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CAPITAL MANAGEMENT
A member of the La Française Group

Mapping of global responsible investment best practices

Project under the general agreement
between the Norwegian Ministry of Finance
and Inflection Point Capital Management

December 2017

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Acknowledgements

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Matthew Kiernan, CEO, Inflection Point Capital Management and Michael Marais, Strategic Advisor to Inflection Point Capital Management.

Quality and proof-reading
Gordon Noble, Principal Advisor at University of Sydney (Better Infrastructure Initiative) and previous Managing Director at Inflection Point Capital Management.
Roger Surridge, editorial design consultant.

The authors are grateful for valuable contributions on specific information relevant to Sections 2.2.2 and 2.2.3 in the report from the following organisations:
DANSIF
FINSIF
NORSIF
SWESIF
UKSIF
International Corporate Governance Network
PRI
UK Financial Reporting Council

List of Acronyms

AODP	Asset Owner Disclosure Project
ACGA	Asian Corporate Governance Association
CBI	Climate Bond Initiative
CDP	Carbon Disclosure Project
FASB	US Financial Accounting Standards Board
FASAC	US Financial Accounting Standards Advisory Council
FCLT	Focusing Capital on the Long Term
FRC	UK Financial Reporting Council
GRESB	Global ESG Benchmark for Real Assets
ICGN	International Corporate Governance Network
IFRS	International Accounting Standards Board
IIGCC	Institutional Investors Group on Climate Change
INCR	Investor Network on Climate Risk
PDC	Portfolio Decarbonization Coalition
PRI	Principles for Responsible Investment
RI	Responsible Investment / Investor
SASB	Sustainability Accounting Standards Board
SEC	US Securities and Exchange Commission
TCFD	Financial Stability Board Task Force on Climate-related Financial Disclosures
TPI	Transition Pathway Initiative
UNEP FI	United Nations Environment Programme Finance Initiative
UN SDGs	United Nations Sustainable Development Goals

Executive Summary

A group of the leading asset owners, varying in scale, function, and focus, established in a range of jurisdictions worldwide, are making responsible investment (RI) an integral part of their management.

These institutions, tasked with safeguarding and growing the savings of millions of citizens, workers and retirees, are implementing changes to embed environmental, social and governance (ESG) considerations in their investment policy and investment decision-making activities across multiple asset classes.

Institutional investors are employing a diverse range of governance and organizational arrangements, as well as different approaches and tools, adapted to their specific context in order to take their RI agenda forward. For all funds interviewed, the work to integrate RI in a way that suits their institution in a cohesive manner is a work in progress. Institutions are increasing the resources, often from a low base, that are dedicated to the significant challenge that RI presents and are viewing RI as an essential contribution to being a successful, long-term investor.

The source material for this report is drawn from interviews with a range of institutional investors globally as well as a range of RI experts from a broad selection of countries both developed and emerging.

Both the opportunities and constraints facing large asset owners are qualitatively different from those confronting smaller asset owners. For the largest asset owners, often described as Universal Owners, their investments are so broad and diversified that they essentially own a slice of the global economy and this influences both their investment strategy, often based on a passive approach, as well as the RI tools they employ and the prioritisations they make. For such Universal Owners, there is no escaping negative externalities as one portfolio company's failure to treat pollutants to save money will create undesirable environmental impacts and potentially pass on costs to other portfolio companies in their global holdings.

With a deeper understanding of ESG risks, institutional investors are also beginning to appreciate the investment opportunities presented by the emergence of new industries, the transition to a more diversified, low carbon energy future, and the possible returns from those technologies and services coming to market to put the world on a pathway to achieve the UN Sustainable Development Goals.

Clearly, there is no "one size fits all" that works for all asset owners, large or small, to effectively embed and implement RI in their institutions. Each asset owner will have a different and unique context with varying purpose, mandate, size, legislative constraints, political context and resources.

This report does, however, identify ten common "building blocks" that enhance an institution's chances of hard wiring RI successfully into robust asset management operations that have a long-term and responsible outlook.

Alongside evolving RI standards and other broader market influences, the project interviews identified common "building blocks" that can assist both Universal Owners and smaller funds in creating a robust approach to RI. These include:

1. Leadership from the top;
2. Recognition of long investment horizon;
3. Belief that RI brings net positive benefits;
4. Integration of RI into investment beliefs;
5. Strengthening risk management;
6. Total portfolio approach reflecting organization circumstances;
7. Building partnerships with peer investors;
8. Commitment to engagement;
9. Intermediary alignment; and
10. Commitment to continuous improvement and innovation.

No single institution interviewed exhibited all of the characteristics we describe; the leaders prioritize and focus on those RI measures which add the greatest value in their particular circumstances.

Across the institutions interviewed, we have seen distinct trends worth noting.

For example, there is less reliance on central RI teams and a greater focus on building ESG capability and knowledge within each investment team. Increasingly, RI teams coordinate, supervise and advise as other individual teams across a variety of asset classes run the process.

Often, institutions regard new resources dedicated to RI as an investment in becoming a more effective manager, rather than a cost. The vast majority of institutions interviewed see resources for RI as the worthwhile price of improved investment decision-making. Despite difficulties of quantifying RI's impact on portfolio performance, it's clear that all institutions believe RI has strengthened the level of trust among their stakeholders as well as enhancing the organization's reputation and international profile.

There was a strong consensus among the institutions that a balanced RI programme should embrace both active and passive investment approaches, albeit that different RI strategies and tools are better suited to each. Active strategies are typically much more narrowly focused and company specific. While active management is not an absolute prerequisite for an effective RI strategy, it does provide a greater opportunity to deploy the full range of RI tools than do passive approaches. However, it's clear also that passive strategies are suitable for RI and both active and passive investment styles may be used with RI as an underpinning philosophy, depending on the specificity of a given mandate. Across both investment styles, RI exposes risk factors which may not be picked up by traditional financial analysis, yet could have a material bearing on portfolio performance.

There appears to be a decreasing emphasis on discrete, stand-alone sustainability-mandate portfolios in favour of an attempt to integrate ESG across the institutions' entire investment platforms.

There was a broad consensus that engagement with portfolio companies should be tried first to improve their ESG performance ahead of divestment. When an asset owner employs negative screening they do so because it is in line with the purpose and values of the organization and its ultimate beneficiaries. There is a distinct preference, however, for engagement as a first option as once a company is divested, the investor loses any degree of potential influence to drive improvement.

RI experts interviewed believe that large asset owners should prioritise those RI issues that impact macro-economic growth such as sustainable financial systems, effective corporate governance, corruption, climate change, public health, public education, gender equality and those other systemic issues that underpin or destroy healthy economic development.

Evidence from the policy, regulatory, investor and civil society spheres suggests that, although not yet mainstreamed and embedded across the whole global investment chain, more asset owners will make RI integral to what they do in coming years.

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Background and Framing

The Norwegian Ministry of Finance (the Ministry) reviews Norges Bank's management of the Government Pension Fund Global (GPFG) at the beginning of each term of the Norwegian Parliament. The Ministry intends to present its review in the report to Parliament on the management of the Fund in the spring of 2018.

As part of this four-yearly review, the Ministry has asked Inflection Point Capital Management (IPCM) to prepare a report on Responsible Investment (RI) best practice activities in other large and comparable funds. The assessment should include:

- A description of comparable funds' organization (including policy and guidelines and approaches/tools) and use of resources related to responsible management activities.
- An assessment of what is considered best practice in the above.
- An assessment of the extent to which active management is a prerequisite for or improves the ability to act as a responsible investor.

The project does not involve an evaluation of the RI activities of Norges Bank through Norges Bank Investment Management (NBIM).

In framing the project, IPCM has sought to capture RI best practices across a global selection of asset owner institutions that have implemented RI policies and activities in a systematic manner over several years. Recognising that GPFG is unique in both its size and set-up, IPCM has chosen to broaden the research remit beyond a strict interpretation of "comparable", also exploring RI best practices for funds that deviate in terms of size, set-up and asset allocation strategy. IPCM acknowledges that there are benefits in comparing asset owners with large scale that have both an enhanced ability to resource activities and certain limitations imposed by their size, but such comparable funds in both size, set-up and strategy are difficult to find. However, the similarity in investment practices globally through the widespread application of the Efficient Markets Hypothesis and Modern Portfolio Theory, means that it is also relevant to look at smaller sized asset owners' RI practices.

One of the findings from the research is that a clear tailoring of RI efforts to the unique context of the asset owner in question will help ensure robust implementation and long-term efficiency. At the same time, we see some common denominators and hallmarks for best RI practices amongst a diverse range of asset owners, independent of size. Across the spectrum, asset owners can learn from the experience of other funds whether large or small.

III

Approach

IPCM conducted peer and expert group reviews interviewing key people at Chief Executive Officer (CEO), Chief Investment Officer (CIO), and senior management levels, as well as contributing IPCM's professional insights on RI best practices. To adequately reflect the diversity in RI, as well as the speed at which RI is developing, interviews were conducted with 18 asset owner institutions across 13 jurisdictions. A further eleven experts from around the world, who have deep knowledge of the developments within RI, were consulted.

Those interviewed have been transparent and forthcoming with relevant information. Interview participants are aware that this report will be made public by the Ministry. While research findings are largely assessed at an aggregate level in the main report, 15 asset owner institutions interviewed have agreed that their RI efforts be portrayed in more detailed "RI Profiles" (see Annex II to this report). It is believed that the research findings will thus contribute to the on-going dialogue around current and future development of RI best practices globally.

A list of all institutions and experts who have contributed to the report can be found in Annex I to this report.

The core of the report is divided into four distinct Sections:

SECTION 1 reports how institutional investors that were interviewed for the report carry out their RI operations both at policy level and through implementation in their day-to-day operations. Section 1 also gives a high-level overview of RI practices within the Sovereign Wealth Fund group, and a report of experts' views on what is current RI best practices.

SECTION 2 gives overarching perspectives on RI best practices and explores some of the underlying drivers of these practices and the inherent expectations on funds who want to be RI leaders.

SECTION 3 examines cross cutting investment issues, specifically examining the role of active and passive investment styles relative to RI efforts, the integration of climate change into investment practices, and ethical screening.

SECTION 4 assesses where RI is headed in the next 3-5 years. The last ten years have seen a dynamic development of RI practices and it appears that the next decade will see significant continued momentum.

Definitions of key concepts used in this report

Sovereign Wealth Funds (SWFs): A SWF is a state-owned investment fund consisting of pools of capital derived from a country's reserves, set aside for investment purposes to benefit the country's economy and citizens. The funding for a SWF comes from payments surpluses, official foreign currency operations, the proceeds of privatisations, governmental transfer payments, fiscal surpluses, and/or receipts resulting from resource exports. The definition of SWF excludes, among other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds (funded by employee/employer contributions), or assets managed for the benefit of individuals.[1]

Universal Owner: Universal owners are *"Asset owners who recognize that through their portfolios they own a slice of the whole economy and the market. They adapt their actions to enhance the return prospects of their portfolios, and hence the prospects for the whole economy and the market as well."*[2]

Responsible Investment (RI): RI is a broad term, which has partly grown out of the United Nations-backed Principles for Responsible Investment (PRI)[3] with six principles directing investor practices at its core. The content and understanding of the term has evolved substantially over time and this is on-going. It is often used as synonym to or a term encompassing the following: Environmental Social and Governance (ESG) integration; Socially Responsible Investing (SRI); Sustainable Investing; and Impact Investing.

ESG integration: A process whereby an evaluation of companies' performance and positioning on ESG issues is combined with traditional financial indicators to arrive at a more comprehensive view of companies' risks and investment return potential. Principle 1 of the PRI commits signatories to "incorporate ESG issues into investment analysis and decision-making processes".

1 https://www.swfinstitute.org/sovereign-wealth-fund/

2 Rotman International Journal of Investment Management: http://www.icpmnetwork.com/research-paper/pension-funds-as-universal-owners-opportunity-beckons-and-leadership-calls/

3 https://www.unpri.org/

Section 1

Practitioner and expert views on RI best practices

1.1

Asset owner perspectives

The common denominator among the funds interviewed[4] is that they see broader sustainability issues and the integration of ESG factors as relevant to their investment strategy and operations, and many are regarded as leaders within RI. About one third of the asset owners in this project are founding members of the United Nations-backed Principles for Responsible Investment (PRI) having committed to the PRI in late April 2006, or shortly thereafter. A significant majority of all institutions interviewed, whether PRI members or not, have embedded RI policies and actions in their asset management operations over many years.

It will be apparent from the list of asset owners interviewed (Table 1) that few institutions compare to the Norwegian GPFG in size, set-up and strategy. Size will have some impact on the need to prioritise and the actual priorities in RI strategy and tools that are more suitable and efficient to use. Broadly speaking, a smaller asset owner can be more adept and able to innovate and move money more quickly, whereas a large universal owner is particularly well suited to engage companies, industries, and regulators and through that, positively affect overall markets. A large institution is inherently more visible and may be met with higher expectations because of its visibility. However, with higher levels of transparency and scrutiny through regulation and stakeholder pressure, all asset owners across the board are increasingly expected to explain what they do and how they do it.

Table 1

Asset owner institutions that have been interviewed as part of this project

Institution	Country	AuM (Euro)	Backing Sponsor
AP4	Sweden	36 billion	Government of Sweden / Ministry of Finance
APG (ABP as main asset owner client)	Netherlands	457 billion	ABP (€389bn Dutch civil service pension scheme) is APG's main asset owner client.
CalPERS	USA	257 billion	State of California
CalSTRS	USA	182 billion	State of California
Canada Pension Plan Investment Board	Canada	269 billion	Government of Canada (parliament / federal and provincial ministers)
Environment Agency Pension Fund	UK	3.4 billion	Government of UK (Environment Agency)
ERAPF	France	26 billion	RAFP — French public service additional pension scheme

4 Interviews were conducted between September and November 2017 with 18 asset owner institutions across 13 jurisdictions and supplemented by interviews with 11 industry experts. One institution wishes to remain anonymous. A list of those interviewed is captured in Annex I to this report

Institution	Country	AuM (Euro)	Backing Sponsor
Future Fund	Australia	103 billion	Government of Australia
Government of Singapore Investment Corporation	Singapore	undisclosed (+300 billion according to Sovereign Wealth Fund Institute)*	Government of Singapore
Government Pension Investment Fund	Japan	1.1 trillion	Government of Japan (Minister of Health, Labour and Welfare)
Ireland Strategic Investment Fund	Ireland	8 billion	Government of Ireland (National Treasury Management Agency)
Local Government Super	Australia	6.5 billion	New South Wales (Australia) local government
New Zealand Superannuation Fund	New Zealand	20 billion	Government of New Zealand
NY State Common	USA	163 billion	New York State and Local Retirement Systems (NYSLRS)
Ontario Teachers' Pension Plan	Canada	150 billion	Jointly sponsored by the Ontario government, through the Minister of Education, and the executive of the Ontario Teachers' Federation (OTF)
PGGM (PFZW as main asset owner client)	Netherlands	206 billion	PGGM is wholly owned by PGGM Coöperatie U.A. and was established by the social partners in the health and social sector. Stichting Pensioenfonds Zorg en Welzijn (PFZW), the second largest pension fund in the Netherlands (€185 billion under management), is PGGM's main asset owner client.
PIC (GEPF as main asset owner client)	South Africa	114 billion	PIC is wholly owned by the Government of South Africa. Its main asset owner client is The Government Employees Pension Fund in South Africa, Africa's largest pension fund (€98 billion under management)

* https://www.swfinstitute.org/fund-rankings/

Why responsible investing is a priority

Three issues were identified as key drivers of RI for the asset owner institutions interviewed: long term focus; culture; and investee performance.

Long-term focus: Asset owner institutions interviewed identified a link between RI and long-term performance. One third of those interviewed expressly state that they view RI as enabling them to be better long-term investors. Asset owners recognise that there is a need to ensure systemic resilience for their funds, with issues such as climate risk, resource scarcity, income inequality and corruption increasingly seen as relevant to operations and investment performance. Some asset owners interviewed explicitly emphasised the need to align their funds' overall reporting frequency with a long-term outlook. High reporting frequency is viewed by these asset owners as a catalyst for short-term investment behaviour, which is un-helpful for funds with a long horizon. These funds are advocating annual rather than quarterly reporting from long-term asset owners, or in the case of one institution; reporting every four to five years, rather than annually.

