Responsible Investing Roundtable

The metric for success?

May 2018

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Introduction

Responsible Investing is getting more focus than it ever has done before, with many stating that their strategies will not only give peace of mind, but will produce increased levels of return. In some ways, therefore, responsible investing can be seen as a strategy to specifically generate return.

There are many different stages of responsible investing with one level taking into account firms that integrate Environmental, Social and Governance (ESG) factors as part of their overall process; secondly, firms that produce SRI specific funds which could look to exclude certain types of stocks; and/or those strategies that track how they make a tangible impact in the world.

In light of this increased interest, corporations in which funds invest are encouraged to integrate ESG factors as part of their operating policy. This can include factors such as environmental stewardship, consumer protection, human rights and diversity.

Although many may view the SRI approach as subjective, there are ways to measure ESG factors, with MSCI producing their ESG index series with over $85 billion in institutional, retail and exchange traded funds being benchmarked to the MSCI ESG index series; and the FTSE4Good Index series designed to measure the performance of companies demonstrating strong ESG practices.

Going forwards, we can expect increased transparency and more concrete data being produced, measuring how investments are making an impact. Indeed, there is certainly room for more tangible analysis to be produced in the future to determine whether this type of investing is truly a ‘metric for success’.

In addition, why stop there? We can also expect to see positive screening rather than negative screening, with funds looking for those firms that are actively make a difference, rather than excluding those that may cause an ethical conflict.

CAMRADATA’s Roundtable looked into how the approach to Responsible Investing is developing over time, the current issues that are being faced and innovative solutions we can expect to see in future.

“Indeed, there is certainly room for more tangible analysis to be produced in the future to determine whether this type of investing is truly a ‘metric for success’”

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Candriam Investors Group

Company Profile

Candriam has been a pioneer in the area of Sustainable and Responsible Investments (SRI) for over 20 years. In excess of 25% of our $135 billion AUM is managed in sustainable investments. Candriam is part of New York Life Investments (NYLIM), among the world's leading asset managers with $555 billion of AUM. (Data as at 31.12.2017)

Solange Le Jeune

Senior SRI Analyst

Solange joined Candriam Investors Group in October 2017 as a Senior SRI analyst. She has more than 10 years' experience in ESG having worked with UK asset managers on ESG analysis, integration and stewardship strategies.

Prior to joining Candriam, Solange was an ESG Analyst at Schroders Investment Management (2011-2017) where she focused on ESG integration strategies across all asset classes and geographies. Solange started her career in the UK with Jupiter Asset Management (2008-2011) in the sustainability team, providing ESG analysis for Jupiter Ecology fund and its other sustainability funds. In France she first built experience in SRI with Ethifinance, a rating agency and SIFA, a social impact fund provider.

Solange holds a MSc in Management from EM Lyon Business School, France, and a Masters in International Affairs and Sustainability from Sciences Po Paris.

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Newton Investment Management

Company Profile

Newton Investment Management is a London-based, global investment management firm, providing a focused range of investment strategies to public and private-sector DB and DC pension funds, corporations, charities and, via BNY Mellon, individuals. With £53.8bn assets under management (as at 31 December 2017), we have expertise in a range of disciplines, including global, regional and emerging-market equities, multi-asset strategies, absolute-return investing, and global bonds.

We use a global thematic approach to help achieve long-term perspective and identify areas of risk and opportunity for our clients. We consider environmental, social and governance issues in relation to every company in which we invest, in the belief that responsible investment is better investment.

To find out more, visit our website at newtonim.com

Ian Burger

Head of Corporate Governance

Ian is the head of corporate governance at Newton Investment Management. He is responsible for corporate governance considerations throughout Newton's investment process and also leads ESG analysis for certain sectors.

Outside of Newton, Ian is involved in shaping the debate on ESG through his membership and participation in various groups such as being a board member of the International Corporate Governance Network, member of the IFRS advisory council, co-chair of the GC100 and Investors Group, member of the PLSA's Stewardship Advisory Group and member of the Investment Association's Sustainability and Responsible Investment Committee.

Ian is a Fellow of the Chartered Institute of Secretaries, a trustee of its three charities and received the ICSA's President's medal at the institute's 125th anniversary in 2016.

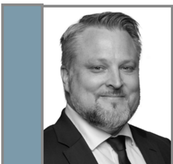
Sponsor

Storebrand Asset Management

Company Profile

Storebrand Asset Management (SAM) is the largest private asset manager in Norway with over €75bn under management and provides a broad range of services within investments to over 250 institutional clients in the Nordic region, mainly through fund solutions. Our services, however, also include discretionary/segregated accounts. In cooperation with our clients we aim to provide solutions tailored to their needs, investment horizons and risk profiles.

Storebrand is a pioneer within sustainable investments and we are one of the few asset managers globally who work with a complete focus on this area across all our solutions. Through sustainability we aim to add value via positive returns in our customer portfolios.



Philip Ripman

Senior Analyst and Portfolio Manager

Philip joined Storebrand Asset Management's sustainable investments team in 2006 and has been Fund Manager for Storebrand Global Solutions/SPP Global Top 100 since May 2015.

His specialty areas are SDG 7 Affordable and Clean Energy, SDG 13 Climate Action and controversial weapons. He holds an MA in Chinese Studies including time spent at Nankai University and a Master of Social Sciences.

Participants

Mark Mansley
Chief Investment Officer

Mark Mansley is the Chief Investment Officer at Brunel Pension Partnership Limited and has over 30 years' experience of investment. His particular passion has been for many years make investment work in the real world – so it is not only financially successful but also long term, responsible and contributes to a sustainable society.

As well as helping develop the Environment Agency's responsible investment strategy over the last decade, he has worked on impact investing with Rathbone Greenbank Investments, on Climate change with the Universities Superannuation Scheme, and has helped several fund managers, such as Aviva, improve their investment processes and integrate sustainability considerations. Nonetheless, as a Cambridge mathematician and Chartered Fellow of the Securities Investment Institute, he is also committed to rigour in investment.

