of all stripes — not just ESG-focused investors — can use ESG controversy data to better manage risk.

4. RR: The research found RepRisk scores to be an effective alpha signal for a broad universe of US companies. What do you see as the benefit of integrating daily-updated risk scores in the investment process?

SS: One of the challenges that investors face is that many traditional ESG ratings providers use company reports and other self-disclosed sources, which often do not capture daily-updated ESG controversy data. We think integrating daily-updated ESG controversy data from third-party sources can augment company-disclosed data and signal emerging ESG risks so that investors can quickly assess and respond.

5. RR: RepRisk data is found to be a particularly effective signal in small caps. Do you find that ESG disclosures are more limited with smaller companies? What strategies can investors adopt to gain meaningful insights and data despite those limitations?

SS: One challenge in analyzing companies from an ESG lens within small caps is the consistently lower disclosure by these companies – they are earlier in their life-cycle and may be resource-constrained relative to their large, mature counterparts. To bridge the disclosure gaps, alternative ESG data providers that draw on other sources besides company-disclosed data can be really useful in assessing ESG risks for smaller companies. In fact, our analysis found that controversy data was a particularly effective alpha signal in the small cap segment of the US market.

6. RR: The research found that stocks highly ranked on ESG metrics or highly owned by ESG funds were not immune to reputational risk. In fact, “good” companies with high ESG ratings tend to underperform when their RepRisk score jumped (i.e. risk increased). In your view, what does this result tell us about companies’ ESG policies vs. on-the-ground performance?

SS: Our report also explored what happens when stocks that are highly rated on ESG or highly owned by ESG funds face emerging ESG controversies. We found that “good” companies – those with high ESG scores as measured by Sustainalytics – tended to underperform even more than the average stock when controversy ranks jumped (i.e. risk increased). This seems to indicate that investors could really benefit from fusing company-disclosed information with daily-updated verified data sources from third parties to catch ESG controversies as they emerge.

7. RR: The timeframe researched in this report is 2007-2020 with point-in-time generated scores. Does an extensive data history yield more reliable results for back testing analysis?

SS: Using a longer time period for analysis allows us to look at performance across multiple business cycles, multiple political and regulatory regimes, and, in our view, leads to a more robust analysis – the risks of an ESG factor being confounded with up markets, down markets, or periods of light or heavy regulations, are mitigated. Finding an “all-weather” signal can be a lot more valuable to investors than finding a factor that is rewarded under specific circumstances.

8. RR: In your opinion, what do the conclusions of this research imply for the industry as a whole and the use of ESG data?

SS: We’ve observed that investors are increasingly leveraging company-disclosed ESG data alongside daily-updated ESG controversy data sets to better assess current and emerging ESG risks.

Backtesting disclosure:

Backtested performance does not represent the actual performance of any account or fund. Backtested performance depicts the hypothetical backtested performance of a particular strategy over the time period indicated. In future periods, market and economic conditions will likely differ and the same strategy will not necessarily produce the same results. No representation is being made that any actual portfolio is likely to have achieved returns similar to those shown herein. There are frequently sharp differences between backtested returns and the actual returns realised in the actual management of a portfolio. Backtested performance results are created by applying an investment strategy or methodology to historical data and attempts to give an indication as to how a strategy might have performed during a certain period in the past if the product had been in existence during such time. Backtested results have inherent limitations including the fact that they are calculated with the full benefit of hindsight, which allows the security selection methodology to be adjusted to maximise the returns. Further, the results shown do not reflect actual trading or the impact that material economic and market factors might have had on an investor’s decision-making under actual circumstances. Backtested returns do not reflect advisory fees, trading costs, or other fees or expenses. Backtesting is hypothetical in nature and not indicative of future performance.

Conclusion

BofA Securities' research report "When Bad News Hits Good Companies" found an estimated USD \$600 Billion of market cap for S&P 500 companies has been lost to "ESG controversies" over the last seven years. RepRisk data was analyzed to determine what impact ESG risks can have on investment performance, and found that in the US, Europe, and Asia, stocks with low (less risky) RepRisk scores consistently outperformed those with high (most risky) RepRisk scores over the period studied (2007-2020). The research also found RepRisk scores to be an effective alpha signal for a broad universe of US companies, including small caps.

Bio – Savita Subramanian

Savita Subramanian is a managing director, head of ESG Research and head of U.S. Equity & Quantitative Strategy at BofA Global Research. She is responsible for recommending U.S. sector allocations for equities and determining forecasts for the S&P 500 and other major U.S. indices, as well as developing and marketing the firm's quantitative equity strategy to institutional and individual clients. She also leads Global Research's Environmental, Social, and Governance (ESG) efforts.

Subramanian has been with the firm since 2001. She has been a ranked analyst in the Institutional Investor survey for the last nine years. Prior to joining the firm, Subramanian was an analyst at Scudder Kemper Investments in New York and San Francisco.

Subramanian frequently appears in television and print journalism, and is a regular guest speaker at financial conferences. Subramanian is on the board of the UCLA Mathematics & Finance program and on the membership committee of Q Group. She is also a member of the Chicago Quantitative Alliance, the Society of Quantitative Analysts, and Women on Wall Street.

Subramanian received a bachelor's degree with a double major of mathematics and philosophy with honors from the University of California at Berkeley and an MBA with a concentration in finance from Columbia University. She remains actively involved in the Columbia Business School alumni organization.