Culture: One third of asset owners referred to their organization's culture, purpose, and ultimate beneficiaries as a very strong driver for RI. Individual funds and smaller groups of funds referred to trust building, the ability to attract new members, and good stewardship as reasons for why they prioritise RI.

Investee performance: ESG factors are seen, by a majority of interviewees, as drivers — or barriers — to profitability and shareholder value. Companies that are doing well according to ESG parameters are expected by these asset owners, to do well financially in the long term. It is believed that an ESG perspective improves risk management.

Embedding RI in investment beliefs, strategy and mandates

All asset owners interviewed acknowledge RI as a priority at some or various levels in their fund's policy framework, including investment beliefs, statement of investment principles, overarching RI policy, asset class-specific RI policies, and external mandate templates. There was a general recognition that high-level board support combined with clear and precise instructions in policies and mandates will ensure efficient RI operations.

Investment beliefs/Statement of Investment Principles: Over half of the respondents say that their fund's investment beliefs encompass RI. The majority have reframed their beliefs in recent years to encompass RI, sustainability, and ESG integration.

Board and senior executive buy-in: For the majority of those institutions interviewed, there is high-level board approval for RI. Explicit board support around the importance of RI translates into efficient operations and a commitment throughout the organization. Top management of these institutions are recognising the investment case inherent in RI.

General RI policy across asset classes: The majority of institutions interviewed have an RI policy in place that applies across asset classes. Management is focused on ensuring that the RI policy is communicated and implemented consistently across the whole portfolio, and individual investment teams are given responsibility for integrating RI into the respective asset class.

Cross institution buy-in and expectations on external managers: A majority have very clear expectations on the implementation of the RI policy, both in-house and with external managers. Asset owners emphasise that getting to this point involves building new culture and new knowledge. There is less reliance on a central RI team, and more reliance on building capability and knowledge within each investment team to consider ESG factors from the standpoint of materiality. Several asset owner institutions have established internal task forces and teams with direct backing from the board that are explicitly looking at how RI and ESG integration should be implemented. Those asset owners that rely mostly on external managers place importance on giving clear mandates where RI/ESG integration expectations are included from the outset. This is combined with systems set up to monitor manager performance across given parameters.

Collaboration with standard setters and service providers: A handful of asset owners interviewed point to their reliance on and collaboration with standard setters and external providers as important in order to achieve the type of reporting that will give rise to ESG data that they can integrate.

Implementation of RI in asset management operations

Clear cross industry trends: There are two highly visible trends among the majority of asset owners interviewed:

a) RI is implemented through systematic cross-team collaboration;
b) A total-portfolio approach guides RI implementation.

Total portfolio approach: There is general acknowledgement that a "total portfolio approach" is a big task and that different asset classes require different RI policies. Several of the asset owners interviewed have defined near-term plans to systematically expand ESG integration across the board.

RI capability decentralised: Where a dedicated RI team exists, that team works continuously and directly with investment, risk, audit and compliance teams. The RI team will in most cases report directly to the CIO. Some asset owners choose not to have a specific RI team but require all investment teams to develop processes to integrate ESG considerations into the operation/asset class in question. This goes hand-in-hand with a view that RI is relevant to long-term risk management and performance.

Monitoring managers: Half of the asset owners interviewed indicated that a stricter and tighter process for selection, guidance and monitoring of external managers is in place. There is also more attention to rating managers on ESG integration, for instance on RI policy, staffing and the degree to which the manager implements the RI policy. One fund interviewed said that they use PRI assessments and benchmarking of asset managers actively in their manager selection process. Another fund asks all its managers to be signatories to the PRI.

RI tools

There is a broad variety of RI tools used among the asset owner group interviewed, including: a-priori exclusion; ESG rating for best-in-class stock selection; ESG-integration; company engagement; public policy engagement; thematic engagement; external ESG research; new data tool sets; carbon foot-printing; specific investment targets; impact investment mandates; better disclosure from companies of relevant information; and collaboration with like-minded peers.

The following three tools are consistently applied in some form by all:

- ESG integration, both with internal and external managers;
- Company engagement and voting, as well as public policy engagement;
- Collaboration with like-minded peers and advocacy.

ESG integration: The integration of ESG issues in the investment process is viewed as a clear priority for all asset owners interviewed. There is a move towards more in-depth and more systematic integration. ESG integration is used both to inform company valuation and stock-picking and also to develop thematic investment mandates.

Engagement with companies and regulators: For the majority of asset owners interviewed, company engagement and voting have been and remain cornerstones for their RI activities. Good corporate governance at investee company level is seen as an important driver of shareholder value, and voting the individual fund's proxies is the primary way of influencing this. There is a high level of transparency on voting policies and on actual voting among the asset owners interviewed. The quality of ESG data and the quality of corporate reporting are

concerns among several asset owners, and this has triggered systematic engagement with regulators, for instance on reporting requirements. As an example, many of the asset owners interviewed provided input to the process initiated by the Financial Stability Board's[5] Task Force on Climate-related Financial Disclosures (TCFD),[6] which led to a set of disclosure recommendations around climate-related financial reporting.

Collaboration: Engagement with companies and regulators is in many cases done through collaborative investor platforms by those asset owners interviewed. Collaboration is unanimously seen as more efficient, both in terms of keeping costs down but also in terms of achieving impact. Among the collaborative policy, standards and advocacy initiatives mostly cited by our interviewee group are, inter alia: Aiming for A[7]; Asset Owner Disclosure Project (AODP);[8] Climate Bonds Initiative (CBI);[9] Carbon Disclosure Project (CDP);[10] Carbon Disclosure Standards Board (CDSB);[11] Ceres/Investor Network on Climate Risk (INCR);[12] Focusing Capital on the Long-term (FCLT);[13] Global Climate 100;[14] Institutional Investors Group On Climate Change (IIGCC);[15] GRESB[16] (Global ESG Benchmark for Real Assets); Institute & Faculty of Actuaries (UK);[17] Sustainability Accounting Standards Board (SASB);[18] ShareAction;[19] Portfolio Decarbonisation Coalition (PDC);[20] UN-Backed Principles for Responsible Investment (PRI);[21] Financial Stability Board's Taskforce on Climate-related Financial Disclosure (TCFD);[22] Transition Pathway Initiative (TPI);[23] and the United Nations Environment Programme Finance Initiative (UNEP FI).[24]

External research, including carbon foot-printing: External ESG research is an important tool for many asset owners interviewed. Some are extending the ESG data tools directly for use by their portfolio managers. More than a third of asset owners interviewed conduct carbon foot-printing and or carbon risk assessments for their portfolios.

5 http://www.fsb.org/

6 https://www.fsb-tcfd.org/publications/final-recommendations-report/

7 http://investorsonclimatechange.org/portfolio/aiming-for-a/

8 http://aodproject.net/

9 https://www.climatebonds.net/

10 https://www.cdp.net/en

11 https://www.cdsb.net/

12 https://www.ceres.org/networks/ceres-investor-network

13 http://www.fcltglobal.org/

14 http://carbonmajors.org/

15 See footnote 8

16 https://gresb.com

17 https://www.actuaries.org.uk/

18 https://www.sasb.org/about-the-sasb/

19 https://shareaction.org/

20 http://unepfi.org/pdc/

21 https://www.unpri.org/

22 https://www.fsb-tcfd.org/

23 http://www.lse.ac.uk/GranthamInstitute/tpi/

24 http://www.unepfi.org/

Negative screens: Approximately one third of asset owners interviewed apply a negative screen to their investment universe a priori. (See section 3.3 Ethical Screening below for further detail).

Resources and costs

RI teams, investment teams and collaboration: The large majority of asset owners interviewed have small RI teams ranging from 2 to 7 people. There is a clear trend among all asset owners interviewed to let RI teams coordinate, supervise and advise, and then to have other teams run the processes. A few asset owners have chosen not to designate a particular RI or ESG team. In all of these cases, the onus of RI implementation lies with each individual investment team across a variety of asset classes. Most of the institutions interviewed did not disclose a price tag for RI related efforts. What several of them stated was that this is not seen as a cost but an investment. It is viewed as simply a normal part of well-functioning asset management operations.

Training

Systematic training a key: Knowledge-building in RI is key for the majority of institutional investors interviewed. More than 70% of the funds systematically train their staff on RI and ESG integration. For some asset owners, this is a very recent development. All institutions seem to combine formal training with ongoing dialogue and the sharing of information among the various investment teams. Some will use the assistance of external expertise, including the PRI Academy.[25] There are innovative ways of encouraging the dissemination of information, including the use of "RI champions" who can move between teams, and the ability for investment staff to volunteer with the ESG team. One asset owner points out that while the investment staff need training on RI, the RI experts also need training on investment.

Board continual learning: Board education and dialogue is also important for 70% of the asset owners interviewed. These asset owners emphasise the need to continuously improve knowledge at board level. Interactions with the board will vary in frequency, but from the interviews RI and ESG integration are clearly on the board's agenda.

Communication

Transparency the key to RI impact: Transparency is key for the majority of the funds interviewed. Around half of the institutional investors say they communicate directly with sponsors and beneficiaries of the fund through annual reporting, Parliamentary hearings (where applicable) and ongoing dialogue. The majority (70%) use a variety of tools to communicate with sponsors, beneficiaries and wider stakeholders, including the use of a website, yearly reporting, sustainability reporting, webinar engagement and social media. The communication is generally structured around reporting cycles for the institution in question, but there is also a clear attitude of keeping the door open to dialogue as and when it makes sense. Several asset owners say that with increased transparency, they experience less

25 https://priacademy.org/

pressure from, for instance, NGOs. One European asset owner explained that they organize annual stakeholder meetings for pension fund participants.

Innovation in RI programmes

Several asset owners stressed that elevating ESG to top policy level in their institution is an innovation and or improvement for them, as is the continuous process of taking ESG-integration to all asset classes and operations. Innovation, specific to each institution, often allows a fund to carry out high quality RI operations which are consistent with their mandates and play to their natural strengths. A summary of asset owner innovations reported to us includes:

ESG as part of investment beliefs: The integration of ESG factors directly into statements of investment principles or beliefs was identified by several asset owners as an innovation.

ESG integration: The integration of ESG factors into day-to-day investment processes was identified by half of the asset owners as an innovation. Several within that group also identify integration across all asset classes as an innovation, alongside attempting to influence the wider investment value chain in terms of consistency on ESG issues.

New investment strategies: Different asset owners made concrete capital allocations to a variety of new RI strategies:

- Custom SRI benchmark index;
- Long-term investment index;
- Low carbon smart beta;
- Shifting entire passive equities portfolio into low carbon smart beta;
- Green bonds;
- ESG quant equity;
- African renewables.

Climate change investment policy: Several asset owners pointed to comprehensive climate change investment policies across all asset classes as innovative.

Collaboration with peers: Regional and global climate change advocacy groups actively supported by a majority of asset owners interviewed include: IIGCC; Ceres/INCR; PDC; and TPI.

UN SDGs: Developing a new SDG taxonomy to help integrate the SDGs with investment strategy was identified by three asset owners interviewed.

Seeking system changes: Having climate considerations integrated with actuarial assessments was identified by one asset owner. Engaging on system-wide issues such as gender diversity and freedom of sexual orientation was identified by another asset owner. Promoting the findings of the TCFD was identified by several asset owners as an important trend going forward.

Outcomes

Portfolio performance and value: A clear majority of funds interviewed said they see RI efforts as contributing to risk management and investment performance. While this

remains a strong belief, backed by what these asset owners see as credible research[26] available in the market place, several pointed out that it is hard to untangle the causality between RI and investment return. The same institutional investors emphasised that they find it counterproductive to try to specifically attribute performance to particular ESG factors and to establish firm cause-and-effect relationships. Similarly, trying to assess the monetary value of risk avoided is extremely difficult.

Trust and fiduciary duty: A clear majority-view was that RI efforts help build trust and reputation. The trust building is an ongoing priority for these funds, and they see that communication with sponsors, beneficiaries and other stakeholders around RI is an important ingredient of that trust. Several of these institutional investors also said that it is incumbent on them to look at long-term sustainability factors in order to properly fulfil their fiduciary duty.

Impact and standing: Several funds point to the need for robust communication around ESG impact measurement. A few asset owners explained that their RI leader status has translated into a certain pedigree in the market place, allowing them to access the best managers and to attract and retain the best employees.

1.2

Expert views on RI

The experts interviewed[27] have wide-ranging specialisms and a combined experience covering a cross-section of eight key markets, including emerging markets such as Brazil, China, India and South Africa. Questions asked were engineered to uncover the experts' perspectives on current RI best practices and where they believed RI was headed.

Who are the RI leaders?

Interviewees were asked who they consider RI leaders in the global investment community. Rather than giving a list of specific names, experts focused on some key elements which in their opinions provide for robust and efficient RI practices. Below in Box 1 is a summary of these elements.

26 See, for example: Harvard Business School, Mozaffar Khan, George Serafeim and Aaron Yoon (2016) Corporate Sustainability: First Evidence on Materiality; University of Oxford/Arabesque (2015) From the Stockholder to the Stakeholder; Friede, G. et al. (2015) Aggregated Evidence From More Than 2,000 Empirical Studies, Journal of Sustainable Finance and Investment 5:4, pp 210-233; DB Climate Change Advisors/Deutsche Bank (2012) Sustainable Investing: Establishing Long-Term Value and Performance; MSCI (November 2017) Foundations of ESG Investing; Harvard Business Review, George Serafeim (December 2017) Can Index Funds Be a Force for Sustainable Capitalism.

27 Helga Birgden (Mercer); Gordon Clark (University of Oxford); Archana Hingorani (Former CEO IIML/ILFS, India, and Chair, UN Environment Programme Finance Initiative Property Working Group); Catherine Howarth (ShareAction); Mervyn King (Chair Emeritus GRI & Founding Chair Integrated Reporting Council) ; Luiz Maia (Brookfields Brazil); John Oliphant (Third Way Investment Group and Former CEO/CIO of the Government Employees Pension Fund of South Africa);David Pitt-Watson (London Business School); Martin Skancke (Chair, PRI); Takejiro Sueyoshi (CEO Green Finance Organization & UN Environment Programme Finance Initiative Ambassador Asia-Pacific); Roger Urwin (Willis Towers Watson).

Box 1

Hallmarks of best RI practice according to experts

- Innovation.
- Accountability.
- Convincing governance arrangements.
- Comprehensive approach.
- Supportive leadership at Board and Senior Management levels.
- Strong Investment Beliefs.
- Clear strategy on RI.
- Rigorous and disciplined execution.
- Volume and diversity in the portfolio that is addressing ESG, across the range of asset classes.
- Transparency.
- Forward-looking commitment.
- Engagement with stakeholders and management of the Fund's reputation risk.
- Strong focus on climate change (risks and opportunities).
- Capital allocation to promote positive ESG outcomes.
- Collaboration with peers and coalition building.
- Sustainability and profitability hand-in-hand.

Which RI opportunities are available to large, long-term asset owners?

Long-term, universal owner outlook: The majority of experts interviewed agreed that intervention at the systemic level, to help shape a sustainable global economy, is a key RI opportunity for a long-term fund. As one expert noted, any cost of inefficiency in the markets is ultimately borne by the large institutional investors. By "inefficiency", we mean here situations where external effects, such as ESG issues, may not be adequately factored into market prices, as for example is the case with climate change as the "ultimate negative externality."[28]

There is also opportunity in leadership and conviction, and in demonstrating that RI can apply to all asset classes. Further, there is opportunity to exploit size and influence in engagement with companies and standard setters. Proactive participation in system-wide initiatives is recommended by experts. Finally, and perhaps most importantly, the larger funds may have the opportunity to effect environmental and social outcomes by mobilizing capital at scale using RI considerations, if such mobilization affects pricing and allocation of capital in the marketplace. Long-term stock returns are likely to be found among the disruptive environmental and social forces that will reshape the global economy over the coming decades; there will be major opportunities for value creation for investors. At the same time, of course, it must be noted that, if poorly understood or even ignored, those same forces can be a significant source of investment risk as well.