Chris Varco
Investment Managing Director, Mission Related Investments

Chris is an Investment Managing Director in the Mission-Related Investing 'MRI' Group in Cambridge Associates' London office. Chris works with investment directors across all practice areas on MRI manager research and all other client MRI requirements.

Prior to joining Cambridge, Chris was the Programme Director at the Montpelier Foundation in London, and made impact investments aiming to help disadvantaged communities in developing countries, the UK and USA. The foundation invests in sectors such as agriculture, sustainable energy, education, and access to finance and essential services. He remains a Trustee on the foundation board.

The foundation was set up by Montpelier Investment Management, an alternative investment fund in London investing in global special situations and emerging markets. Chris was a Partner and Senior Analyst in the firm, heading up investment research across asset classes, examining listed and private opportunities in equity and debt.

Chris began his investment career in 2003 at Threadneedle Investments in London, as an equities analyst and fund manager. He worked in the Emerging Markets team on Global Emerging Market and Latin American portfolios, alongside broader global sector research responsibilities.

Participants

Andrew Grant

Senior Analyst (Oil and Gas)

Andrew joined Carbon Tracker in 2014 as a Senior Analyst, leading research on oil & gas and coal mining. He has authored a number of Carbon Tracker's major reports on these sectors, including the Carbon Supply Cost Curves series, scenario analysis of the oil refining industry in Margin Call, and exploring transition risk at the company level in 2 Degrees of Separation.

Prior to joining Carbon Tracker, Andrew formerly worked at Barclays Natural Resources Investments, a private equity department of Barclays that committed capital across a range of commodities and related industries. Andrew has previous experience in HR at Barclays Capital and as a consultant specialising in executive remuneration and corporate governance at New Bridge Street.

Andrew has a degree in Chemistry & Law from Bristol University.

Reza Mahmud

Senior Investment Consultant

Reza represents PwC's Pensions Investment Consulting business, which focuses on Trustee and Corporate advice. He helped establish and is a member of PwC's multi-disciplinary Investment Committee (pensions, insurance, sovereign wealth funds, private wealth). Prior to PwC he was a multi-asset investment manager at Aviva Life and Pensions,and before that he served with Brunei's sovereign wealth fund as a portfolio manager and asset allocation analyst.

Reza has an LLB law degree from Exeter University and an Investment Management MSc from Cass Business School (City University). He has also studied behavioural finance and investments at Harvard University, University of Chicago Graduate School of Business, and London Business School, and studied Psychology and Cognitive Science at Johns Hopkins University.

Participants

Honor Fell

Associate

Honor is an Associate in Redington's Manager Research team. Honor is responsible for the research, selection and monitoring of equity managers as well leading Redington's Responsible Investment work. She works in conjunction with the Investment Consulting team to provide advice to a range of institutional clients.

Honor joined Redington in 2013 after receiving an undergraduate degree in Geography from Cambridge University.

Amandeep Shihn

Director, Manager Research

Amandeep Shihn leads on Emerging Markets Equity and Sustainable Investment manager research within Willis Towers Watson's Manager Research team. Particular areas of focus are researching Global, Emerging Market and Asian equity strategies and sustainable investing. In this role he is involved in portfolio construction for Willis Towers Watson's global client base and has designed a number of the tools used to research asset managers and monitor their portfolios from a sustainability perspective.

Prior to joining the research team, Amandeep was a member of Willis Towers Watson's investment strategy team where he worked on strategic asset allocation and liability management projects.

Amandeep graduated from the University of Bristol with a BSc in Economics and Imperial College Business School with MSc in Finance.

Participants

Brendan Maton
Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

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Responsible Investing Roundtable

The metric for success?

CAMRADATA held its annual Responsible Investment roundtable in London earlier this year. The panel discussed the efficacy of Low Carbon indices and the pressures on the directors of quoted companies to act for short-term profit rather than long-term sustainability. There was agreement that the relationship between shareholders and directors could be mutually improved: shareholders collectively have not pressed enough for long-termism. There was also consensus that ESG analysis ought to be integrated within portfolio management of commercial asset managers. Otherwise, ESG analysis is at risk of being merely an option that can be ignored by those directly in charge of portfolios without consideration of the risks. Generationally, this ignorance is less prevalent among younger managers.

In summary, the discussion's overarching theme was the imperative for asset owners and asset managers to understand corporate culture and ally with those organisations that demonstrate the best, most robust culture.

> "There was agreement that the relationship between shareholders and directors could be mutually improved: shareholders collectively have not pressed enough for long-termism"

An overheating world is regarded by many as the greatest threat mankind faces this century. It was fittingly the first discussion point at the CAMRADATA Responsible Investing roundtable of 2018, whose goal was to discover 'metrics for success'. The International Energy Agency (IEA) and others provide scenarios for reductions in carbon emissions and associated slowdown in temperature rises. Governments around the world have endorsed emission-cutting programmes based on those scenarios, most recently at the Paris summit eighteen months ago. Pioneering work by the likes of Carbon Tracker has bridged environmental data to the scenarios of fossil fuel extractors and emitters for their future, introducing the concept of "stranded assets" – energy that cannot be burned in an overheating world.

The question addressed to the CAMRADATA panel was how they respond as financiers in this changing environment. An increasingly popular response is to track a Low Carbon index, which shares most of the character of a conventional index weighted by companies' market capitalisation, but is modified to underweight heavy carbon-emitters and overweight 'greener' enterprises.

Tracking Low Carbon indices can cut portfolio exposure to carbon emissions by more than 75%, with annualised tracking error of 0.3%.

This is what the UK's Environment Agency Pension Fund chose to do for its passive exposure to public equities three years ago, after noticing that a disproportionate amount of the Fund's carbon budget was being 'spent' in the passive equity portfolio.

Mark Mansley was CIO of the EAPF at the time of the selection and is now CIO of Brunel Pensions Partnership, the delegated manager selector for nine local authority pension funds and the EAPF. "EAPF was more than happy to take the risk of annualised tracking error of 0.3% given the radical reduction it gave us in carbon emissions." Mansley told the CAMRADATA roundtable. "It translates into a 1.5% underperformance (or outperformance) risk over 25 years for a substantial reduction in climate related risk. I would describe that as a highly attractive trade-off."

