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ESG Integration and Clean Energy: A look at the two key themes playing out in ESG ETF space

Despite the global pandemic and perhaps as a result of the market volatility it brought on, 2020 was a record year for ETF inflows both north and south of the border. It was also a banner year for ESG ETFs, which outsold any other sector or theme's inflows.

In fact, in Canada, ESG ETFs represented 91% of all inflows into the thematic ETFs. Though they represent only 1.5% of total Canadian ETF AUM, they punched above their weight accounting for 4.6% of total flow. South of the border, the same trend was evident. ESG ETFs accounted for \$34 billion in inflows – four times their starting asset base. At the end of 2020, US-listed ESG ETFs accounted for some \$189 billion in assets. (Source: National Bank Financial)

Institutional subscriptions drove creations; however, smaller retail creations are also growing at a steady pace.

Examining the flow of capital in ETFs, two key trends have become established when it comes to responsible investing:

1. **Demand for investment solutions that integrate all three aspects – Environmental, Social, and Governance**
2. **Demand for clean energy and lower carbon footprint solutions.** No longer just seeking to exclude the worst offenders. Not just avoiding the problem, but actively looking to invest and profit from solutions towards a greener planet

The ESG integration approach has been sought out by large asset owners. MSCI is the largest provider of ESG research and indexes globally, and their MSCI ESG Aware and MSCI ESG Leaders indexes have attracted the bulk of the institutional dollars because they are transparent and rules based, yet provide broad liquid exposure, low cost, and robust monitoring.

One of the criticisms of ESG investing has been a lack of standardized data. However, great strides have been made over the last decade. ESG ratings have improved significantly and have become much more measurable.

MSCI has developed an intuitive scoring system similar to bond ratings. A composite score is calculated based on 37 key issues (see table, on next page), and a letter grade is assigned to the security (AAA and AA rated being leaders, single B, CCC being laggards).

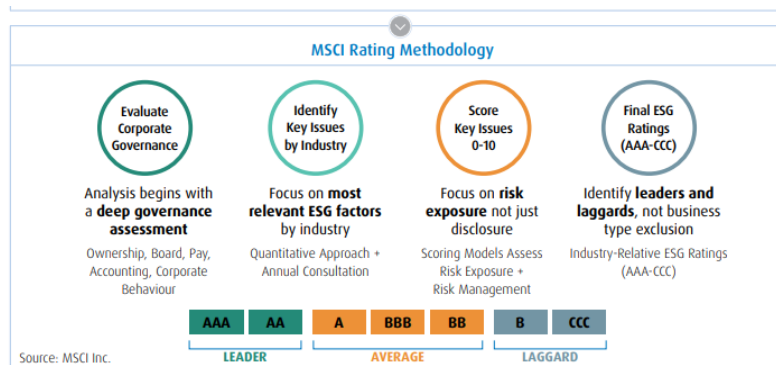
Figure 2 MSCI ESG Key Issue Hierarchy

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	Climate Change	Carbon Emissions* Energy Efficiency Product Carbon Footprint	Financing Environmental Impact Climate Change Vulnerability
	Natural Resources	Water Stress* Biodiversity & Land Use	Raw Material Sourcing
	Pollution & Waste	Toxic Emissions & Waste* Packaging Material & Waste	Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech Opportunities in Green Building	Opp's in Renewable Energy
Social	Human Capital	Labor Management* Health & Safety*	Human Capital Development Supply Chain Labor Standards
	Product Liability	Product Safety & Quality Chemical Safety Financial Product Safety	Privacy & Data Security Responsible Investment Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications Access to Finance	Access to Health Care Opp's in Nutrition & Health
Governance	Corporate Governance*	Board** Pay**	Ownership** Accounting**
	Corporate Behavior	Business Ethics* Anti-Competitive Practices*	Corruption & Instability Financial System Instability

* indicates "universal" issues assessed for all companies in MSCI World

** Board, Pay, Ownership, and Accounting carry weight in the ESG Rating model for all companies. Currently, they contribute to the Corporate Governance score directly and 0-10 sub-scores are not available.

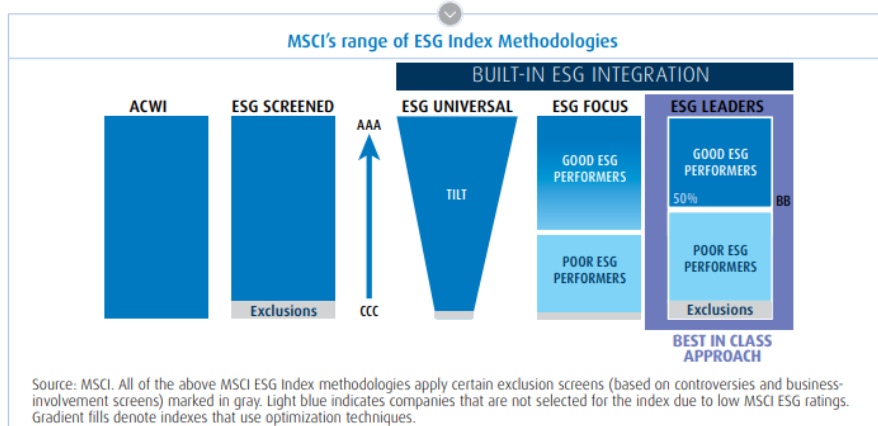
Source: MSCI



MSCI's ESG Scoring Framework

The **MSCI ESG Aware** indexes (which first appeared as US-listed ETFs in 2016) screen for positive ESG characteristics and seek risk & return characteristics similar to the respective parent index. They exclude companies involved in severe controversies (civilian firearms, controversial weapons, tobacco, certain levels of revenues derived from thermal coal or oil sands).