28 PlanetPolicy: "Paying the Cost of Climate Change," Michael Greenstone, Brookings Institution, September 19, 2014. See:www.brookings.edu/blog/planetpolicy/2014/09/19/paying-the-cost-of-climate-change/

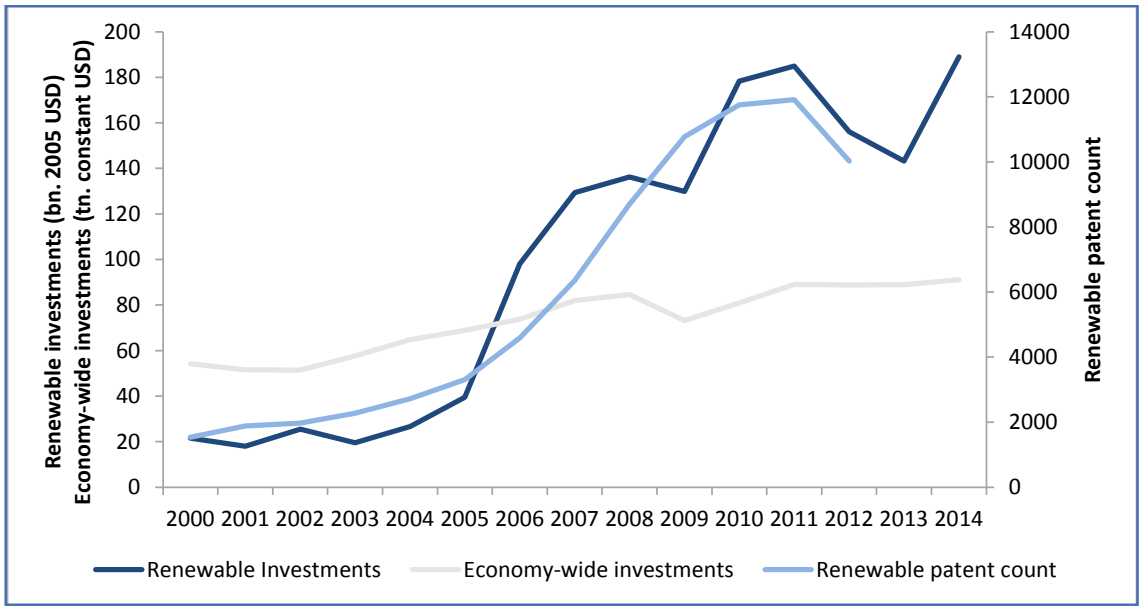
Energy transition: Several experts pointed to the opportunities in investing in the transition to a low-carbon global energy economy, and to the growing need for sustainable infrastructure. Experts also emphasised the opportunity in being less benchmark-driven and tilting assets away from cap-weighted benchmarks to various investment factors, including sustainability factors. This of course implies either some level of active management or an active role in designing ESG-enhanced indexes. In both cases, the implicit assumption is that including sustainability factors will improve — or at least not harm — risk-adjusted returns.

There has been significant recent growth and improvement of commercially available rating systems which assess companies' sustainability impacts. This type of research should help asset owners assess their investments relative to key performance targets. Challenges remain, however, around reliable and comparable underlying data including data access and transparency as reflected in the discussions in the TCFD Report.[29] Certain industries, for example the automobile industry, are moving quickly and investors need to respond to these changes. Figure 1 below gives an indication that there is indeed growing investment momentum behind renewables, which are a critical component of the energy transition.

Figure 1

Key trends in investment flows and patent counts in renewable-power sources in OECD and G20 countries

2000-14 for investment flows, billion USD and trillion constant USD; 2000-12 for patent counts
Source: OECD / BNEF (2015) / IMF (2016)



Embed RI in Investment beliefs: The majority of experts see it is as critical for institutional asset owners to embed RI in investment beliefs and to articulate it in a manner so that it becomes part of the investment architecture and avoids "silo thinking". With constant change and disruption to economies and financial markets, the investment beliefs need to be revisited regularly.

29 https://www.fsb-tcfd.org/

Total portfolio approach: All experts interviewed state that an RI policy should extend, ideally, across all asset classes. Experts advise that time should be spent to create consistency among RI approaches across asset classes and strategies. An integrated approach across all of these asset classes is the ideal.

Implementation considerations: The RI policy should form part of the operational disciplines of both internal operations and external managers and agents. It was recognised that it may be difficult to "police" different individuals' and agents' levels of compliance; therefore, real care needs to be taken to ensure appropriate execution according to an institution's RI beliefs.

Governance example: Funds need to look after their own corporate governance to set a good example for the investment chain.

Knowledge-sharing and guidance: Several experts advise that asset owners need to have a balanced dialogue between real specialists on ESG and sustainability, and other parts of the investment team, portfolio managers in particular. Other experts emphasise the need to give RI guidance around every aspect of the investment process, including fundamental research, top-down research, strategy setting, scenario mapping, reporting and stakeholder interaction.

Observations on implications of size and strategy

Beta performance: Several experts point out that it is in large asset owners' interest to contribute positively to the well-being and robustness of the market overall. This includes addressing the management of the transitions which are happening, including the social transition that people all over the world are experiencing. That should result in a more cohesive economic environment, with more room for sustainable growth.

Scaling smaller fund's RI practices: Some experts point out that it can be difficult to scale up small fund's RI approaches. By contrast, however, an RI practice such as engagement is absolutely scalable, and being large becomes a relative advantage. Similarly, with tilted portfolios that address underlying ESG risks, some experts believe that large funds can mobilize and redirect large volumes of capital, and send a powerful signal to the markets and other investors.

Best practice stakeholder dialogue: Experts argue that funds can help educate stakeholders about the investment world, the investment process, the constraints, and the role of an institutional investor. In turn, there is an opportunity for institutional investors to gain insights about trends and disruptions from stakeholders such as NGOs. Stakeholder dialogue is currently practiced with outdated governance and technology.

1.3
Developing RI practices in the global SWFs community

Cultural, geo-political, national, jurisdictional and institutional factors come into play to frame how individual Sovereign Wealth Funds (SWF) approach RI. A fund's mandate, governance and operational realities will determine how they blend the varying ethical, normative and materiality-focused approaches to manage RI risks and opportunities. The global SWF community is coming under greater scrutiny with respect to RI from the policy

community and civil society as the political and fiscal importance of SWFs continue to grow and the assets they control increase.[30] It is clear that there is a broad spectrum of how the SWFs approach the overall concept of RI and then adopt, adapt or forgo best practice approaches to meet their RI needs. Some funds are identified as clear RI global leaders within the overall investment community, other SWFs are active but prefer not to disclose their strategy. Another segment of SWFs are either just embracing the concepts of sustainability and RI, or are taking steps to understand the potential implications on their investments and operations and whether to act on RI or not. Examples of RI implementation and knowledge sharing amongst SWFs include:

Example 1 — New Zealand Superannuation Fund: NZ Super was an early mover on RI as a founding signatory of the PRI in 2006 and building RI into its investment beliefs in 2008. Since then the institution has built RI into the heart of its approach including the 2016 adoption of a portfolio-wide Comprehensive Climate Change Investment Strategy. Notably, NZ Super employs an annual RI rating of managers which is the responsibility of the team managing the managers rather than RI specialists. As current Chair of the International Forum of Sovereign Wealth Funds (IFSWF), NZ Super has introduced climate change and broader ESG considerations to the IFSWF's agenda in recent years.

Example 2 — Irish Strategic Investment Fund: Following the impact of the Global Financial Crash[31] on the Irish economy, the Irish SWF was recreated[32] in 2014 with a new constitution and a distinctly more domestic focus than the predecessor fund, although the new entity still manages a global portfolio in listed equities. ISIF sees the PRI as reflecting the objectives the fund wants to achieve and the Santiago Principles[33] as a guide to how a fund should seek to organise itself. The new, re-established fund recommitted to the PRI and Santiago Principles in 2016. ISIF views its work to integrate ESG considerations into its investments in Irish private markets — both direct and through funds — as innovative and ground-breaking in the domestic context although it remains a work in progress.

Example 3 — Australia Future Fund: Future Fund was a driving force behind the creation of the Santiago Principles[34] and has been an IFSWF member since 2009. Future Fund sees real value in the ability to share experiences amongst the most senior SWF executives at IFSWF in a non-commercial environment, citing examples such as recent discussions on: technology and disruption; scenario planning for SWFs; and the Norwegian Ministry of Finance's decision to introduce a coal-based exclusion criteria with a 30% revenue threshold for GPFG portfolio holdings. Although not a member of PRI, Future Fund believes the PRI's six principles have helped shape their RI thinking.

30 See Table 2: SWF Assets under Management, Sovereign Wealth Fund Institute. Data compiled by Laura Pellizzola, SIL, Bocconi University and FEEM

31 https://www.reuters.com/article/us-ireland-pensionfund/analysis-clock-ticking-for-irelands-sovereign-wealth-fund-idUSTRE6AM38H20101123

32 https://www.ft.com/content/3992ac02-e9ba-11e4-b863-00144feab7de

33 http://www.ifswf.org/santiago-principles-landing/santiago-principles

34 Ibid.

Converging global trends

Interviewed SWFs understand that a series of converging global trends in the political, policy, market and multi-stakeholder spheres will result in a heightened demand for the majority of SWFs to disclose their risk-reward pathway to handle systemic risks and risks such as controversial industries ranging from unusual weapons to tobacco. These drivers, inter alia, include:

- An accelerating focus on the interplay between both the global and national financial systems with respect to systemic and broad market risks associated with non-sustainable development. Notably, the potential systemic financial and investment impacts related to global warming *(see Section 3.2 on Climate Change)* are the "lens" through which many SWFs come to RI although the relevance of a broader range of material ESG risks and investment opportunities are accelerating;
- National government commitments to sustainability in the multilateral sphere that are, to varying degrees and dependent on choice of policy tools, relevant to different domestic institutions connected to government. Such commitments include: the UNSDG[35]; the Paris Climate Agreement 2015[36] and the subsequent Marrakech Action Proclamation.[37]

35 http://www.un.org/sustainabledevelopment/sustainable-development-goals/

36 http://unfccc.int/paris_agreement/items/9485.php

37 https://unfccc.int/files/meetings/marrakech_nov_2016/application/pdf/marrakech_action_proclamation.pdf

Table 2

Sovereign wealth funds, assets under management

Country	Fund Name	Inception Year	Source of Funds	AUM 2016 (US$bn)
Norway	Government Pension Fund – Global£	1990	Commodity (Oil & Gas)	903.96
UAE-Abu Dhabi	Abu Dhabi Investment Authority†	1976	Commodity (Oil & Gas)	828.00
China	China Investment Corporation**	2007	Trade Surplus	813.76
Kuwait	Kuwait Investment Authority†	1953	Commodity (Oil & Gas)	592.00
Singapore	Government of Singapore Investment Corporation†	1981	Trade Surplus	353.58
Qatar	Qatar Investment Authority†	2005	Commodity (Oil & Gas)	335.00
China	National Social Security Fund†	2000	Trade Surplus	294.85
UAE - Dubai	Investment Corporation of Dubai¤	2006	Commodity (Oil & Gas)	200.82
Saudi Arabia	Public Investment Fund£	1971	Commodity (Oil & Gas)	190.00
Singapore	Temasek Holdings£	1974	Trade Surplus	179.71
UAE-Abu Dhabi	Mubadala Development Company PJSC£	2002	Commodity (Oil & Gas)	125.00
Russia	National Wealth Fund and Reserve Fund£	2008	Commodity (Oil & Gas)	110.85
UAE-Abu Dhabi	Abu Dhabi Investment Council†	2007	Commodity (Oil & Gas)	110.00
Australia	Australian Future Fund£	2006	Non-Commodity	92.51
Republic of Korea	Korea Investment Corporation**	2005	Government-Linked Firms	91.80
Libya	Libyan Investment Authority†	2006	Commodity (Oil & Gas)	66.00
Kazakhstan	Kazakhstan National Fund**	2000	Commodity (Oil & Gas)	65.70
Brunei	Brunei Investment Agency†	1983	Commodity (Oil & Gas)	40.00
Malaysia	Khazanah Nasional Berhard**	1993	Government-Linked Firms	34.95
UAE	Emirates Investment Authority†	2007	Commodity (Oil & Gas)	34.00
Azerbaijan	State Oil Fund of Azerbaijan£	1999	Commodity (Oil & Gas)	33.21
New Zealand	New Zealand Superannuation Fund£	2001	Non-Commodity	21.74
Ireland	Ireland Strategic Investment Fund£	2001	Non-Commodity	21.70
East Timor	Timor-Leste Petroleum Fund†	2005	Commodity (Oil & Gas)	16.90
UAE - Dubai	Istithmar World*	2003	Government-Linked Firms	11.50
UAE - Dubai	Dubai International Financial Center**	2002	Government-Linked Firms	11.00
Bahrain	Mumtalakat Holding Company**	2006	Government-Linked Firms	10.51
Russia	Russian Direct Investment Fund£	2011	Non-Commodity	10.00
Oman	State General Reserve Fund*	1980	Commodity (Oil & Gas)	9.15
Oman	Oman Investment Fund†	2006	Commodity (Oil & Gas)	6.00
Angola	Fundo Soberano de Angola**	2012	Commodity (Oil & Gas)	4.75
UAE-Ras Al Khaimah	Ras Al Khaimah Investment Authority†	2005	Commodity (Oil & Gas)	1.20
Nigeria	Future Generations Fund**	2012	Commodity (Oil & Gas)	1.07
Kingdom of Morocco	Ithmar Capital£	2011	Government-Linked Firms	1.00
Vietnam	State Capital Investment Corporation**	2005	Government-Linked Firms	0.87
Palestine	Palestine Investment Fund£	2003	Non-Commodity	0.80
Kiribati	Revenue Equalization Reserve Fund*	1956	Commodity (Phosphates)	0.65
São Tomé & Principe	National Oil Account*	2004	Commodity (Oil & Gas)	< 0.01
			Total OIL & GAS	3,625.41
			TOTAL TRADE SURPLUS	1,641.90
			TOTAL OTHER	357.23
			TOTAL AUM	**5,624.54**

£ AUM as of December 31, 2016
† Estimate by SWF Institute as of 19 April 2017
** AUM as of 31 December 2015
¥ AUM as of 31 March 2016
ϭ AUM as of 30 June 2016
* Sovereign Investment Laboratory estimate of assets under management as of December 2016.
Ɛ On 21 January 2017, the President, His Highness Sheikh Khalifa bin Zayed Al Nahyan, as the ruler of Abu Dhabi, issued a law creating the Mubadala Investment Company, a company wholly owned by the government of Abu Dhabi. This new company will comprise both the International Petroleum Investment Company and Mubadala Development Company, and their respective assets. This law formalizes the 29 June 2016 announcement that IPIC and Mubadala would merge. The value of assets under management is updated as of April 2017.

Section 2

What are best RI practices and what drives those practices?

2.1 Perspectives on best practices

This report does not aim to give an exhaustive list of to-does for an institutional investor with the ambition of being an RI leader, but rather to shed light on the RI best practices we see amongst a diverse set of asset owners. We have identified a series of ten "building blocks" which we believe form part of robust asset management operations that have a long-term and responsible outlook.

The building blocks have been synthesized from all the approaches utililized by those funds interviewed. While it is clear that there can be no "one size fits all" solution for RI, it is important to note that no single institution exhibited all of the characteristics we describe in the building blocks.

Our research suggests that size is not a major determinant of the level of efficiency individual institutions achieve in implementing RI practices. It is apparent that robust and efficient RI operations are influenced in particular by the presence of three core components:

1. A clear purpose and alignment with the sponsor/members;
2. Dedication to governance both in-house and externally throughout the investment chain; and
3. The ability to create a learning culture which ensures ownership of RI throughout the organization.