He explained that he much preferred discussing Responsible Investing in terms of risks and returns than ethical ideals. EAPF had afterwards set to refreshing another passive mandate but this time with a factor tilt towards Value (i.e. cheap companies), which showed an even greater bias to fossil fuel emitters.

"It is very interesting when you talk to quants about ESG criteria," said Mansley. "Initially they are reluctant to impose additional constraints which might affect alpha in their models. But then they remodel the data and find positive outcomes with these constraints!"

"It is very interesting when you talk to quants about ESG criteria," said Mansley. "Initially they are reluctant to impose additional constraints which might affect alpha in their models. But then they remodel the data and find positive outcomes with these constraints"

Storebrand, Norway's largest commercial asset manager, has taken the concept one step further and created an enhanced index fund, Storebrand Global Plus. This has a tracking error of 0.9% and a substantially greater exposure to pure play green-economy companies – 8.4% versus 0.4% for the index. Most pure-plays are just outside the benchmark MSCI World universe, which helps explain the higher tracking error than conventional Low Carbon index products.

"We wanted a tilt towards green energy" explains Philip Ripman, manager of Storebrand Global Plus.

Chris Varco, senior consultant at Cambridge Associates, noted that these new Low Carbon products abound because of the quantity of new data reported by companies.

"Even in the last two years, there has been a profusion of information for quant analysts to play with and model. It's no surprise to me that we are seeing this trend of smart beta and ESG. Because active sustainable managers tend to have a bias towards the Growth and Quality factors, it makes sense for any passive complement to weigh in on Value," he said.

> "Because active sustainable managers tend to have a bias towards the Growth and Quality factors, it makes sense for any passive complement to weigh in on Value"

Not all Low Carbon indices are the same, however. This matters not just for products tracking them – or enhancing them à la Storebrand - but fundamental active managers seeking a benchmark. Newton has £50bn in active strategies that integrate ESG. Although the firm's investment style is characterised by macro themes and bottom-up stockpicking, benchmarks still matter in demonstrating the efficacy of the active approach. But Ian Burger, Newton's head of corporate governance, said inconsistency of methodology across indices made benchmarking difficult.

The panel had some sympathy. Ripman noted that emissions data were patchy, even at Scope I and II levels. Mansley said MSCI Low Carbon indices rely on historical emissions data rather than sense of future direction; so weight overly to oil servicing companies in lieu of oil producers.

"It's a great point," said Andrew Grant, a senior analyst at Carbon Tracker covering the oil & gas sectors. "Which sector do they think will be hit hardest when emissions limitations really bite? Oil services don't look immune."

This point was taken up by Solange Le Jeune, ESG analyst at Candriam Global Investors, whose ESG strategies account for 27% of all assets under management. She said that there had to be discussion with major energy producers rather than exclusion because these companies had to embrace the need to create the transition to a greener economy. "They cannot be simply dismissed," she said.

"Not investing in these companies does not mean they are not financed by capital markets. So by being active investors, we can influence and push for better strategic decisions. It is through engagement and voting that large energy companies have come to developing 'two-degree scenarios'.

Because Candriam develops best-in-class strategies for its clients, meaning that no sector is discriminated against, our focus is on picking best managed companies, those best positioned for the energy transition."

Candriam's best-in-class strategy means the bottom 50% of any sector will be dropped in the initital sorting. Regarding emissions data, Le Jeune argued that the entire low-carbon index debate is driven by Scope 1 and II emissions data whilst the energy transition debate should focus much more on Scope III.

In Grant's latest report on Chevron, he claims the US oil major for the first time comes close to acknowledging stranded assets in describing the future of various different projects. Exxon recently bowed to sustained investor pressure to disclose more detail on its scenario planning. Looking back further, in the last phase of BP under Sir John Browne's leadership, the company made a strong push into renewables – only to sell off many green projects following the Global Financial Crisis.

Most Low Carbon indices react to such increases and decreases in a company's green revenues. They follow Lejeune's thinking that exclusion is a crude means of tackling overheating. But active managers can be bolder in predicting the long-run value of energy companies' green activities.

Burger explain Newton's broad approach: "For our sustainable funds, we avoid companies not in line with the IEA's 450 scenario. We then apply an oil extraction cost of $140 a tonne. Is the company still profitable at that price? Then there has to be a minimum 25% spend of Research and Development on Low Carbon tech.
As crude starting points, these three criteria have worked well, according to Burger.
Le Jeune said that Candriam has a rigorous but flexible ESG framework that enables delivery of fossil-free solutions when required by its clients (The manager has just devised a bespoke, fossil-free segregated mandate for a large institutional client).

Referring back to benchmark risk, Le Jeune added: "As asset managers we aim to find the best solutions for their clients. When clients want to invest within the constraints of the benchmarks, then it is our role to make the best stock-picking and the most of engagement activities. We as asset managers cannot simply turn our back on High Carbon sectors. Our ESG research framework heavily penalises companies which present climate and resource depletion risks though. These score negatively against smarter carbon peers in their industry. It's a positive screening approach, which factors in Scope 3."

> "When clients want to invest within the constraints of the benchmarks, then it is our role to make the best stock-picking and the most of engagement activities. We as asset managers cannot simply turn our back on High Carbon sectors"

Engage or break up?

This brought up the issue of engagement. Ripman claimed that engagement can only really be effective if there is the threat of divestment, probably accompanied by publicity around the event by the divestor. He told the CAMRADATA panel how Storebrand had publicly called on Statoil to divest from tar sands in Canada, and was visited by the representatives from Alberta as a result of its campaign.