The **MSCI ESG Leaders** indexes are similar to the ESG Aware indexes, but select only the highest rated companies within each sector, while maintaining 50% of total market capitalization - thus similar risk/return characteristics to the index. These indexes exclude companies involved in those same controversial businesses mentioned above. The Leaders indexes have a higher ESG rating versus the Aware indexes (AA vs A) and a higher quality score overall, so they can be considered a refinement of the ESG Aware indexes.



Source: MSCI

It can be onerous and costly for any firm, but especially smaller investment counsel firms and family offices, to add ESG due diligence to their analysis process for individual securities. These indexes are great tools to outsource this additional due diligence without sacrificing returns, and while helping to mitigate headline risk associated with individual securities that may arise from poor governance or oversight of social or environmental issues.

BMO offers a full suite of MSCI ESG Leaders index ETFs, core portfolio building blocks providing access to equities and fixed income across the globe.

Responsible Investing ETFs

Mgmt. Fee: 0.65%
Risk Rating: High

Equity				
BMO MSCI Canada ESG Leaders Index ETF ESGA	BMO MSCI USA ESG Leaders Index ETF ESGY	BMO MSCI EAFE ESG Leaders Index ETF ESGE	BMO MSCI Global ESG Leaders Index ETF ESGG	BMO Women In Leadership Fund WOMN
Fixed Income		Asset Allocation		Specialty Income
BMO ESG Corporate Bond Index ETF ESGB	BMO ESG US Corporate Bond Index ETF ESGF hedged to CAD	BMO Balanced ESG ETF ZESG		BMO Global High Dividend Covered Call ETF ZWG

Boldly Growing the Good

Optionable ETFs

BMO Global Asset Management has been a UN PRI signatory since 2006. PRI has rated BMO GAM an A+ on our active ownership for listed equity, as well as our strategy and governance.¹

¹ Sustainability Score as of September 30, 2020. Sustainalytics provides company-level analysis used in the calculation of Morningstar's Sustainability Score. Sustainability Mandate derived from the fund prospectus.

BMO Global Asset Management

The second trend is a shift towards clean energy and reducing reliance on fossil fuels. This also coincides with a change in administration in the US. A key aspect of President-Elect Biden's platform is to invest in clean technologies as a way to reboot the economy and create jobs. The US-listed ICLN ETF took in \$900 million dollars last year (the bulk of it in the last quarter), making it the largest clean energy ETF globally with assets under management of close to \$5.5 billion USD (Source: National Bank Financial).

ICLN tracks the S&P Global Clean Energy Index, a market-cap-weighted index of 30 of the most liquid companies involved in businesses such as biofuels, ethanol, geothermal, hydroelectric, solar and wind industries (Source : ETF.com). This index is not new; the US-listed product has been trading since 2008.

Other products in the space are focused on low carbon targets, and sub-sectors found within the S&P Global Clean Energy Index (such as wind and solar).

BMO is proud to be launching ZCLN, which tracks the same index (S&P Global Clean Energy) at the end of January. There are several advantages to buying the Canadian-listed version including no currency conversion, and no US Estate Tax exposure.

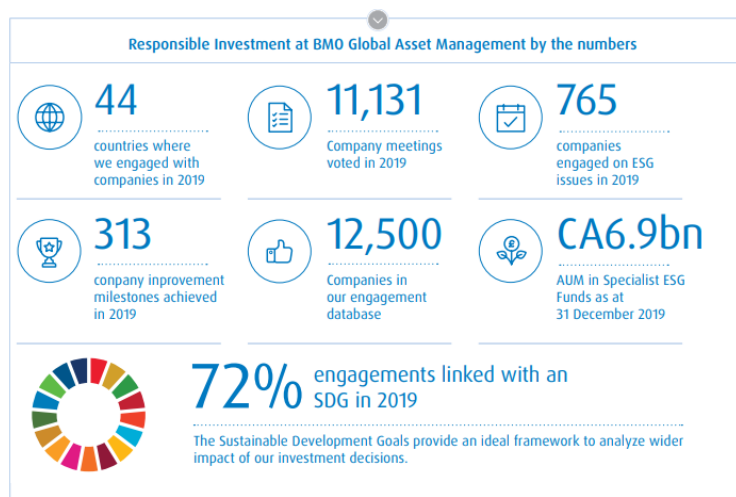
While the change of leadership stateside makes this a timely trade, the threat of climate change will unfortunately be with us for longer than any political party in power. Tools like these make it possible for investors to align their portfolios with their values in order to help affect change on a larger scale.

A Word on Stewardship: What is it & Why is it Important?

As asset managers, we have a privileged and trusted position as stewards of capital, which gives us both influence and responsibility. BMO Global Asset Management's heritage and commitment to ESG investing runs deep. We take our responsibility seriously and that includes considering the impact of our investments on society and the environment. Over 30+ years we've developed a range that includes specialist ESG products, investment strategies with ESG integration and engagement incorporated, our Responsible Engagement Overlay service, reo®, and now our ESG ETFs. Active ownership is the cornerstone of our responsible investment approach, even in our passive index-tracking products. We believe that our responsibility as investors does not end when an investment is made. This is shown in our commitment to active ownership and engagement.

We are proud to provide full transparency on how BMO GAM voted, by ETF and at the security level.

- BMO ETFs Proxy Voting Dashboard: <https://vds.issgovernance.com/vds/#/MzA5NTAw/>
- Voting Data (by company) : <http://vds.issproxy.com/SearchPage.php?CustomerID=3660>



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