The RI building blocks are:

1. Leadership from the top

There is a clear view that leadership from the top of the organization matters fundamentally. We have seen repeated examples where a strong commitment from senior executives galvanized the entire organization, and was instrumental in spreading ESG through every level of the organization. Conversely, in the absence of a strong and visible commitment from the very top, RI efforts are likely to be scattered and ineffective, if indeed they are present at all.

2. Recognition of long investment horizon

There is a clear link between long investment horizons and RI; many key sustainability issues are essentially long term, slow-burning phenomena. While their effects can already be seen today, their full impact may not be felt for a decade or more. For that reason, sustainability-driven investment risks and opportunities are entirely relevant for those funds whose mandates and investment horizons are similarly long, and whose holdings are highly diversified by geography, asset class, and industry sector. Many RI leaders view their long

investment horizons as a competitive advantage vis-a-vis other large investors. Short term liquidity is not a significant concern for them, and their ability to ride out market volatility without being forced to sell assets at unfavourable times is a major comparative advantage.

There was recognition amongst research participants that Universal Owners[38] that invest in companies globally, covering every industry sector and all major markets, have a direct vested interest in optimizing system-wide economic, environmental, and social conditions over a long-term horizon. To this end, universal owners have an interest in influencing standards and those bodies that set standards, to affect well-functioning and sustainable markets.

3. Belief that RI brings net positive benefits

A growing volume of academic studies and meta-studies strongly suggests that companies exhibiting strong ESG credentials have historically generated superior risk-adjusted returns over the medium and long term.[39] While ESG integration was initially viewed as primarily a technique to enhance the management of downside risk, leading asset owners are increasingly aware that ESG issues also present investment opportunities on the upside. While no guarantee of future performance, asset owners regard resourcing RI as an investment that supports improved investment decision-making. While few have attempted to quantify RI's impact on portfolio financial performance, virtually every research participant agreed that their RI efforts had strengthened the level of trust amongst their stakeholders, as well as enhancing the organization's reputation and international profile. There was a general consensus that financial benefits would be gained in the medium and long term. In addition asset owner research participants are increasingly concerned to produce positive environmental and social outcomes.

4. Integration of RI into investment beliefs

Investment beliefs are the intellectual underpinning of the entire investment programme, and subsequent investment decisions should be consistent with those beliefs. Typical investment beliefs might include, for example, a view that markets are fully efficient. Where funds hold that view, the organization is highly likely to have an investment portfolio which is predominantly passive. In the specific case of RI, the majority interviewed for this project have included RI in their statement of investment beliefs. They hold a belief that companies that do well on ESG will also do well financially, at least in the long run. It therefore follows logically that addressing material ESG issues is entirely consistent with their fiduciary responsibilities. Indeed, in their view, it would be a dereliction of fiduciary responsibility[40] to fail to address ESG issues.

5. Strengthening risk management

Improved risk management is often viewed as an important reason for pursuing RI by both asset owner and asset managers. It has historically been the management of downside investment risk which initially attracted investors to RI. The case is simple: looking at companies

38 Rotman International Journal of Investment Management: http://www.icpmnetwork.com/research-paper/pension-funds-as-universal-owners-opportunity-beckons-and-leadership-calls/

39 See footnote 8

40 http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

and other assets through an ESG lens adds a different and broader perspective. It exposes risk factors which may not be picked up by traditional financial analysis, yet could have a material bearing on portfolio performance. It can also provide valuable insights about the management quality of companies being considered for investment.

6. Total portfolio approach reflecting organization circumstances

ESG analysis is beginning to be applied to fixed-income, real estate, private equity, infrastructure, real assets, and even hedge fund portfolios.[41] ESG integration is an organizational challenge for even a single asset class and to extend the process across other asset classes magnifies the challenge. Integrating ESG across all asset classes is still at an early stage; no fund interviewed has yet achieved full coverage, and one leading institution candidly said that they viewed it as a 5-year project at minimum. RI leaders have learned how to prioritise, and to focus their energies on those RI practices which best match both their needs and their particular capabilities and circumstances.

7. Building partnerships with peer investors

Partnerships and other forms of structured collaboration are cost-efficient and can have greater impact, whether it is around engagement or standard-setting. Large funds reported benefits from sharing experiences and best practices with their peers. The PRI Collaboration Platform[42] is one example of a collaborative platform which significantly amplifies the voice and impact of each individual institutional investor who participates. Group initiatives which bring asset owner peers together in the RI space, or mainstream investor groups that have adopted the RI agenda as part of their considerations, have multiplied rapidly in the past decade.[43]

8. Commitment to engagement

Almost without exception, research participant funds are committed to a programme of strong and consistent engagement with portfolio companies to improve their ESG performance. There is a high degree of confidence that engagement enhances long-term portfolio performance. Several funds interviewed have set up small teams dedicated purely to engagement in order to pursue this potential value premium. In addition to engaging with individual companies, a number of RI leaders are increasingly engaging with governments, regulators, and industry associations on broader, system-wide and stock market listing requirements. This is particularly the case for the larger institutional investors that hold passive portfolios. There is a broad (though not unanimous) consensus among our research base that engagement with portfolio companies should be tried first to improve their ESG performance. As a general rule, only in cases where there is no realistic prospect of positive change will divestment be actively considered; once a company is divested, the investor loses any degree of potential influence to drive improvement.

41 The PRI provides guidance on ESG integration across asset classes, including listed equity, fixed income and alternatives: https://www.unpri.org. GRESB, https://gresb.com provides guidance on integration of ESG factors in real assets, including real estate, debt and infrastructure.

42 https://www.unpri.org/page/pri_website_base.collaboration-platform

43 Inter alia such initiatives include: IIGCC http://www.iigcc.org, INCR https://www.ceres.org/networks/ceres-investor-network; UNEP FI Portfolio Decarbonization Coalition http://unepfi.org/pdc/; TPI http://www.lse.ac.uk/GranthamInstitute/tpi/, and more recently, IFSWF http://www.ifswf.org/

9. Intermediary alignment

Purpose, culture, and priorities of the organization and its beneficiaries are key ingredients in how RI leaders operate at high level and how they integrate long-term, non-traditional factors in their operations. In the highly intermediated value chain of investment, it is both important and challenging to ensure that the entire value chain is also aligned with the priorities of the asset owner. The leading RI practitioners make a conscious effort to ensure that both consultants and external asset managers are similarly aligned with the asset owners' priorities and interests.

10. Commitment to continuous improvement and innovation

Even the most advanced asset owners with whom we spoke were not satisfied with the status of their current RI programme; all regarded them as works in progress, and were determined to continue to improve. RI excellence will likely always be a moving target, and stakeholder demands are likely to raise the bar continuously. What was once best practice may later become simply the minimum level required to retain the organization's social license to operate.

2.2
Drivers of best practice

An asset owner wishing to understand RI or aspiring to be a leader in RI, needs to be aware of the underlying drivers of RI best practice and the expectations that are placed on asset owners through various pressure points. These expectations derive from a broad combination of elements including policy developments, regulatory and "soft law" pressures, voluntary initiatives, and stakeholder expectations.

2.2.1 Public policy developments

In the growth and development of RI best practice, the role of political consensus and public policy should not be underestimated. In one sense, the RI phenomenon as we know it today, can be seen to have had its immediate genesis in the UNCED[44] Earth Summit in Rio de Janeiro in 1992.[45] This summit was a response to the earlier work of the Brundtland Commission,[46] named after the former Norwegian Prime Minister, that reported in October 1987. The 1992 Summit convened an unprecedented gathering of over 190 heads of state, and building on the Brundtland vision, agreed on the broad outlines of a commitment to "sustainable development" of both environmental and social conditions worldwide.

These remain the fundamental objectives of RI today. It should be noted that the preparations for the 1992 Summit catalysed the creation of the UN Environment Programme Finance Initiative (UNEP FI[47]) in May 1992 and in July 2000, the UN Global Compact. UNEP FI, working with the UN Global Compact,[48] went on 11 years later in September 2003 to become

44 https://sustainabledevelopment.un.org/milestones/unced

45 http://www.un.org/geninfo/bp/envirp2.html

46 https://en.wikipedia.org/wiki/Brundtland_Commission

47 http://www.unepfi.org/about/unep-fi-statement/history-of-the-statement/

48 https://www.unglobalcompact.org/what-is-gc

the original UN backers of the concept and work[49] behind the PRI. PRI was launched three years later by then UN Secretary General Kofi Annan at the New York Stock Exchange in late April 2006. And, while it took more than a decade after the 1992 Earth Summit to emerge, the gradual recognition of the critical role of the investment community can be seen as the real birth of modern-day RI.

More recently, the political consensus around the Paris Climate Agreement and the UN's adoption of the SDGs have provided both further impetus and a conceptual framework which promises to impel RI best practice even further forward. Importantly, political consensus and the resulting public policy in turn give rise to formal regulation and "soft law", in the form of codes of practice, and a series of voluntary initiatives.

2.2.2 Regulatory and soft law developments

Investment activities are subject to legislation and regulation by governments. Trends and developments that we are witnessing include:

1. Greater requirements for transparency;
2. Greater requirements for reporting on RI and ESG integration;
3. A general move among public policy-makers in key jurisdictions to add ESG language/ requirements to existing capital market or corporate regulation to strengthen governance, risk management and transparency.

There are some key international standards that have formed the baseline for responsible investors over several years. These include, but are not limited to, the UN Global Compact, the OECD Principles for Corporate Governance, OECD Guidelines for Multinational Enterprises, and the PRI. The challenge for asset owners is that the target is constantly moving through revisions of guidelines, as well as additions of new standards and guidelines.

Growth of Corporate Governance Codes

The OECD Principles of Corporate Governance[50] are an important "soft law" pillar and an international reference point that aids implementation of corporate governance across jurisdictions. Originally developed by the OECD in 1999, then updated in 2004, the 2015 revision of the Principles of Corporate Governance addresses emerging issues that are increasingly relevant, such as market confidence, business integrity and inclusiveness. For many of the asset owners interviewed in this project, the OECD Principles of Corporate Governance are used as a benchmark for good corporate governance at investee companies. That benchmark is supplemented by more than 100 market-specific Corporate Governance Codes across the globe.[51]

The landscape in corporate governance is changing and there will be market variations as to what is seen as best practice. In an article published by Harvard Law School Forum,[52] the

49 http://www.unepfi.org/publications/general-publications/mainstreaming-sustainable-investment-summary-report/

50 *"Good corporate governance is not an end in itself. It is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment".*

51 According to the European Corporate Governance Institute, there are corporate governance standards or codes applied in 110 markets worldwide: http://www.ecgi.org/codes/all_codes.php

52 https://corpgov.law.harvard.edu/2017/01/06/global-and-regional-trends-in-corporate-governance-for-2017/

authors explored five key regions and markets; the United States, the European Union, India, Japan and Brazil. The authors believe that public companies will face trends in the near future including:

a) Increasing expectations around the oversight role of the board;
b) Continued focus on board refreshment and composition;
c) Greater scrutiny of company plans for sustained value creation; and
d) Greater focus on ESG issues, in particular those related to climate change and sustainability, as industries beyond the extractive sector begin to feel investor pressure in this area.

Growth of Stewardship Codes

Corporate Governance addresses good governance at corporate level, whereas Stewardship addresses good governance at investor level. There is a recent and growing number of stewardship codes across jurisdictions. These codes help set a standard for investor behaviour in relation to internal governance — including decision-making on asset allocation, awarding investment mandates, designing investment strategies, buying or selling specific securities — and in relation to engagement with investee companies and the investment chain.

ICGN has set out its view of best practices regarding investor stewardship obligations, policies and processes in "The ICGN Global Stewardship Principles" published on ICGN's website. ICGN defines Stewardship as follows:

Stewardship can be defined in general terms as the responsible management of something entrusted to one's care. This suggests a fiduciary duty of care on the part of those agents entrusted with management responsibility to act on behalf of the end beneficiaries. In an investment context, institutional investors are the agents acting on behalf of beneficiaries, who are often long-term savers or members of pension funds. … At an investor level, stewardship is about preserving and enhancing long-term value as part of a responsible investment approach. This includes the consideration of wider ethical, environmental and social factors as core components of fiduciary duty. In a broader context, stewardship enhances overall financial market stability and economic growth.[53]

The UK was the first capital market to establish a Stewardship Code in 2010, revised in 2012, and with a revision planned for 2018. Many countries have followed suit, and according to ICGN, there are currently 19[54] capital markets that have defined principles for the exercise of ownership rights in investee companies either through Stewardship codes or EFAMA[55] principles. As per December 2017, we are aware of ongoing consultations on stewardship codes in the Netherlands and Australia. The ICGN has established a Global Stewardship Code Network, offering for members to share information and views on the development and implementation of the codes.

53 https://www.icgn.org/policy (see booklet "ICGN Global Stewardship Principles")

54 Brazil, Canada, Denmark, European Union, Hong Kong, Italy, Japan, Kenya, Malaysia, Netherlands, Philippens, Singapore, South Africa, South Korea, Switzerland, Taiwan, Thailand, UK, USA (Source: https://www.icgn.org/global-stewardship-codes-network)

55 EFAMA (European Fund and Asset Management Association) www.efama.org/.../11-4035%20efama%20ecg_final_6%20april%202011%20v2.pdf

The Stewardship concept and the codes built around it are recent and under development. It is difficult at the current time to provide a robust assessment of how these codes influence investor behaviour. The UK Stewardship Code currently has 264 signatories who have all developed and published Stewardship Statements in accordance with the seven principles of the Code. While reporting is a requirement of compliance with the Stewardship Code, actively reporting on the implementation of the Code is not. FRC intends to release a consultation on the UK Corporate Governance Code. Within this consultation, FRC intends to ask several questions on the Stewardship Code, including how the Stewardship Code can encourage reporting on the way in which stewardship activities have been conducted (with an emphasis on reporting on the outcomes of stewardship activity, rather than just producing a statement detailing alignment with the principles). The information gathered during this consultation process will inform the drafting of a revised Stewardship Code, which will be released for comment in late 2018. Since 2014, the FRC publishes annual accounts on developments both in Corporate Governance and on Stewardship,[56] which will help inform wider implementation and discussion around future developments.

Voluntary Initiatives

RI-related voluntary initiatives (VIs) such as PRI, Integrated Reporting,[57] CDP, Natural Capital Finance Alliance,[58] UNEP FI, the Equator Principles,[59] AODP,[60] SDGs, C,[61] and Green Bond Principles[62] are also helping to shape the RI agenda. At the same time, however, we found a significant number of asset owners raising concerns about "initiative overload". It is challenging for asset owners to know where best to deploy limited resources, given the proliferation of VIs and the reporting requirements that come with them. A recent initiative from the PRI in addressing just this challenge is *A Global Guide to Responsible Investment Regulation*[63]. The study reveals that in the largest 50 economies in the world there are almost 300 policy instruments which support investors to consider long-term value drivers, including ESG factors. Over half of these were created between 2013 and 2016. Some of these regulations are brand new, ESG-related regulations. But a lot of them are revisions; policy makers are adding in ESG clauses to existing capital market or corporate regulation to strengthen governance, risk management and transparency. [64]

The *Global Guide to Responsible Investment Regulation* has four key findings and states:

1) RI policy is widespread and the pace is increasing;
2) There is some evidence that it is driving better ESG performance by companies;

56 https://www.frc.org.uk/getattachment/ca1d9909-7e32-4894-b2a7-b971b4406130/Developments-in-Corporate-Governance-and-Stewardship-2016.pdf

57 https://integratedreporting.org/

58 http://www.naturalcapitaldeclaration.org/

59 http://www.equator-principles.com/

60 http://aodproject.net/

61 https://www.climatebonds.net/

62 https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-social-and-sustainability-bonds/green-bond-principles-gbp/

63 Global Guide to Responsible Investment Regulation https://www.unpri.org/page/responsible-investment-regulation. This regulatory database will be updated annually by PRI going forward.

64 From *Responsible Investor* interview with Fiona Reynolds, managing director of PRI, in September 2017: https://www.responsible-investor.com/home/article/pro_eng/

3) Policy effectiveness is hampered by weak implementation and weak signals;
4) Despite the increase in sustainable finance regulation, most governments are not connecting sustainability and capital markets policy — but there are signs this is beginning to change.