> "Engagement can only really be effective if there is the threat of divestment, probably accompanied by publicity around the event by the divestor"

Ripman is used to such tough conversations. "Conversations with companies have ranged from the constructive to the downright difficult," he said. "Some companies still do not understand why we cannot invest in them even after huge corruption scandals." Amandeep Shihn, who leads on Emerging Markets Equity and Sustainable Investment Manager Research at Willis Towers Watson, said divestment didn't solve the problem for society as a whole; the divestor had simply forgone their responsibility for the remedy, passing it on to others who bought their shares. He described passive investors as "the ultimate long-term owners of companies" and made the point that managers of these passive assets, such as BlackRock, Vanguard and Legal & General Investment Management, have a responsibility to engage with companies for the purpose of improving corporate practices and ultimately creating value for investors over the long-term. Honor Fell, a consultant at Redington which advises large institutional investors including pension funds, agreed that passive investors were under increasing pressure.

Minsky moment

Varco quoted Mark Carney, governor of the Bank of England and chair of the Taskforce on Climate-Related Financial Disclosures, that the next wake-up call for capitalism from the environments would not come gradually but a shock event that sharply reveals the frailty of the financial sector because of its exposure to climate risk. Carney has spoken about a climate 'Minsky moment' – referring to economist Hyman Minsky's analysis of how banks overstretched prior to the Financial Crisis. Minsky's point was that long periods of prosperity contain the seeds of their own destruction. In the case of climate change, it is inertia based on the absence of widespread natural disasters in rich countries. "My hunch for this shock event is a deluge on Miami," said Varco.

But there are complications and dilemmas for some institutional investors in preparing or mitigating a 'Minsky moment'. What about pension funds sponsored by heavy carbon-emitters: what is their approach to an overheating world given there will be increased covenant risk if emissions targets bite?

Fell said this was a big issue for such funds and an environmental audit of investments was one way of assessing the size of the issue. There is parliamentary pressure in the UK on financial regulators, including the Pensions Regulator, to make climate change an explicit consideration for those in the financial chain.

But Fell added that asset owners should take stock of their holdings first: “Assess the risks before making any change. Institutional investors should ask themselves: “How sustainable are my investments today?” After answering this question investors are in a position of knowledge. They will understand better what needs to be done to meet sustainability goals.”

Reza Mahmud, an investment consultant at PwC, agreed: “Most clients want to do something. But there is a danger that all this data exacerbates the impulse to act. They aren’t reluctant but they do have resource constraints on their governance,” he said. Burger added that in his time he had witnessed a tremendous improvement in the knowledge of pension fund trustees on matters of Responsible Investment, and a corresponding increase in the number of questions to Newton on the topic.

> “There is parliamentary pressure in the UK on financial regulators, including the Pensions Regulator, to make climate change an explicit consideration for those in the financial chain”

Sinking without trace

A shadow was thrown on the general optimism about mitigation, however, when it came to the role of Carbon Capture and Storage (CCS). These underground sinks are an integral part of the scenarios for reduction emissions from the IEA and other bodies. But Ripman observed that unless CCS facilities start getting built on a serious scale, there is no way they can perform the function expected in the scenarios. He told the panel that Statoil’s two facilities in Norway store less than 2m tonnes of carbon, which is negligible in the face of annual global emissions of 37bn tonnes.

“Basically you would have to build storage with the surface area of India to meet the IEA scenarios,” he said. “But you can’t put these things up overnight. Which explains why the oil majors’ scenario-planning does not go beyond 2050: they know what the absence of CCS means for global warming. It’s scary.”

Grant agreed: “Regardless of the target temperature rise, you have to stabilize and that means negating emissions. Cutting them is not enough. We have the technology, so it can be done but the economics are not yet there. We need regulatory impetus and governmental backing.”

Company culture

The conversation then turned to the culture of asset managers and investee companies. The asset managers at the table were asked if their organisation situated ESG teams alongside portfolio management. “If they are on different floors, then you know the ESG team does not have sway,” claimed Ripman. “I know from experience: I used to be an analyst and I had to take the lift to speak to portfolio managers.”

That was in the days when ESG centred on exclusions. Ripman noted that these days there are more discussions on opportunities.

> “It’s a fail if any portfolio manager has to have an ESG specialist by her side when explaining their approach to analysing and engaging investee companies”

Mansley said: “From my perspective, it’s a fail if any portfolio manager has to have an ESG specialist by her side when explaining their approach to analysing and engaging investee companies. Portfolio managers ought to have this stuff at the top of their mind.” Burger said that for Newton’s sustainable funds, the ESG team has right of veto on any holding. This means however much a portfolio manager likes a company, it cannot be included in these funds if the ESG team has rejected it.

This is also the strength of building best-in-class universes where the ESG team has a strong say, according to Candriam. Le Jeune believed there was a generational shift in asset management regarding extra-financial factors. “Lots of older managers were trained to undertake analysis without these criteria. They find it hard to change the habits of a working lifetime whereas younger portfolio managers naturally incorporate ESG into their models. It should ease the transition to ESG integration dramatically going forwards.”

On the culture of asset owners, Mansley said Brunel PP’s ten owner funds have spent a lot of its formative months deciding on their beliefs. “The first is very basic: We are long-term investors,” he told the CAMRADATA panel. Basic as it is, the belief is profound because it acts as a stabilising defence against the temptation to react to short-term market moments, such as a blip in manager performance.

This is in line with Shihn’s prioritisation of mission and beliefs before making asset allocation decisions. Like Mansley and Mahmud, Shihn feels asset owners should proceed from a sure set of beliefs rather than seek to take action like buying a new ESG fund because this is what some peers might be doing.

Shihn noted that some of WTW's pension fund clients might have only 10%-15% of assets in public equities with the bulk being in fixed income assets as this "better suits their liability profiles".

This suggests that changing public equity portfolios to reflect their ESG beliefs might be a lower priority for trustees given the finite governance budgets. He also said that private market investments can provide alternative and financially attractive means to express sustainability themes within a portfolio context. Hydroelectric dams, social housing, solar farms and sustainable agriculture projects are just some of the investments WTW's Private Markets team has accessed recently. Shihn emphasised, however, that these are not commitments made by a priori ESG criteria; they qualify as good quality long-term investments, but they also happen to have positive ESG attributes.