International standards for business conduct

OECD Guidelines for Multinational Enterprises (MNEs): The OECD Guidelines for MNEs are the most comprehensive set of government-backed recommendations on responsible business conduct in existence today. They were first adopted in 1976 and have been reviewed five times since, the most recent update taking place in 2011. In that last update, the UN "Protect, Respect and Remedy" Framework[65] and Guiding Principles (issued in 2011), are implemented as relevant to the application of the OECD Guidelines for MNEs. While the OECD Guidelines apply to all industries and sectors of the economy, they do not make direct reference to the financial sector. In the interim between 2011 and 2017, in-depth discussions have taken place around the responsibilities for minority shareholders, including SWFs, under these Guidelines.

One of the most innovative aspects of the Guidelines was the creation of "National Contact Points" (NCPs) in the year 2000. Each country supporting the Guidelines is required to set up an NCP, for the purpose of assisting both MNEs and their stakeholders to implement the Guidelines effectively. Importantly, the NCPs are mandated to provide a mediation and conciliation platform for resolving Guideline-related disputes between MNEs and their stakeholders. Since 2000, over 400 such cases have been heard, in over 100 countries.

While the OECD Guidelines for MNEs are not directly applicable to financial investors, they are seen as relevant to, amongst others, institutional asset owners. A paper published this year by the OECD on *Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises*[66] is helpful in giving clarity around minority shareholder responsibility. The paper has been developed through close consultation with a multi-stakeholder advisory group of over 50 representatives from the financial sector, including leading investment institutions, government, civil society, international organizations and other experts.

Investors' contribution to the building of RI standards and practices: A clear majority of asset owners interviewed have given input to policies, standards and guidelines when they see it as relevant to their position as shareholder and investor. Because there is a plethora of initiatives, asset owners are cautious in how they prioritise, so not only does it have to be obviously relevant to them, but the set-up for the process needs to be robust.

Examples of standards that many of the asset owners we interviewed have prioritised giving input to are Stewardship Codes across key markets and the Financial Stability Board's TCFD. One institution interviewed, APG (which represents dominant Dutch asset owner client ABP), is a member of the EU's High-Level Group on Sustainable Investments (HLEG),[67] which has been established to advise on developing a comprehensive EU strategy on sustainable finance.

65 http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

66 https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf

67 https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

Through this membership, APG is consulting with PGGM and other peers to feed comments and input into the High-Level Group process. The HLEG will deliver its final report by January 2018.

2.2.3 Stakeholder expectations

As was evident through the interviews conducted for this project, institutional asset owners are fully aware of increased stakeholder expectations. There is a desire, especially among those asset owners who are under continuous public scrutiny, to make sure they are able to stay ahead through transparency and dialogue. Several asset owners say that with increased transparency, they experience less pressure from NGOs. We also interpret from the interviews that asset owners have more confidence in prioritising what they see as important for long-term value creation, rather than simply responding to what the media or pressure groups are chasing in a given moment.

That said, several asset owners interviewed describe their dialogue with the media and NGOs as positive overall. Some are even actively seeking out dialogue with NGOs, and view it as a two-way dialogue where there may be learning on both sides. One of the experts interviewed pointed to the unique intelligence within civil society and NGOs that asset owners can tap into for market intelligence, on trends and disruptions, that institutional investors don't necessarily have.

Growth of sustainable investment forums: As evidence of what the investor community and the market is coming to expect in relation to RI, we have done a small-sample mapping of Sustainable Investment Forums across five jurisdictions. All SIFs welcome institutions from across the investment chain. Three of the five SIFs have experienced moderate to high growth over the last three years. The other two are keeping their membership stable. This is an indication that sustainability as an investment issue is either met with stable or growing interest in these markets. Table 3 gives an indication of SIF activity and focus.

Table 3
SIF activity and focus

Sustainable Investment Forum	Membership growth over the last 3 years	Themes dominating SIF discussions over last 3 years	Key actions to help further uptake of SIF practices in the market
FinSIF	FinSIF has grown from 54 members in 2014 to 64 members in 2017 2015 = 13%; 2016 = 1.6%; 2017 = 3.2%	2015 - CO2 risks and analysis, impact investing, good governance, carbon foot-printing, biodiversity & RI, solar energy. 2016 - ESG ratings, CR reporting & verification, impact investing. 2017 - Water risks, SI in university curriculums, RI studies and meta-studies, the risks and return perspective of RI.	Strengthening collaboration between Nordic SIF's. Events / Workshops considering different needs of members. Cyber security, ESG investing and performance. The role of RI studies.

Sustainable Investment Forum	Membership growth over the last 3 years	Themes dominating SIF discussions over last 3 years	Key actions to help further uptake of SIF practices in the market
SweSIF	Swesif has grown from 37 members in 2014 to 88 members so far in 2017. This equals a total growth of 138%, or an average annual growth of 33,5%.	Improving transparency and awareness around SI products & strategies - resulted in SweSIF's Sustainability declaration for funds (Hållbarhetsprofilen) - used today by 64 fund companies, with 100 funds reporting according to a common format.	A project has been initiated to map and vitalise sell-side ESG strategies (and in next step link to buy-side demand and corporate reporting practices). Focus on emerging Impact Investment strategies (from a broad market perspective).
NorSIF	NorSIF has grown from 22 members in 2014 to 42 members in 2017 - nearly a doubling of members over the last 3 years.	ESG integration — reporting, water risk, private equity etc. Academia — sustainability in finance education. Climate — coal industry, water crisis, unconventional oil and gas, transport, renewable energy, green bonds. Governance — good CG, responsible tax, climate regulation. Knowledge sharing — RI & reporting. Impact investing, human rights, labour, sustainable food.	Norsif has a clear goal to be the most important forum for RI in Norway. To maintain this position, which would "help further uptake in the market of SIF practices", we need to develop our platform and relevance in society as a whole and the financial ecosystem especially. Themes going forward: Collaboration and leveraging off experience, SI in finance education, media visibility & relevance, governance, best practice, active ownership, improve ESG reporting.
DanSIF	Growth has been quite low with only a few new members coming in – had a big reach early on, so there are not so many potential members remaining.	Climate change. Active ownership. Human rights.	Aim to further integrate ESG into investment decisions and are taking steps to improve the possibilities for Dansif to do this.
UKSIF	UKSIF membership has been stable at about 240 over the past 3 years, but this obscures a decline in individual financial adviser members offset by growth in larger corporate members.	Covered over 50 topics in the past 3 years: things which the membership request, or are new and shaping the industry. UN SDG's ; Fiduciary duty; Bees; Palm oil; Gender equality; Meat production; The circular economy; ESG integration; Cyber security	Three strands to our work: Informing, Influencing, Networking. Themes for work going forward will be: Leveraging outputs of EU High Level expert group on sustainable finance. Leveraging success with pensions regulator on fiduciary duty in company pensions by applying it to personal pensions. Developing a communications strategy.

Section 3

Cross-cutting investment issues

While each of the best practice leaders has their own unique issues to confront, there are many cross-cutting issues that will have to be addressed by virtually all of them. This report touches on three such themes, which are:

- Active and passive investment approaches
- Climate Change
- Ethical Screening

3.1

Active and passive investment approaches: Does an active investment style enhance RI efforts?

There was broad consensus among respondents that, while active management is not an absolute prerequisite for an effective RI strategy, it does provide greater opportunities to deploy the full range of RI tools than do passive ones. At the same time, it was a significant majority view that passive strategies are also suitable for RI, and that both investment styles should be used with an RI underpinning philosophy, albeit with somewhat different RI approaches and objectives.

There was a general consensus among interviewees that active investment is arguably the purest format for implementing an RI policy. With active management, all the tools in the RI toolbox can be utilized: individual stock selection (positive screening or ESG integration); the exclusion of individual securities or entire industry sectors regarded as undesirable by the asset owner (negative screening); and company engagement. In the case of company engagement, active strategies have a particular advantage. Almost by definition, active portfolios typically contain only a fraction of the number of companies found in most passive portfolios. With a much smaller number of companies in the portfolio, the portfolio manager can know each company and its management in much greater depth than is practically possible with a passive strategy, which may have positions in thousands of stocks. This greater familiarity with a company's strengths, weaknesses, and challenges creates the potential for much more granular and effective engagement.

By contrast, with passive strategies, individual stock selection or over/under-weighting are much more difficult to achieve; expressing a view on the ESG merits of an individual company is essentially impossible where the passive strategies use conventional, market capitalization-weighted benchmarks.

However, given the significant growth in the use of passive strategies over the past five years, it becomes all the more important to consider the application of RI tools to that investment style. For the largest asset owners, passive portfolios can constitute 80% of their total managed

assets, or even more. Under these circumstances, if an asset owner wishes to implement an effective RI strategy, it therefore becomes imperative to integrate RI into the passive portfolios. Engagement, especially when focused on systemic issues, is an RI tool which is particularly well-suited to passive portfolios. Because they are typically much larger than their active counterparts, passive investors generally bring a substantial base of assets, and thus influence, to the engagement process. In such cases, it is really the volume of assets supporting the engagement which lends this weight and influence, not the fact that the portfolio happens to be passive.

This is particularly true when investors collaborate in a collective engagement exercise (for example, under the aegis of the PRI[68]); engagement with passive strategies can represent a significant weight of shareholder funds and have a powerful transformational effect on individual companies. The recent collective mobilization of asset owners with respect to the climate change policies of several oil majors through the "Aiming for A"[69] initiative provides a recent case in point. A number of our interview subjects reported that they had participated in one or more collective engagements through the PRI, and believe that their influence and impact were magnified as a result.

It should be also noted that engagement with passive portfolios is often qualitatively different than it is with active strategies. With active portfolios, the engagements are typically much more narrowly focused and company-specific. By contrast, engagement under passive strategies is typically directed towards broader, more systemic issues.

The time frames for engagement also tend to be different. The holding periods for most of the securities held in a typical active portfolio may be only one or two years, or even less. In order to create shareholder value, therefore, the engagements must be focused on areas where the desired changes can be made relatively quickly. By contrast, apart from the quarterly rebalancings which only change portfolios at the margin, the companies in passive portfolios are typically held for a relatively long time. In some respects, this makes passive portfolios even more suitable for engagement around sustainability issues, which tend to have impacts over longer time horizons as well. The view was expressed to us that, because of the longer time frames typically associated with passive strategies, it may be appropriate to focus that engagement not on individual companies and relatively short-term results, but rather on over-arching, system-wide issues, which typically take longer to resolve.

In addition to company engagement, the other RI tool available to passive investors is the creation of custom benchmarks which can express the investors' views on particular industry sectors and activities. In recent years, for example, as climate change has become a greater concern for a number of long-term investors, several have invested in "fossil-free" passive indexes. There is also a third approach, which is basically a synthesis half-way between active and passive strategies, called "smart beta". It is becoming increasingly popular among institutional asset owners and was mentioned favourably by a number of our interviewees.

Smart beta approaches generally take a traditional market benchmark, but then "tilt" it by overweighting one or more traditional investment factors, such as momentum, low volatility, growth, or value. Over the past few years, there has been a growing trend to include ESG

68 https://www.unpri.org/page/pri_website_base.collaboration-platform

69 http://investorsonclimatechange.org/portfolio/aiming-for-a/

factors in that list of potential tilts. Under this approach, the asset owner or manager consciously incorporates ESG considerations in the design and construction of what are typically customized indexes. They are then managed passively, typically with very low tracking error and turnover. These smart beta indexes, with differing tilts towards one or more ESG factors, can typically mobilise and absorb large volumes of assets.

To summarize the discussion about the relationship between investment styles and RI, we find that active management is not a prerequisite for an effective RI strategy, although it is generally considered to be the most effective investment style for doing so. Importantly, however, passive and semi-passive (smart beta) strategies also lend themselves to RI. In the case of fully passive strategies, the RI dimension is added through active engagement with companies and organizations, or through the creation of custom indexes which incorporate exclusions. With smart beta, there are two opportunities for applying RI considerations: in the index design itself; and then subsequently via engagement.

3.2
Climate Change: driving disruption and innovation

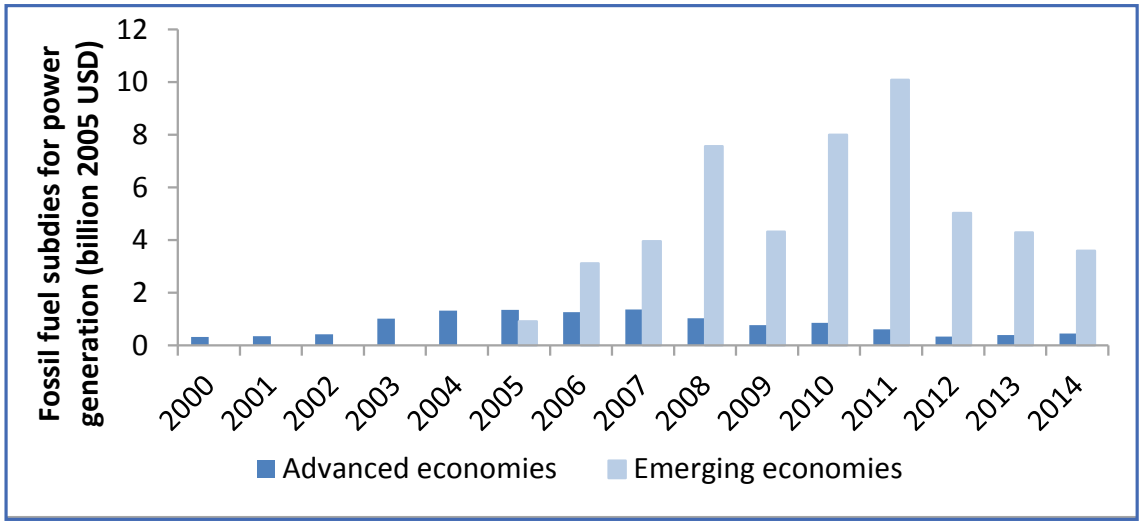
Asset owners in a climate of change

Whether in passive, active or semi-passive alternative portfolios, those asset owners leading on climate change explained in interviews how they are moving to understand the critical investment threats created for long-term asset protection and growth. The leading funds are also exploring opportunities across asset classes. The emergence of new industries, the transition to a more diversified, low carbon energy future *(see Figure 2: Key trends in support for fossil fuels used in power generation)*, and the possible investments in those technologies and services coming to market to mitigate the causes and impacts of global warming are opening new investment pathways.

Figure 2

Key trends in support for fossil fuels used in power generation

2000-14, by country group, in billion 2005 USD. *Source: OECD (2015k)*



The most advanced funds are thinking beyond investment strategy to broader systemic issues with significant implications for the overall global savings system. For example, a UK asset owner is exploring links between climate and longevity and now expects, as a matter of course, for the actuaries it works with to address climate change in a meaningful way. One European fund is concerned both from the standpoint that large asset owners may already be holding "stranded assets" and that a regulatory-driven repricing of climate risk may, in the future, challenge asset owner capabilities to match assets and liabilities over the long-term. Clearly, funds interviewed understand that the future reality of the "stranded assets" concept depends heavily on the evolution of public policy that will determine the future of the climate regime. Also, the "stranded assets" concept could extend beyond fossil fuel processes and technologies if policy changes undermine new and emerging technologies.

Asset owners earlier in the climate change journey note the critical importance of learning from those peer institutions more advanced in understanding the investor-relevant implications of global warming. The role of leadership organizations in climate change, such as CalPERS, ERAPF, Norway's GPFG, New Zealand Super, and PGGM Asset Management, cited by asset owner peers, provide critical signposts for future action by the broader investor community.

Those funds most advanced on climate change issues described in interviews why they are working with academia to redefine how they can invest in this complex space, and also how to measure the impacts of their investments, when the market fails to deliver credible solutions aligned with their needs.

Interviewed funds report that increasing policy, regulatory, and peer group preferences, and in a limited number of cases, beneficiary expectations, are influencing how asset owners disclose the carbon dimensions of their holdings. The evolving metrics associated with carbon foot-printing and the carbon intensity of holdings will increasingly be reflected in climate-related RI Best Practice expectations and disclosure in the mid-term to 2020.

The leading asset owners are well versed on the work of the Financial Stability Board's TFCD and believe that it will bring significant changes to how multiple actors across the investment chain, including asset owners, report on the climate impacts of their investments and the measures they are taking to address decarbonisation.

The leading funds are denoted also by their active, committed and, in some cases, long-term engagement and thought-leadership activities in climate-related public policy negotiations *(see Box 2: Climate negotiations in brief).* Those asset owners in the vanguard of the investor climate response stress the need for on-going collaboration with similar institutions through credible, evidence-based academic and voluntary initiative platforms.

Despite advances made by the leading asset owner RI practitioners, there is a belief that the majority of asset owners are at an earlier point of consideration of the threats and opportunities posed by global warming for their investment beliefs, policies and investment decision-making. For those asset owners interviewed, they believe that the systematic and systemic integration of climate issues along the investment chain is not yet mainstreamed although significant advances have been made.

Box 2

Climate negotiations in brief

After 23 years of UN convened climate negotiations, in December 2015 governments backed the Paris Climate Agreement[70] and the Marrakech Action Proclamation[71] (MAP) that followed in 2016. Asset owners are far more embedded as observers to this UN process in recent years, either directly or through collective investor initiatives, than they were a decade ago. The investor voice is now readily welcomed to the UNFCCC processes. Essentially, these UN agreements were a commitment to keep planetary warming above pre-industrial levels below 2 degrees centigrade during the 21st Century. As of the latest UNFCCC Conference of the Parties (CoP23) that convened in Bonn, Germany, in November 2017, 169 countries, of those 197 which are parties to the UNFCCC, have now ratified the agreement. The full implications of the withdrawal of the USA from the Paris Agreement, announced in early June 2017 but not legally implementable until November 2020, remains to be seen. In response to the withdrawal by the US Federal Government, the US Climate Alliance,[72] now backed by 15 US States, was created also in June 2017 by a group of States promoting the importance of US climate action at the sub-Federal level. Some observers[73] argue that the compelling economics of both climate threats and opportunities has now moved beyond politics into a market-driven phase.

Climate change: the asset owner response

For those asset owners interviewed, the response to the complex risk-reward dimensions of climate change is both diverse and marked by significant variance. A number of the most proactive institutions addressing climate issues in their governance, investment policy and investment decision-making accept that climate change has the potential to create impacts at the global and sectoral markets levels, across all asset classes, and in their entire portfolio holdings. These asset owners are also characterised by an understanding that a collaborative response — policy-wise, academically and in engaging investee sectors and corporations — offers a cost-efficient pathway for asset owners responding to an "existential"[74] issue.

As part of this focused assessment of climate change risk and opportunity, these asset owner leaders are working to understand the potential threats to their long-term investment positions of "stranded assets"[75] and how this is playing out in the real economy now and in the future.

For indicative examples of how leading asset owners are responding to climate change see Box 3: Proactive asset owners addressing climate change.

70 http://unfccc.int/paris_agreement/items/9485.php

71 https://unfccc.int/files/meetings/marrakech_nov_2016/application/pdf/marrakech_action_proclamation.pdf

72 https://www.usclimatealliance.org/

73 http://www.smh.com.au/environment/climate-change/tide-has-turned-global-rating-agency-says-climate-economics-trump-politics-20171012-gyzhey.html

74 Interview with New York State Common Retirement Fund, 20 September 2017.

75 http://www.lse.ac.uk/GranthamInstitute/faqs/what-are-stranded-assets/

Box 3

Proactive asset owners addressing climate change

See below five examples where the interviewed asset owners are addressing the threat of climate change and the opportunities of the unfolding energy transition in a diverse and dynamic way:

Example 1: CalPERS have made a commitment that across all of their investments, in the next five years, they will have integration of ESG considerations across the board. Towards that in the context of data and reporting, CalPERS is working with: SEC[76]; FASAC (FASB)[77]; PSION[78] (audit); IFRS[79]; FASB[80]; SASB[81]; and the Council of Institutional Investors to inform the standard setting process for piloted reporting standards that capture ESG risks. Also, the institution sees a fundamental demographic change in that the spending power of Millennials is replacing that of "Baby Boomers" and this group is more tuned to environmental concerns[82] such as climate change. Such demographic shifts are "powerful"[83] and, increasingly, will drive future developments relevant to RI Best Practice;

Example 2: EAPF are committed to making their portfolio more resilient to a changing world and towards this have taken three practical steps: close monitoring of managers on a trust and verify basis; carbon foot printing of the portfolio; and employing more specific benchmarks. Systemically, EAPF was part of a collective UK effort to make climate change part of mainstream actuarial activity which includes actuaries "recognising the validity of the climate question" and being able to address it in a meaningful way. The dialogue with actuaries has included a focus on climate change and longevity thereby taking the issue "beyond investment strategy";

Example 3: ERAFP is, amongst a broad range of climate related initiatives, seeking an amendment in its regulatory framework allowing asset allocation to go beyond the current 3% cap on unlisted equity and infrastructure to potentially capture more investment upside of the low carbon energy transition[84]. Also, dissatisfied with the inherent biases brought by existing benchmarks ERAPF worked with a French academic institution, EDHEC Risk Institute[85], and FTSE[86] to create a risk-weighted index to serve its climate related investment needs. ERAPF is concerned over how stranded assets might threaten the future ability of the asset owner community to match assets and liabilities if a price shock, possibly related to carbon taxes, emerges from within the global and or national policy communities;

Example 4: New Zealand Super has embedded a four-point climate strategy across its entire investment portfolio with a stated aim of making the Fund more resilient to climate risk. The Fund is advocating in a high-profile manner[87] for Global Financial Institutions, such as the World Bank, to act as a clearing house for climate proofed infrastructure projects to serve the varied needs of diverse asset owners;

Example 5: PGGM Asset Management has a stated objective, described during interview, to allocate €20 billion to four impact themes by 2020, one of which is climate change (risk and opportunity). PGGM is working with Harvard University, the City University of New York, and Wageningen University, to measure the impact of its investments on the focus themes. €12 billion of the €20 billion target has been allocated to date. PGGM's 180 external managers must all have ESG policies in place and the organization provides guidance to managers on what is required.

76 https://www.sec.gov/

77 http://www.fasb.org/fasac/

78 https://www.frc.org.uk/getattachment/f77a8ced-853a-44f8-9632-f1f4d675c835/Practice-Note-15-(Revised)-November-2017.pdf

79 http://www.ifrs.org/

80 http://www.fasb.org/home

81 6 https://www.sasb.org/

82 Interview with CalPERS, 2 October 2017.

83 8 Ibid

84 Interview with ERAPF, 5 September 2017

85 http://www.edhec-risk.com/

86 http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/indices/summary/summary-indices.html?index=UKX

87 https://www.nzsuperfund.co.nz/news-media/nz-super-fund-ceo-adrian-orr-speaks-world-bank-imf-annual-meetings

Policy and markets

Asset owners were absent from climate policy discussions for the bulk of the 25 years during which they have taken place within the intergovernmental sphere. As a group, asset owners became directly engaged in this process in the mid-2000s and intensively so as a collective body during the November 2011 UNFCCC CoP in Durban, South Africa. Two factors have driven deeper involvement of asset owners in the policy process: firstly, a growing awareness amongst institutional investors over the last decade of the threat of systemic change to long-term assets and the financial system itself; and secondly, more recently, an awakening within the policy community of the need to mobilise private capital to address the global challenge posed by global warming. This change has driven direct engagement between climate policy-makers and the broad investment community. In short: over the past decade the interests of institutional investors and climate policy-makers have become more aligned on the need to address climate change and create a predictable regulatory environment for the allocation of capital.

Now, the leading asset owner institutions confirmed in interviews the increasing degree to which they are engaged in climate policy discussions at the intergovernmental and national level. The growing interest of major economic policy-making institutions, including the FSB, various Central Banks, the OECD, and the World Bank/IMF, amongst others, has accelerated asset owner engagement in policy processes.

Those asset owners engaged in climate policy understand that the emergence of markets and investment opportunities related to climate change have stemmed, essentially, from a science-based policy construct. This construct was framed by the Intergovernmental Panel on Climate Change (IPCC), established in 1988, and driven politically at the multi-lateral level by the parties to the UN Framework Convention on Climate Change (UNFCCC) adopted by governments in May 1992. The number of investor focused climate policy groups[88] has multiplied dramatically in recent years to the extent that the role of private and state-backed investors is a well-accepted part of annual negotiations.

The TCFD stressed four aspects for financial institution action in its June 2017 outcomes, namely: Governance; Strategy; Risk Management; and Metrics and Targets. With the four recommendations applicable across "all markets and jurisdictions" the political pressure for asset owners, asset managers and other significant institutions in the investment chain to adopt and adapt the TCFD recommendations will grow.

Investment challenges

All climate related investment opportunities are dependent, to a certain extent, on the manner in which an uncertain, and at times unpredictable, global policy process is embedded in regional and national policy and regulatory frameworks. Coupled with this, the maturity of climate-related markets, both public and private, is problematic for large asset owners in that projects often fall into a category that limits the prospect of economies of scale through the investment process. With the exception of robust and well-established parts of the renewable

88 Amongst others, key UN-backed investor relevant developments include: the UN Secretary General launched Financing Platform for the SDGs (October 2016); the UN-backed PRI (April 2006); the UNEP Inquiry into a Sustainable Financial System (2014); UNEP FI's Portfolio Decarbonisation Coalition (September 2014); and the UN-driven Sustainable Stock Exchange initiative (May 2008).

energy sector, often in developed countries, climate-related markets are often characterised by policy uncertainty, nascent technologies, smaller companies and smaller project size. As noted by the World Bank[89]: "Many green projects such as distributed renewable energy in cities, climate adaptation measures for buildings and district-level public transport projects tend to be at a smaller scale." Equally, in the funds sector, the size and track-record limitations of many climate-aligned investment products makes investment at scale challenging for large asset owners.

Climate-aligned fixed income

From the fund research interviews, it is clear that there is a strong interest for a climate-aligned fixed income market that grows to scale and, presently, such a market is at best nascent. The more knowledgeable and demanding asset owners are working with academic and specialist commercial partners to create their own more refined climate-focused indexes that serve explicit needs *(see Box 2, example 3/ERAPF)* and open new climate-related investment opportunities for them. Finally, the impressive growth of mainly project-related climate bonds over the past decade and, most recently, the emergence of climate-aligned sovereign debt issuance was noted by interviewees. Starting from a zero base in 2007 the climate and green bond market has grown exponentially in the past decade, but in terms of outstanding issuance still remains at less than 1% of the overall global bond market. Estimated issuance in 2017[90] will reach USD130 billion, with the entire climate-aligned bond universe estimated at USD895 billion. However, as noted, the entry into the market in 2017 of sovereign issuers, with France leading with a USD7.5 billion offering, observers are confident the market will reach a USD 1 trillion size by 2020.

3.3
Ethical screening practices

There is a long historical tradition of ethical investing. Investors of various faiths including Islam, Judaism and Christianity have traditionally avoided investments in undertakings that conflicted with their religious beliefs, such as the production of alcohol or tobacco or weapons. Over the course of the last 10 years, there has been a steady move away from ethical /SRI style investing, which can be summarised as "where not to invest", to RI-style investing which can be summarised as "where do we invest and how do we best influence portfolio companies and markets". Screening approaches are evolving and are increasingly based on the materiality of risks. One of the reasons for this is that the growth of RI practices has produced far more research in areas such as tobacco that were previously subject to normative based screening.

There currently appears to be no real consensus about negative screening among the major asset owners to whom we spoke; a significant number do practice it (NZ Super, PGGM, APG, Local Government Super in Australia, AP4), while several do not (including GPIF in Japan, the UK Environment Agency Pension Fund).

One trend which we see emerging over the last few years is a gradual overlap of the line between ethical and financial considerations. Increasingly, we see financial and investment

89 http://blogs.worldbank.org/psd/sovereign-wealth-funds-catalyst-climate-finance

90 https://www.climatebonds.net/

risk considerations being advanced alongside purely ethical ones. In the case of both coal and tobacco companies, for example, we were told that both motivations were relevant to their exclusion. Ethical concerns around the environment (coal) and health (tobacco) were cited for those two issues, but at the same time it was argued that the long-term financial prospects for both types of companies were also poor.

The two most common exclusions that were encountered were for certain types of weapons and tobacco. Most of the asset owners who practice exclusion emphasized that they had a very small list of standard exclusions. In some cases, additional exclusions were added which reflected the particular concerns of a local region or country. In New Zealand, for example, companies engaged in whale processing are excluded from the New Zealand Super portfolio. In Australia, where the destruction of old-growth forests is an issue, forestry companies that are active in such forests are excluded from the portfolios of Local Government Super.

The majority of asset owners interviewed who use negative screening in some form, do so because it is in line with the purpose and values of the organization and its ultimate beneficiaries. Exclusion is a tool among other tools, but there is a distinct preference for engagement with companies as a first option. There is general agreement that once one has divested (or indeed excluded a priori) a company, the ability to influence it towards improvement is essentially lost. There is also a consensus that, where exclusions are practised, they should be done through a process which is consistent, repeatable, and transparent. A number of interviewees referenced the need for exclusion where companies were in breach of universal and or normative standards, as well as explicit intergovernmental and governmental sanctions, recognised by their country's government.

Section 4
Where is RI headed?

Context: the rise of RI and what next?

Before looking at the future of RI it is important to understand its evolution in recent years, as such an exploration will help us understand where RI is headed.

The convergence and amplifying effect of three complex events during the past two decades have propelled a leading group of global asset owners to increasingly align their investment beliefs, strategic decision-making and actions with the evolving concept of RI. The complex risk-reward dynamics of these events — the global financial crash, governance failures in systems and corporations, and climate change — have catalysed a renewed exploration of risk in leading institutions entrusted with the savings of millions of people worldwide. As a deeper understanding of the risks these events exposed asset owners to emerged, the opportunities for investments in new industries, break-through technologies and better governed companies has crystallised also through the RI lens.

Since the late 1990s, concerns over systemic risks, whether man-made and or from changes to natural systems, to the overall long-term stability of the market system have grown. Threats to the natural systems, natural resources, value chains and market systems that investors depend on for returns have ensured that the institutions controlling the deepest pools of capital have sought answers to how they should organize themselves and operate in a changing world marked by various forms of volatility, old and new, with a capacity to destroy value.

As noted, the three critical events coalescing within the twenty-year period up to 2017 included:

- The global financial crash of 2007-8, and its on-going economic and social aftermath that focused forward-thinking asset owners in the vanguard of RI to look at risk more broadly;
- The once in three generations crash itself came after an intense series of "boom and bust" episodes for free-market capitalism — the Asian Crash (1997-98), Dot.com crash (2000-2) and the wave of corporate scandals[91] (2001-2003) — that worked to sensitize asset owners to deep governance risks both systemically and at the corporate level;
- The acceleration of our collective understanding of the potentially profound impacts of climate change on our political economy globally, our political and socio-economic systems, both regionally and nationally, and a range of broad human developmental drivers have deepened the asset owner need to think long-term in order to protect and grow assets for their beneficiaries.

91 https://www.gsb.stanford.edu/insights/what-led-enron-worldcom

The 21st Century version of RI focuses on the inter-linked complexity of ESG issues, evolved in parallel to the three significant events touched on above. An additional important driver for the emergence of RI during this period was a series of decisions within the multi-lateral system, notably the United Nations, to explore how the humanitarian, developmental and environmental interests of the global policy-making system were aligned with the interest of institutions managing capital for the long-term.

Based on the experience and insights of those interviewed for this project, it is possible to make some predictions about future developments in the RI space. Over the next 3-5 years, we would anticipate developments highlighted in the following section.

4.1
The continued mainstreaming of RI

The mainstreaming of RI?

A distinct challenge with RI is to determine the extent to which it has truly mainstreamed and to credibly assess the scale of global investments flowing across asset classes into the evolving RI space. There is a need to cut through the increasing coverage and social media buzz stemming from an accelerating range of ESG and sustainable investing activities driven by multiplying RI focused initiatives and policy-maker focus.