Mahmud said that if you think about the rapid changes in the world, then infrastructure is an important catalyst as it's a fundamental enabler of economic productivity. In private markets there is greater concentration of ownership and therefore naturally greater propensity for corporate engagement to occur, according to Shihn. Ripman said there had been arguments for Norway's Government Pension Fund Global, instead of its very broad ownership of a percentage of all major quoted companies, to take majority stakes in those companies it wished to change.

> "Our first priority is to look after investors. There are limits to the extent to which we can change the world beyond this"

Mansley countered that any one investor had to be pragmatic in its aims as the (part) owner of a business. "Our first priority is to look after investors. There are limits to the extent to which we can change the world beyond this."

He added that the problem as a Limited Partner in private equity stakes was that if an investment turned out to be less [green] than expected, it was expensive to remedy the situation, unlike with public securities.

On long-termism in public markets, Mahmud noted that one sovereign wealth fund needed to allocate more to their in-house teams for listed equities as the external asset managers tended to focus on a much shorter timeframe than the fund's own intergenerational investment objective.

> Investing holistically can be defined as the endeavour to understand and sustain the best types of organisational culture

Who wants to run a plc?

This led nicely on to corporate short-termism. The CAMRADATA panel was asked whether directors of quoted companies provide better stewardship than in previous decades or whether they have lost their way under the pressure of quarterly reporting and overinflated pay packets.

Le Jeune said that there was certainly room for improvement. “We are at the beginning of the debate but there is certainly more pressure to push directors this way.
We need to set the right kind of performance targets.”

“Is the voice of long-term investors loud or clear enough?” asked Mansley. “Have we put directors under so much pressure that no ordinary person would want such a job? There is a risk that only psychopaths will take a CEO’s role, or at best someone who is focused on earning silly sums of money for just a few years in the job,” he said. “Organisations and the people who run them need an openness of mind,” added Ripman.

Varco alluded to a recent MSCI study which found that companies with a dual share structure, often created to protect the influence of a founder, had outperformed single-share class companies. He noted that the study was over the last ten years and thus influenced by the fortunes of recently floated Silicon Valley giants. The point remains that it is hard to establish best corporate governance practice by a few simplistic criteria. Burger highlighted that the concept of shareholder primacy, that puts shareholders’ interests first and foremost, is being hotly debated in key markets. There is scope for the legal definition of “corporate purpose” to be changed, such as the underutilised section of UK company law surrounding director duties being defined and tested. This could have a material impact on corporate short-termism.

Mansley concluded that perhaps investing holistically can be defined as the endeavour to understand and sustain the best types of organisational culture.

CAMRADATA's Assisted Searches

For institutional investors with very specific manager search requirements, we run assisted searches on their behalf. This service is free of charge for institutional investors.

> "CAMRADATA Assisted Search added a new dimension to our tender process. We were able to narrow the field in terms of the service we were after and gain interest from a wide range of market participants. A bonus was the help we received in coordinating a presentation day and providing a central neutral location at which to meet."
>
> **Peter Beaumont, Finance Director, Cornish Mutual**

Below highlights just some of the asset classes CAMRADATA Assisted Searches have covered over the past quarter:

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Using a lean, green weighing machine

Two trends dominate institutional investing today: allocating capital responsibly and allocating capital by quantitative factors. The first looks towards sustainable long-termism. The latter looks to extract the benefits of active investing cost-effectively. Both trends are captured by Candriam's range of bond and equity ETFs.

Investors have been challenging the notion that traditional benchmarks represent their default guide to allocating capital. Nowhere is this more evident than in the wish to allocate capital responsibly for the long-term.

Our research shows that investing by responsible criteria per se improves risk-adjusted returns in bond and equity markets. To do so requires reshaping and refining the standard bond and equity indices. We reject over one-third of the constituents of each major regional bond and equity index in the first step of our refining process, which is based on companies' sensitivity to global trends – macro analysis - and their relationship with other groups in the business chain, including customers and suppliers – micro analysis.

> "Only a handful of factors capture risk premia that make for superior returns. Among this handful of rewarded risk premia, Candriam's ETFs target size, quality, low volatility, momentum and value"

MACRO

- The company's exposure towards global trends such as climate change
- Resources depletion
- Emerging economies
- Demography
- Interconnectivity
- Social well-being

MICRO

- The company's behaviour towards employees
- Suppliers
- Investors
- The environment
- Countries in which it operates

For sovereign issuers, we have four criteria: Human Capital, Natural Capital, Social Capital and Economic Sustainability which are equally weighted. To give just a flavour of the sub-criteria, Natural Capital looks at each country's total emissions, waste treatment, ecosystems and biodiversity, water consumption and transport policy inter alia.

Our universe of potential investments thus starts with the top 70% from each industrial sector by these analyses. We further apply a screen by the criteria of the UN Global Compact as a further check on unsuitable companies. For countries, we insist on minimum standards for democracy and lack of corruption.

Such a strategy alone would make for an interesting, robust and beneficial product.

But it lacks consideration of another major trend in investing: the emergence of a 'via media' between traditional active and passive known as factor investing, which can demonstrably improve risk-return profiles still further.

There are literally hundreds of factors to every company. We could equally call them characteristics or facets. For example, the number of vehicles used by that company is an analysable factor, and one we can compare with peers. But only a handful of factors capture risk premia that make for superior returns. Among this handful of rewarded risk premia, Candriam's ETFs target size, quality, low volatility, momentum and value.

The first step in the factor process is to reduce characteristic flaws of bond indices (allocating to the most indebted) and equity indices (overweighting past winners).

In fixed income indices, the more debt an issuer takes on, the greater influence it carries in the index. By the end of 2016, the first quintile of issuers in the European Economic Area Eurobond universe had an average debt to GDP ratio of over 43% while the lowest quintile averaged just 0.4%. The rational investor would not want indebtedness to decide the weightings of their portfolio. Nor would their issuers to decide their duration exposure, but this happens in bond indices because issuers lengthen the term of their debt when interest rates are low and shorten them when rates rise.

The parallel flaw in equity indices is that 'glamour' stocks attract too much capital. They tend towards a high allocation in stocks with hefty Price-Earnings ratio, leading to investing predominantly in expensive stocks. Equity indices are consequently less diversified than people assume.

In contrast, our methodology largely mitigates both types of flaws. First, by widening the universe for securities beyond standard indices whilst capping the maximum exposure any issue, issuer or company can have. In corporate bonds, we limit the number of issues per issuer to ten and the maximum weight of any issue to 0.5% of the portfolio. In equities, we ensure that 50% of the portfolio is allocated to a certain minimum weighting.

After refining the universes by Responsible criteria and then weighting by fundamental economic measures, we apply a combination of explicit factor tilts from our chose handful of size, value, momentum and quality. It is important to highlight that combining multiple factors into one portfolio greatly improves risk-adjusted returns compared to mono-factor smart beta funds.

For each regional universe e.g. European equities, we rank each stock by preferred factor. From the results each stocks is placed within a quintile. We then tilt the previously established responsible and economic weighting of stocks according to their quintile. The final result is a broad exposure to the universe, not a narrow portfolio.

The evidence suggests we have a successful formula. The table below for real portfolios shows superior risk-adjusted returns characteristics for our strategies versus market cap indicies.

"The rational investor would not want indebtedness to decide the weightings of their portfolio. Nor would their issuers to decide their duration exposure, but this happens in bond indices because issuers lengthen the term of their debt when interest rates are low and shorten them when rates rise"

COMBINED MULTI-FACTOR METHODOLOGY STATISTICS

The table below outlines statistical data relating to the combined multi-factor methodology between 2016 and 2017 prior to the launch of Candriam's range of bond and equity ETFs.

	European Equities*	EMU Equities*	Japan Equities*	Corporate Bonds*	Government Bonds*
Annualised Return	9.62%	11.66%	6.94%	3.65%	2.58%
Annualised Std Dev	17.87%	17.81%	21.12%	1.88%	1.83%
Annualised Sharpe (Rf=0%)	0.54%	0.65%	0.33%	1.95%	2.46%
Maximum Drawdown	16.93%	16.72%	20.58%	-0.19%	0.74%
Historical VaR (95%)	-1.68%	-1.66%	-2.02%	-	4.00%

*Source: Candriam, Bloomberg. *Equities & Corporate Bonds = Jan 2016 - May 2017, ** Government Bonds = May 2016 - May 2017*

Written by
Fawzy Salarbux,
Global Head of
Consultant Relations

In conclusion, conventional benchmark indices do not prioritise the most responsible or sustainable sources of capital. To appropriate Keynes' maxim, they are voting machines in the short term. Candriam's ETFs, on the other hand, have been constructed as machines to weight companies and borrowers for the long run.

For any further information, please contact Fawzy Salarbux, Global Head of Consultant Relations, (fawzy.salarbux@candriam.com).
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Our responsibility: investing with you for future generations

Pioneers in responsible investment for 20 years

In recent years, as topics such as climate change – and the considerable risks that it presents to our planet and to humanity – have risen up the agenda, there has been a growing global awareness of environmental and sustainability issues and the impact they can have on investments. Against this backdrop, we have also seen increasing conviction from asset owners that careful consideration of sustainable criteria can lead to better long-term investment outcomes.

This marks an evolution from the traditional strategy of excluding certain sectors (which, in our view, can be rather simplistic). Instead, a sustainable approach uses environmental, social and governance (ESG) analytics to differentiate between companies based on their actual fundamentals and strategies rather than their sector classification. We believe that this more engaged approach can help investors to avoid poorly performing companies and identify higher-quality companies regardless of their sector.

The case for ESG

This thinking has been backed up by a broad range of academic research. Since the 1970s, academics and investors have published over 2,000 separate studies looking at the relationship between ESG criteria and corporate financial performance. In 2015, a meta-study was published, combining the findings of these previous studies.[1] The aggregated evidence makes a positive case for ESG investing by highlighting how a large majority of the studies have shown that companies with positive ESG credentials have performed better, and that the ESG impact on financial performance appears stable over time.

Further research has served to show how active ownership – engaging with companies to address ESG-related concerns – can also have a beneficial effect on performance. One study analysed an extensive proprietary database of corporate social responsibility engagements with US public companies over a 10-year period from 1999-2009.[2] The findings showed that, after successful engagement, companies experienced improvements in operating performance, profitability, efficiency and governance. Furthermore, if engagement with a company turned out to be unsuccessful, there was no negative impact on investment returns.

> “Remaining invested in oil & gas companies could provide the best opportunity to enact change through engagement: a big oil company may be the very business with sufficient resources to research and invest in alternative, ‘greener’ energy sources for the future”

Engaging on climate change

Engagement with companies could be particularly relevant in the context of climate change, which is likely to become an increasingly significant investment topic as investors are challenged to disclose what they are doing in terms of identifying and taking action on climate-related risks and opportunities. While some investors have come under pressure to implement some form of fossil-fuel exclusion, the degree to which we are reliant on fossil fuels make this a far more complex divestment discussion than other historical campaigns such as tobacco and apartheid. Furthermore, if investors choose to exclude fossil-fuel investments from portfolios, they will in effect become powerless to make their voices heard by companies in the sector. Conversely, remaining invested in oil & gas companies could provide the best opportunity to enact change through engagement: a big oil company may be the very business with sufficient resources to research and invest in alternative, ‘greener’ energy sources for the future.

We believe engagement is an effective way for investors to make progress in this area. We recently joined a collaborative investment group, Climate Action 100+, a five-year investor-led initiative (with combined assets under management of £20 trillion) which works to engage with the world’s largest corporate greenhouse-gas emitters to improve governance on climate change, curb emissions and strengthen climate-related financial disclosures. A further initiative is the Task Force on Climate-related Financial Disclosures (TCFD), which provides recommendations on the climate-related information that companies should disclose to help investors make sound financial decisions. We integrate the recommendations made by the group in our engagement with companies, and a member of our team sits on the PRI (Principles for Responsible Investment) TCFD advisory group, which aims to establish recommendations for company engagement on this topic.