Clearly, over the past decade, and particularly since 2012, RI has been the subject of a much deeper level of interest for the largest asset owners across the world's main capital markets as the interviews supporting this report confirm. Whether the high profile global advocacy for ESG investing by the GPIF of Japan, the strategic decision by New Zealand Super to integrate a low carbon approach across its entire portfolio or the root and branch revival of CalPERS post its own deeply harmful scandal,[92] the adoption by leading asset owners in the space has been impressive. But we must ask how far beyond these leading institutions has RI penetrated?

One proxy for the scale of this phenomenon has been the growth of the PRI. When launched in April 2006, the PRI had 54 founding members with close to USD 5 trillion in combined assets. By November 2017, the membership of the PRI stood at 1859 institutions (broken down as 365 asset owners, 1260 investment managers and 234 service providers)[93] with total assets represented above USD 80 trillion, a testament to how rapidly RI has begun to penetrate the mainstream. Clearly, the total size of the managed asset universe creates an upper limit which makes continued growth at that level impossible. Instead, we foresee a continued increase in the depth and quality of actual RI implementation. Towards that goal, in 2016 the PRI, after an extensive global consultation, launched a 10-year "Blueprint for Responsible Investment."[94]

In November 2017, it is clear that, within the broad PRI signatory base, the degree of RI implementation currently varies widely. Some signatories will undoubtedly abandon the effort (or possibly be excluded for non-compliance with the Principles), but we expect the majority to remain, and continue their progressive RI journey. We consider this process to

92 http://www.latimes.com/business/la-fi-calpers-buenrostro-20160531-snap-story.html

93 https://www.unpri.org/signatory-directory/

94 https://blueprint.unpri.org/

be unstoppable, driven by a combination of stakeholder demand, regulatory pressures, and commercial opportunity.

A second potent indicator of the mainstreaming of RI is the recent arrival of large, traditional asset managers offering products that are ESG/sustainability-labelled. What was once a niche, specialist activity is becoming increasingly competitive, and populated by large, generalist managers responding to the growing commercial opportunity. We fully expect to see this trend continue.

4.2
Focus on climate change as an investment factor

Over the past three years, there has been exponential growth in the level of asset owner concern about the implications of climate change for institutional portfolios. Two recent developments, the Paris Climate Agreement and the findings of the TCFD have been instrumental in increasing the pressure on asset owners.

In October 2017, the CEO of New Zealand Super addressed the joint meeting of the World Bank and International Monetary Fund, underlining the importance of climate change as an increasingly critical investment risk-opportunity factor. He argued that failure to address climate change, and other ESG factors, was tantamount to an abdication of fiduciary responsibility. We anticipate that asset owner action on climate change will accelerate over the next three to five years, and this will lead to new innovative products targeted at asset owners.

4.3
Growing focus on UN Sustainable Development Goals

In September 2015, the UN adopted the SDGs. The SDGs are essentially the successor to the previous Millennium Development Goals (MDGs). The response of the investment community to the SDGs has been varied with interviewed asset owners seeing the potential of the SDGs, inter alia, ranging from: a public relations exercise; a reporting framework and or reporting tool; an amplifier encouraging investee companies to adopt and adapt ESG disciplines; a positive selection tool; and a reference point with which to generate SDG-aligned investment products.

A limited number of asset owners have gone further in their direct engagement with the SDGs as a framework to assist with their strategic considerations and investment decision-making. Led by the Dutch funds APG and PGGM, significant commitments are being made to try to integrate the SDGs into investment policies and practice. APG, for its part, intends to double its portfolio of "high sustainability investments" to EUR 58 billion by 2020. Nor are the Dutch funds alone in this regard: in Sweden, the four AP buffer funds have announced their intention to use the SDGs as an investment framework, as has CBUS, the construction workers' pension fund in Australia. What is qualitatively new about the SDGs is that they invite investors to move beyond viewing them as sources of downside risk to a different approach, where investors seek to produce direct outcomes by deploying their capital in a manner aligned with the universal owner theory.

4.4

A "total portfolio" approach

We expect to see an increasingly strong effort by RI leaders to spread the integration of ESG analysis throughout their entire investment platforms, whether this is accomplished via internal or external portfolio managers. There are two dimensions to this: the use of ESG analysis in as many asset classes as practicable; and efforts to integrate ESG considerations into all investment decision-making. For some, such as CalPERS in the United States, the Environment Agency Pension Fund in the UK, APG in the Netherlands, or Sweden's AP4, this will likely mean a decreasing emphasis on discrete, stand-alone sustainability-mandate portfolios in favour of an attempt to integrate ESG across their entire investment platforms. Even the most advanced asset owners view this as a multi-year project although this does not mean the end of stand-alone RI mandates, particularly for asset owners lacking the scale and resources of the biggest players. In practice, this also means the expanded application of ESG analysis beyond listed equities and into additional assets classes.

4.5

Growing attention to systemic issues

Broad, global issues affect entire portfolios. For this reason, universal owners have a strong vested interest in the entire global economic, social, and environmental system, and will benefit if overall standards and conditions in those systems are as positive and favourable as possible. In practice, therefore, a number of large asset owners have concluded that constructive engagement on broad, systemic issues is at least as important as engaging with individual portfolio companies. Indicative of the growing interest in systemic issues is the UNEP Inquiry. The Inquiry is a global, multi-year collaborative initiative addressed at systemic conditions and their current and potential impact on global sustainability. Its 2015 report, *The Financial System We Need*,[95] analysed practices, impediments, and opportunities in over 15 countries worldwide, and the Inquiry has published over 70 working papers.

In the case of stock exchanges, a specific, dedicated initiative has been underway since 2009: the Sustainable Stock Exchanges initiative (SSE). The SSE is a global collaborative initiative launched by then-UN Secretary General Ban Ki-Moon. Importantly, it also includes the World Federation of Stock Exchanges, and currently involves some 66 stock exchanges, from Argentina to Zimbabwe. The SSE is a classic example of an initiative focused on the systemic, framework conditions within which individual companies operate, and has had significant input from asset owners. We fully expect asset owners' interest and contributions at the system-wide level to continue and build as part of the PRI's 10-year Blueprint for Responsible Investment.

4.6

The rise of ESG-enhanced "smart beta"

Partly because of their lower costs and their typically low tracking error relative to conventional benchmarks, the growth of smart beta strategies in general has been exceptional. Today, roughly 46% of institutional asset owners surveyed recently have an allocation to

95 http://unepinquiry.org/publication/the-financial-system-we-need-from-momentum-to-transformation/

such strategies, an increase of fully 77% since 2015. Moreover, this momentum seems to be continuing: in the first quarter of 2017, year-on-year growth in new assets devoted to smart beta was over 2,000%.[96]

With specific regard to RI, what is particularly relevant about the rapid growth of smart beta is the recent development of indexes which include ESG considerations among the factors. According to FTSE Russell's 2017 survey of global institutional investors,[97] 41% of those investors currently using or considering using smart beta intend to incorporate ESG considerations in them. From a fund's perspective, such indexes offer at least three significant benefits: relatively low cost; typically very low tracking error risk relative to conventional, market capitalization-weighted benchmarks; and an opportunity to express, at least in part, their investment beliefs about ESG. In short, we believe that the incorporation of ESG factors into smart beta strategies will be an important trend in the RI space.

4.7
Growing stakeholder scrutiny of RI claims and the Millennials

Finally, we believe that institutional investors should prepare themselves for an increased level of scrutiny and scepticism about their claims regarding RI programmes and performance. The growing volume of available information about asset owners' activities and the rise of social media empowers cost-free commentary. There is also growing regulatory pressure for greater transparency and disclosure on ESG performance: France's Article 173's[98] requirement for investors to disclose their climate risk and a similar requirement for public pension funds in Sweden, are just two early examples.

With the purchasing power of millennials taking over the purchasing power of the baby-boomers, one can expect more emphasis on themes like climate change, environment and inequality. Recent research[99] [100] on millennials' investment preferences shows a clear generational drive in favour of RI.

As one of the asset owners interviewed in this project commented,[101] the tide is running in wider society in line with these issues. The question is, which asset owners will be front runners and "the best in finance" over the next ten-year period.

"The best in finance are regaining their sense of purpose by recognizing that finance is not an end in itself, but a means to promote investment, innovation, growth and prosperity."
Mark Carney, Governor of the Bank of England.[102]

96 FTSE Russell, Smart Beta: 2017 Global Survey Findings www.ftserussell.com/smart-beta-survey.

97 Ibid.

98 http://www.frenchsif.org/isr-esg/wp-content/uploads/Understanding_article173-French_SIF_Handbook.pdf

99 "Millenials Drive Growth in Sustainable Investing", August 2017 See: http://www.morganstanley.com/ideas/sustainable-socially-responsible-investing-millennials-drive-growth.html

100 Opinium Research on behalf of Triodos Bank, October 2016: https://www.triodos.co.uk/en/about-triodos/news-and-media/media-releases/socially-responsible-investments-research/

101 From interview with Anne Simpson, Senior Portfolio Manager and Head of Corporate Governance at CalPERS, 2 October 2017.

102 Speech by Mark Carney, Governor of the Bank of England to graduates at the University of Alberta, Canada, 8 June, 2016. See: https://www.theglobeandmail.com/report-on-business/university-graduates-entering-volatile-job-market-mark-carney-says/article30354198/

Annex I

Institutions and experts interviewed

Asset owner[103] institutions

AP4

Arne Lööw — Head of Corporate Governance

APG

Mirte Bronsdijk — Senior Corporate Governance Specialist

Anna Pot — Manager: Responsible Investment

CalPERS

Anne Simpson — Head of Corporate Governance

Divya Mankikar — Sustainability Investment Manager

CalSTRS

Chris Ailman — Chief Investment Officer

Canada Pension Plan Investment Board

Stephanie Leaist — MD & Head of Sustainable Investment

Environment Agency Pension Fund

Mark Mansley — Chief Investment Officer

Faith Ward — Chief Responsible Investment and Risk Officer

ERAFP

Philippe Desfossés — Chief Executive Officer

Marie Marchais — SRI Officer

Future Fund

Will Hetherton — Head of Public Affairs & Strategic Relations

Joel Posters — Head of ESG

GIC

Wai Keong Loh — Director of Enterprise Strategy

Arun Vasudevan — Senior Vice President of Enterprise Strategy

Rachel Teo — Senior VP

GPIF

Hiromichi Mizuno — Executive Director & CIO

Hiroshi Komori — Head of Stewardship

103 14 of these institutions are asset owner institutions and three are asset managers who all represent dominant asset owner clients.

Ireland Strategic Investment Fund

Eugene O'Callaghan — Director
Emma Jane Joyce —Senior Manager

Local Government Super

Bill Hartnett — Head of Sustainability

New York Common Retirement Fund

Gianna McCarthy — Director of Corporate Governance

New Zealand Superannuation Fund

Anne-Maree O'Connor — Head of Responsible Investment

Ontario Teachers' Pension Plan

Deborah Ng — Head of Responsible Investment

PGGM

Eloy Lindeijer — Chief Investment Management, PGGM, and a member of the Executive Committee

Public Investment Corporation

Rubeena Solomon — Executive Head: Investment Management

Experts

Helga Birgden

Principal and Head of Responsible Investment Business at Mercer Investment Consulting

Gordon Clark

Professor and Director of the Smith School of Enterprise and the Environment at Oxford University with cross-appointments between the Said Business School and the School of Geography and the Environment at Oxford

Archana Hingorani

Former CEO IIML/IL&FS and Co-Founder of Siana Capital Investments

Catherine Howarth

CEO at ShareAction

Mervyn King

Chairman of King Committee on Corporate Governance / Chair of International Integrated Reporting Council / Member of the Committee for Responsible Investment Guidelines for Financial Institutions (CRISA)

Luiz Maia

Managing Partner at Brookfield Capital Partners

John Oliphant

Executive Director — Third Way Investment Partners / Member — PRI Advisory Council / Chairman of the Code for Responsible Investing in South Africa (CRISA)

David Pitt-Watson

Executive Fellow — London Business School / Chariman — Hermes EOS / UNEP FI Co-chair

Martin Skancke

Chair of PRI Association Board

Takejiro Sueyoshi

CEO of the Green Finance Organization Japan and Special Advisor to UNEP FI Asia Pacific region

Roger Urwin

Global Head of Investment Content at Willis Towers Watson

Annex II
RI Profiles

This Annex supplements the asset owner perspectives on best practice in RI that are assessed at an aggregate level in Section 1.1 of the main report. 12 asset owner institutions and three asset managers all representing dominant asset owner clients, have agreed that their RI efforts be portrayed in more detail through "RI profiles" covering the following main headlines:

- Why is RI important to your organization?
- How is RI embedded in policies and implemented in practice?
- What tools and resources are used, and what are the costs?
- What are the outcomes (on portfolio value, on trust, reputation, standing)?
- Is active management a prerequisite to RI?

The authors of this report hereby acknowledge the overall high level of transparency and willingness to share information that all these institutions have displayed in the research process. The research findings demonstrate how rich, diverse and innovative current RI practices are. It is clear to us that these finding will contribute to the on-going dialogue around current and future development of RI best practices globally.

RI PROFILE of Fjärde AP-fonden (AP4)[104]

Background on AP4

AP4 has €36 billion under management and is one of five buffer funds in the Swedish pension system. The Fund is a governmental authority whose operations are regulated in the Swedish National Pension Funds Act. The Fund shall independently formulate its targets and strategies, to fulfil the task. The Ministry of Finance continually supervises and evaluates the business.

Investment strategy and asset allocation

AP4's mission is through the management of fund capital to maximize shareholder value over time, thus contributing to the stability of the pension system. Environmental and ethical issues must be taken into account without compromising the goal of best possible return.

All listed and tradable instruments except commodity-related investments are permitted. At least 30 percent of assets must go into fixed income securities with low credit and liquidity risk. No more than 5 percent of the assets may be invested in unlisted securities. External managers should manage at least 10 percent of assets.

Why is RI important to AP4?

To AP4, RI is all about long-term performance. The Fund believes that companies doing well in ESG are doing well in finance. It is a must to factor in ESG. It is part of AP4's day to day job. It is also a trust-builder for the Fund as an owner. The Fund has strong backing on RI from the top, both at management and board-levels. *"We are an owner more than an investor."* (Arne Lööw, AP4's Head of Corporate Governance).

How is RI embedded in policies and implemented in practice?

AP4's first ownership policy dates back to 1986 where the terms "engaged owner" and "responsible owner" were used. While company engagement is a corner stone of AP4's RI efforts, ESG integration has been practiced in a more structured way over the last 10 years. It is getting increasingly more important. Implementation lies with the portfolio managers who are in ongoing dialogue with a lean RI-team of three. In the past, the RI team had to prove why this makes sense. This is not the case anymore. The whole organization knows what to do and why it is important.

What tools and resources are used, and what are the costs?

AP4 uses:

- Screening tools through:
- — External help with incident-based weekly updates, supplemented by more thorough information ad hoc
- — Some internal screening, supplemented by external help, with more of a best practice angle e.g. finding the best CO_2 performers in each sector

104 This profile is based on information provided during interview carried out 15th September 2017, and on publicly available information.

— Going forward AP4 want to fine-tune the screening and do more in-house. AP4 want to look at other areas where screening might be suitable, both positive or negative. Water-use could be one area.
- Portfolio management: ESG and sustainability is one source of information for PMs
- Engagement is a very important tool:

— Engagement with Swedish investee companies is done in-house
— Non-Swedish equities: AP4 has some direct contact with companies, but most of that engagement is done through the Council on Ethics of the Swedish National Pensions Funds AP1, AP2, AP3 and AP4.

The cost for screening is seen as a natural part of AP4's investment cost. AP4 does not do a breakdown of costs related to RI policy and implementation. The total cost for the whole fund is 10 basis points.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

AP4 sees three main outcomes:

Performance: Based on AP4's overall investment beliefs, RI is seen to enhance long-term returns. ESG investment has to compete with other investments. The same performance criteria apply as for all investments. It is measured against the ordinary index.