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1 ESG and Financial Performance: Aggregated evidence from more than 2,000 empirical studies, Journal of Sustainable Finance & Investment (Friede, Busch & Bassen), 2015
2 Active Ownership (Dimson, Karakaş and Li), The Review of Financial Studies, December 2015

> Although it is still debatable to what extent millennials' words of support for such an investment approach will be matched by their actions, it is estimated that this cohort will form 75% of the global workforce by 2025

Written by
Rob Stewart,
Head of Responsible and Charity Investment

Meeting millennials' expectations

One of the key drivers behind the growth in interest in sustainable investing in recent years has been the 'millennial' generation, which can broadly be defined as people born between the early 1980s and early 2000s, and which has become known for being technology-savvy, liberal, well-educated and socially and environmentally aware. According to research conducted by Morgan Stanley, 86% of millennials say they are interested in socially responsible investing. Millennials are also twice as likely to invest in a stock or a fund if social responsibility is part of the value-creation thesis.[3] According to the Schroders Global Investor Study 2016, which surveyed 20,000 end-investors in 28 countries, the millennial generation ranked ESG factors as equally important as investment outcomes when considering investment decisions.[4] Although it is still debatable to what extent millennials' words of support for such an investment approach will be matched by their actions, it is estimated that this cohort will form 75% of the global workforce by 2025,[5] and therefore the industry will ultimately need to respond to the changing requirements of both millennial and other modern-day investors.

Sustainable 'red lines'

While many asset managers now incorporate ESG considerations into their investment process, sustainable and 'impact' strategies (investments made to generate a measureable social or environmental impact) are far less commonplace. At Newton, responsible investing has been a key part of our investment process for a long time, and we see sustainable investing as a natural evolution of this. Sustainable investment strategies move beyond ESG integration, putting ESG factors at the forefront of decision-making. In our view, the key elements of a successful sustainable investment approach include:

- Investing in companies that positively manage the material impacts of their operations and products on the environment and society, as well as businesses that have unrealised ESG-related opportunities.

- Giving responsible investment specialists veto power in the stock-selection process, enabling them to prevent a sustainable portfolio from holding a particular company. This transfers the ultimate discretion from a portfolio manager, where it traditionally lies, to specialist responsible investment analysts. We see this as a subtle but important shift, signalling a change in the priorities of the considerations that shape a portfolio – both to an investment team and to the external world.

- Establishing engagement plans with set timelines for companies that can be helped to improve through engagement.

- The use of 'red lines' to rule out certain companies from being considered for investment in sustainable strategies, such as those companies that are not aligned with the UN Global Compact's ten principles that promote responsible corporate citizenship, or with the aim of limiting global warming to well below 2°C.

We regard such considerations as increasingly important as client demand for ESG-oriented and sustainable strategies increases. Investors may feel that sustainable and impact investing comes with considerable challenges, in particular the difficulty of measuring the positive impact of an investment, as data provided by companies can be unreliable and often difficult to collect in rural or developing areas. However, we think ESG factors and sustainable investing are likely to become increasingly significant for investors as time goes on, and therefore the importance of addressing such issues ever more critical.

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3 https://www.morganstanley.com/ideas/millennial-sustainable-investing

4 http://www.schroders.com/en/media-relations/newsroom/all_news_releases/schroders-global-investor-study-2016-millennials-put-greater-importance-on-esg-factors/

5 https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/gx-dttl-2014-millennial-survey-report.pdf

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GROWING SUSTAINABLE FUTURES

Our sustainable investment strategies seek to help investors achieve their long-term goals in a responsible manner. We put environmental, social and governance (ESG) analysis at the forefront of our investment process in order to identify companies that have attractive investment attributes and manage positively the material impacts of their operations and products on the environment and society.

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NEWTON

Investment Management

Part of

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.

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Sustainable investments is a discipline that considers environmental, social and governance (ESG) criteria to provide long-term financial returns and simultaneously contribute to sustainable development. The field has grown steadily with the increased assurance that management of funds in accordance with sustainability criteria also promotes financial returns. With numerous approaches ranging from Socially Responsible Investing (SRI) to social, ethical, mission-based or impact investing, the field has evolved from a narrow scope to a broader integration of ESG factors.

Since the launch of the UN Principles for Responsible Investments (PRI) in 2006, the number of signatories who support responsible investments has grown from the initial 100 to over 1 800 across 50 countries. With the signatories' US$ 68 trillion under management, the expectation of sustainably managed funds has evolved from niche to norm. While sustainable investments are increasingly mainstreamed, there is still work to be done on standardization and methodology. Could the UN's Sustainable Development Goals (SDGs) be the next step forward?

> "The risk/ opportunity outlook for companies and their alignment towards the SDGs opens for a shift in investments towards agile and future-oriented companies"

The Sustainable Development Goals are global guidelines to end poverty, protect the planet and ensure worldwide peace and prosperity. The SDGs have significant global backing both on a company and state level, since all UN's 193 nations and thousands of businesses have contributed to shape the goals. A dedicated SDG Fund has been set up by the UN to support sustainable development activities through public-private partnerships. The finance sector plays an integral part in the progress on accomplishing the SDGs by 2030. How should the finance sector approach the SDGs, and how can asset managers in particular contribute to SDG progress?

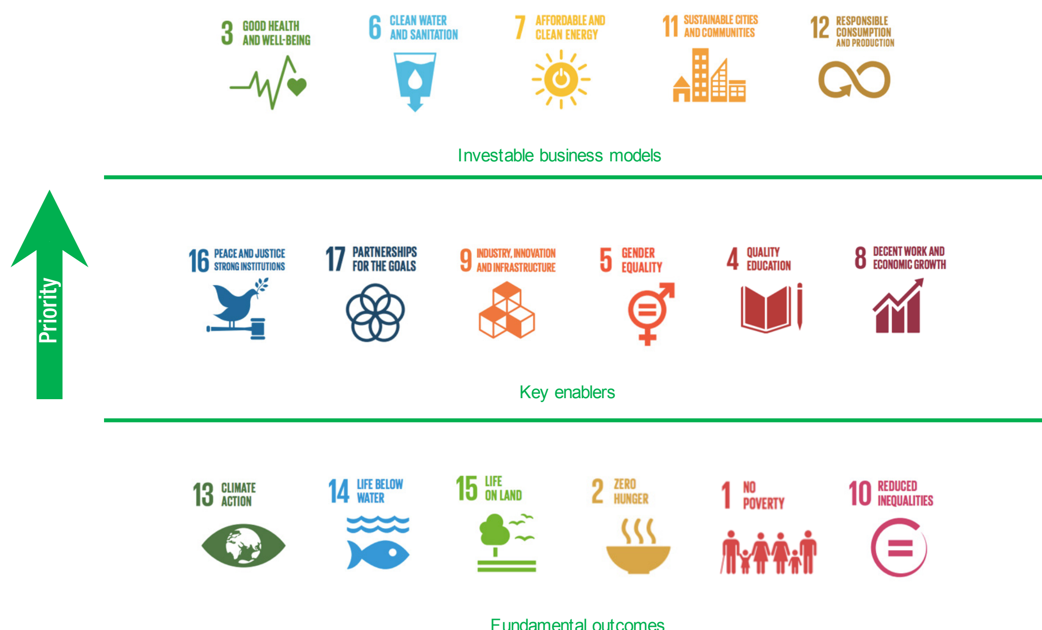
Several actors are at the forefront of SDG integration. CalPERS, the largest pension fund in the US, is already one of the global leaders in company ESG risk engagement. CalPERS' chief investment officer, Ted Eliopoulos, has characterized the SDGs as a "gift to investors". After the Board directed the $357 billion portfolio to be aligned with the SDGs, the fund is taking its sustainability investment plan to a new level.

The Dutch pension fund managers PGGM & APG Asset Management have also been at the forefront of aligning their investments with the SDGs. Their finalization of SDG investment opportunities in 13 of the 17 SDGs is well underway, and the approach is to be integrated across all asset classes. With $705 billion in AUM, the two investors aim to make a substantial contribution to the SDGs while fulfilling the risk return requirements of their clients.

Storebrand established a team for sustainable investments in 1995. We have followed the development in the field closely ever since, and as a consequence has evolved its ESG process accordingly. We see the SDGs as a promising framework which resonates with both investors, investees and governments. Storebrand Asset Management (SAM) has identified the most material SDGs from an investment perspective.

The risk/ opportunity outlook for companies and their alignment towards the SDGs opens for a shift in investments towards agile and future-oriented companies. Our approach is that resilient business models that promote the SDGs can maximize long-term financial returns and provide positive effects on ESG factors.

Our analysis led to three SDG categories: Investable business models, key enablers and fundamental outcomes. The first is product oriented, with many measurable and company-specific sub-indicators. Secondly, the key enablers are important tools to achieve the first category, but the goals are more operationally oriented. Examples include anti-corruption in goal 16 and gender equality in goal 5. The third category, fundamental outcomes, is more state oriented and less directed at companies' products or operations. If companies have sound management in line with the sub-targets and indicators of the first two categories, there will be a positive effect also in the third SDG segment.



Storebrand's categorization of the SDGs after how financially relevant they are from the investor perspective. Where can our investments maximize both profits, ESG factors and long-term growth?

To enable the integration of the SDGs in financial analysis, there is a need to quantify the sub-targets and indicators of the most financially relevant SDGs. An example of such indicators is the share of renewables in the energy mix or the energy efficiency of companies in a comparable sector. These indicators are both relevant and measurable, and have consequently gotten their own key performance indicator (KPI) developed internally as a part of Storebrand's sustainability rating. Our in-house sustainability rating has been adjusted to include the most financially relevant targets and indicators. The sustainability rating will optimize company selection in alignment with the SDGs. These enhancements will be implemented across all asset classes before the summer of 2018.

Many financial actors have already embraced the SDGs. The goals provide an overview of areas that need financing towards 2030, but also provide a common language to connect governments and businesses. The implementation of the SDGs in investments contribute to an understandable framework that improves the overview of sustainable investment risks and opportunities. The UN has succeeded before in uniting the financial sector through the UN PRI movement. The SDGs therefore provide a useful framework going forward as they promote engagement on common ground. Long-term sustainable growth seems to be found at the intersection between classical financial analysis and SDG optimization. Functioning both as guidelines and a source of financial returns, the SDGs will drive the field of sustainable investments towards 2030.

"The implementation of the SDGs in investments contribute to an understandable framework that improves the overview of sustainable investment risks and opportunities"

Written by Sunniva Bratt Slette, Sustainability Analyst

Storebrand is the largest private pension in Norway with over US$80 billion assets under management, second only in size to the trillion dollar Norwegian government pension fund. Storebrand started working on sustainability issues in the mid-90s, which was early by industry standards. However, that early work has allowed us to stay at the cutting edge of the field. Today we employ one of the most experienced ESG teams globally. This permits us to set the highest of standards across all of our investments by creating a range of ESG products that are tailored to the industry's requirements and the challenges of the future. The group as a whole has won global accolades for sustainability: We are currently ranked first of all insurance companies at the Corporate Knights ranking of the 100 most sustainable companies.

Storebrand Asset Management – Fossil free funds

We believe fossil free strategies are a powerful tool, helping to shift billions away from investments without a longterm future, and into attractive investments with a positive climate impact. The launch of Storebrand's fossil free funds responds to the growing public concern over climate change, and these funds are our contribution to the growing global divestment movement. We recently sold even more coal companies because we see these investments are detrimental to our climate and are financially unsound.

We are the largest private asset manager in Norway and provides a broad range of services within investments to over 250 institutional clients in the Nordic region managing US$80 billion across all asset classes.

Storebrand has been at the forefront of socially responsible investing and has had Environmental, Social and Governance (ESG) issues as a core value since the mid 1990's. Storebrand's own in-house ESG-team, established in 1995, is central to Storebrand Asset Management.

Our history goes 250 years back in time, and we prepared to continue to set the standard for sustainability investments for the next 250 years.

storebrand

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