Minimising risks: This is important and ESG integration clearly helps the Fund manage risks more robustly over the long term.

Trust and reputation: AP4 believes that its RI efforts are having a very good impact on its standing.

Is active management a prerequisite to RI?

In AP4's view, you still have a responsibility as an owner, even if passively invested. In the Fund's index-linked portfolios they do engagement, although not as deeply as with actively managed portfolios.

RI PROFILE of APG[105]

Background on APG

APG administers over 30% of all collective pension schemes in the Netherlands, managing a total of €457 billion (September 2017) of assets. ABP (€389bn Dutch civil service pension scheme) is APG's main asset owner client. APG works for over 40,000 employers, providing the pension for one in five families in the Netherlands (approximately 4.5 million participants).

105 This profile is based on information provided during interview carried out 5th October 2017, and on publicly available information.

Investment strategy and asset allocation

APG Asset Management focuses on good and affordable pensions for the current and coming generations, investing with a goal of securing the best possible returns at an acceptable risk. Environmental and social aspects as well as governance principles are factors in all investment decisions. APG sets out the framework along with its clients for their investment policy and strategy. This results in a well-balanced and suitable investment portfolio. APG continually tests its policy on risk, funding ratio, liabilities, yield development and agreements made. Every three years, an ALM (Asset Liability Management) study is performed. The majority of APG assets are managed in-house (80%). APG offers a wide range of asset classes to achieve an optimal portfolio construction.

Why is RI important to APG?

Corporate Governance (CG) and RI are an integral part of APG's investment processes. This has been APG's conviction for nearly ten years.

RI is integrated in each and every asset class. It is seen as contributing to APG's risk-return targets and general sustainability. APG's clients and beneficiaries feel very strongly about RI. This is the number one driver for APG and it gives a clear view on what it is APG should focus on. There is also a growing consensus that the end beneficiaries care about ESG and sustainability.

In October 2015, APG reinforced their RI policy in line with clients' goals and targets for the long term. As a result, for example, APG has set tangible carbon footprint targets and defined engagement themes.

APG holds a clear belief that ESG integration helps its investments. The biggest change in APG's journey, and the biggest achievement, is that they have established a new way of investing. The investment teams and the individuals are picking it up and RI has spread from the RI team to the portfolio managers. There is better knowledge sharing and more efficient cross-team collaboration.

How is RI embedded in policies and implemented in practice?

APG has established Investment Beliefs[106] which clearly encompass RI. In a revised RI policy from 2015, APG has established an "Inclusion Policy". This is an internally developed policy methodology where APG selects companies to engage with based on norms and ESG-indicators. APG doesn't buy ESG ratings, but using raw data from data providers they select specific ESG indicators that are deemed important to the companies and sectors APG invests in. APG's current listed equities portfolio holds 4,500 companies. These are all covered in the Inclusion Policy methodology. The aim is to identify leaders and laggards in the portfolio and to be able to target those that need to change. APG will divest if there are no realistic prospects for improvement. This is an important tool for APG to know their investments and to be able to explain that to clients.

106 https://www.apg.nl/en/asset-management/our-beliefs

By 2020, APG aims for all companies in their capital markets portfolios to have been assessed and the Inclusion Policy to be implemented. APG has started with the internal equity portfolio and has a roll-out plan for how to get there.

The revised RI policy also includes:

- **Carbon footprint reduction targets**: APG has done carbon foot-printing since 2014, but are now developing a methodology where each portfolio manager has a CO_2 footprint budget. This gives clear insight into how their portfolio contributes to the overall APG portfolio. The target is to reduce APG's overall carbon footprint by 25% by 2020.
- **Investment targets for UN Sustainable Development Goals**: APG has a policy target of investing in renewable energy and doubling investments in SDIs (Sustainable Development Investments) to a level of €58bn by 2020. In collaboration with PGGM, APG has developed SDG taxonomies,[107] which give clear guidance on what type of investments qualify as SDIs.
- **Thematic engagement targets**: Including no child labour in cacao, labour standards in ship building, and human rights in the extractive industries.

The majority of APG assets are managed in-house. All external asset managers are on board in implementing the RI policy. APG expects and ask a lot of asset managers in supporting implementation of the RI policy. An assessment tool of external managers has been developed and is done in-house by APG.

What tools and resources are used, and what are the costs?

APG currently has 15 people in their Global Responsible Investment & Governance team working on issues across all asset classes. The team covers different areas: Energy, Climate change, Stakeholder engagement. One colleague focuses on ESG integration in alternatives. Another colleague focuses on real estate (listed and unlisted) using GRESB standards as a benchmark.

Engagement and voting: APG enters into dialogue with companies aiming to improve corporate governance and responsibility. UN Global Compact compliance is a benchmark for APG. Both equity and debt provide an angle for engagement. The RI and Governance team consults with the portfolio managers on voting decisions.

Negative screen and positive selection: APG has a negative screen encompassing certain types of weapons; landmines, chemical and biological weapons (banned under Dutch law and international regulations). APG also excludes sovereign bonds that are under arms embargo by the UN Security Council. On the other end of the spectrum, APG will actively look for attractive investments that include sustainability.

Knowledge sharing: APG has developed internal systems that allow its investment professionals to access and share ESG data and research on companies, and log and monitor company engagement throughout the organization (not just within the RI team). The systems allow the setting of clear engagement objectives and are useful for APG's clients in monitoring progress made on engagements and in implementing the RI policy.

107 https://www.apg.nl/en/article/Potential%20sustainable%20development%20investments%20bridging%20the%20gap%20between%20the%20UN-s%20targets/919

It is ultimately APG's clients who decide on the allocation of resources. They are very cost aware but also very committed to RI. Clients have supported the growth of APG's RI and Governance Team.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

"RI contributes to securing risk-adjusted returns." (Mirte Bronsdijk, Senior Corporate Governance Specialist at APG Asset Management).

In implementing the RI policy, APG aims to contribute to the trust and reputation of its clients. APG is vocal about its beliefs and actions, while trying to make the clients the focus point of attention when sharing policies and activities publicly. It is challenging if there is a controversy at an investee company, but APG's aim is to always be well-informed. APG sees thought leadership as a priority and tries to get other asset owners and asset managers to emphasise RI in their operations.

Is active management a prerequisite to RI?

95% of APG's assets are actively managed. That is beneficial to how the Fund integrates ESG issues. There are ongoing discussions between the RI team and portfolio managers, which enhance the level of dialogue and engagement with portfolio companies. Eight years ago, financial and strategic decisions were core to company discussions and ESG was on the side. Now, APG has adopted a collaborative approach where ESG is a common topic.

Active management strongly contributes to the ability to integrate ESG factors. It will be more difficult to implement an RI policy in a passive strategy. There is more distance to the underlying investment and more difficulty in integrating ESG factors. However, it may be easier to exclude a specific sector — if you so wish.

RI PROFILE of CalPERS[108]

Background on California Public Employees' Retirement System (CalPERS)

CalPERS is the largest public pension fund in the US with $344.59 billion under management (November 2017). The mission of CalPERS is to provide responsible and efficient stewardship of the pension system to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries.

The legal authority for the activities of CalPERS can be found in the constitution, laws, and regulation of the state of California. CalPERS is overseen by a 13-member Board of Administration whose members are elected, appointed, or ex officio.

108 This profile is based on information provided during interview carried out 2nd October 2017, and on publicly available information.

Investment strategy and asset allocation

Strategic asset allocation is the dominant determinant of portfolio risk and return; a well-diversified portfolio shapes long-term performance, protects the Retirement Fund, and ensures any weaknesses in one area are offset by gains in another.

CalPERS investment beliefs include, amongst others:

- A long investment horizon is a responsibility and an advantage (considering the impact of investments/investment strategies; the impact in investee companies; taking advantage of factors that materialise slowly; recognising the critical importance of a strong durable economy)
- CalPERS' investment decisions may respect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries
- Long-term value creation requires effective management of financial, physical and human capital

The Board has adopted asset allocation targets for CalPERS' defined benefit pension plans across global equities (50%+), PE (10%), Global Debt (20%), Real Assets (12%), Inflation and Liquidity (less than 10%). CalPERS is one of the largest PE investors in the world.

Why is RI important to CalPERS?

CalPERS' RI agenda is bold and comprehensive and is moving away from carve-outs to a total-fund, ESG integration exercise. The Fund's liabilities stretch out beyond 70 years. Systemic issues are material for a diversified, long-term asset owner like CalPERS. In alignment with members' interests, the Fund sees climate risk, resource scarcity and income inequality as relevant to its operations and investment performance.

There are two critical governance issues on CalPERS' agenda: 1) Supporting the reform effort in Washington (Dodd-Frank) and 2) Advocating corporate governance and shareholder rights, including majority voting and the right to vote against directors. CalPERS laments the weak voting influence in US companies, with its many ensuing difficulties. There are few incentives for companies to talk to shareholders. CalPERS notes, however, that we are now seeing some changes and that shareholders are winning votes in numbers. There is clearer accountability, for instance evidenced through the removal of directors at Hewlett Packard, JP Morgan etc.

CalPERS is an ICGN founder, PRI founder and a member of The Council of Institutional Investors, and sees itself as an RI leader with many peers. The Fund looks to European, Australian and Japanese funds to develop processes to integrate ESG more comprehensively.

"CalPERS is a universal owner; therefore, holds a stake in the overall economy and social and environmental conditions globally." (Anne Simpson, Senior Portfolio Manager and Director of Corporate Governance at CalPERS).

How is RI embedded in policies and implemented in practice?

It's all about governance and tone from the top. CalPERS has learnt the hard way how detrimental bad internal governance is (corruption scandal in 2008) and much work has been

done to overhaul the culture and to establish clear core values. The new CEO (since 2016) is committed to the RI agenda, as was the previous CEO. Like the Norwegian fund, CalPERS is a creature of state government, with according public accountability.

In 2011, CalPERS undertook a number of reviews on everything done on sustainability and more than 100 products were suggested. That led to the development of 10 investment beliefs[109] and the acknowledgement that there are three forms of capital that the Fund needs to protect and enhance: physical, financial and human. These investment beliefs were developed in consultation with the board and the executive team over the course of a year. Governance and sustainability principles were defined around the same time, laying out issues around board quality.

Most recently, CalPERS has defined a five-year RI strategy which commits the Fund to integrate ESG across all of its investment. The strategy covers sustainability expectations of managers (external and internal), where compensation and remuneration need to reflect the integration. The Fund is observing improved attitudes towards RI among portfolio managers. They are increasingly expecting the question "How will you do it"? rather than "Will you do it"?

Data and corporate reporting are crucial to CalPERS. The Fund is advocating better reporting standards in the US through; SEC, FASAC (FASB), PSIOB (audit), IFRS, FASB, SASB and The Council of institutional investors. The Fund has supported piloted reporting standards that capture E + G + S risks.

CalPERS sees that civil society and stakeholders care about RI and point to the power of changing demographics. The purchasing power of Millennials has taken over the purchasing power of the baby-boomers. The Millennials care about environment, and worry about inequality and racism. CalPERS believes this is going to drive the next development in RI. Broader economics are lining up with an RI investment thesis. Companies want to speak to the market through this lens, amongst others to attract the right employees. The Fund opines that the business community is ahead of investors on this, and that investors have a lot of work still to do on implementation.

What tools and resources are used, and what are the costs?

CalPERS' ESG strategic plan: Runs across internal and external portfolios; including RI considerations in compensation and bonuses. There will still be focused, stand-alone ESG mandates in addition to the strategy of ESG integration in all investment activities. Asset owners need size to adopt a total portfolio approach; smaller asset owners will need to rely more on bespoke ESG mandates managed externally.

Education and training: CalPERS acknowledges that there is a significant education job to be done internally. Finance educations do not currently include sustainability and ESG integration. CalPERS has set up an Education and Training committee to enable learning across the organization on RI.

Partnerships: The Fund works with partners and relies on partners. Across the fund there is a goal of better data and corporate reporting. CalPERS has a public equity portfolio of 10,000

109 https://www.calpers.ca.gov/docs/forms-publications/calpers-beliefs.pdf

companies. Partnering with others makes sense because a) it owns little relatively, b) it owns a global portfolio which implies heavy reliance on reporting standards that will give rise to data it can integrate.

Resourcing: CalPERS has had an RI team of 20 people. Now, in 2017, these people are working within the various teams; There are approximately 40 people with some form of responsibility on ESG across a total team of 400. CalPERS would challenge the idea to think of this as a cost. How much does it cost us to analyse credit risk? Nobody asks that question. The Fund is at the stage where it has to look at water risk; warming oceans and other trends. It needs to understand these risks, and to have an integrated way of doing investment.

Climate Action 100+:[110] There are 100 companies in CalPERS' portfolio out of 11,000, that are responsible for half of the globe's carbon emissions. These are the companies that investors need to talk to.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

RI is an important trust builder for CalPERS. The origins of fiduciary duty are in trust law; you look after money that doesn't belong to you. The Fund is very concerned with establishing trust in the market place, with beneficiaries and with wider stakeholders. "It is a constant concern and a continuous responsibility to build and maintain trust." (Anne Simpson, Senior Portfolio Manager and Director of Corporate Governance at CalPERS).

Is active management a prerequisite to RI?

CalPERS has an institutional exposure to indexed investment but emphasises that the Fund is not asleep at the wheel. Because of its size, the Fund harvests returns from economic growth and takes the opportunity to use its voice as an owner. As a long-term owner, the Fund can sometimes be even more forceful and effective. CalPERS has some investments, internally and externally, with a shorter time-span and sees a role for both of active and passive investment. Both lend themselves to RI. Unless one is very short-term, in which case it is harder to see how you deal with these issues.

RI PROFILE of CalSTRS[111]

Background on California State Teacher's Retirement System (CalSTRS)

CalSTRS is the USA's second largest public pension fund with assets totalling approximately $219.6 billion as of October 31, 2017. Established by law in 1913, CalSTRS is part of the State of California's Government Operations Agency and is the largest teachers' retirement fund in the United States, as well as being the eleventh largest public pension fund globally. CalSTRS is overseen by the Teachers' Retirement Board who is responsible for maintaining the Teachers' Retirement Fund in order to pay benefits to CalSTRS' members and their survivors.

110 Climate Action 100+ is new five-year investor initiative that CalPERS has helped initiate, to engage with the world's largest corporate greenhouse gas emitters to curb emissions, strengthen climate-related financial disclosures and improve governance on climate change.

111 This profile is based on information provided during interview carried out 12th October 2017, and on publicly available information.

The board is also responsible for ensuring benefits are paid by the system in accordance with law. The 12-member Teachers' retirement board is made up of elected members, members appointed by the Governor of California, and ex-officio members. As a public pension fund, CalSTRS is not subject to ERISA (the Employee Retirement Income Security Act), which governs corporate pension plans, and is governed by federal and State of California laws that include fiduciary standards similar to ERISA.

Investment strategy and asset allocation

CalSTRS believes that to manage the growth of assets in a prudent manner, it is necessary to establish a clear investment policy and investment management plan under which the Investment Branch will operate. The Board has sole and exclusive fiduciary responsibility to administer the investment assets in a manner that will assure the prompt delivery of benefits and related services to the plan participants and their beneficiaries.

The overarching investment objectives for CalSTRS include:

Providing for present and future benefit payments; Diversifying the assets; The reduction of CalSTRS' funding costs; Maintaining the trust of the participants and public; Establishing a policy and objective review process; Creating reasonable pension investments relative to other pension funds; Minimising costs; Compliance with State and Federal Laws.

As of October 31, 2017, CalSTRS asset allocation mix consists of: Global equity, Fixed Income, Real Estate, Private Equity, Cash/ Liquidity, Inflation Sensitive, and Risk Mitigating Strategies.

Why is RI important to CalSTRS?

The importance of ESG comes from the nature of The Fund's membership; Teachers. Funds with membership groups who are sensitive to these issues, will be pushed on it. The CalSTRS board is comprised of constituents in the programme.

CalSTRS' mandate is to achieve a 7 percent annualized investment return and believes that attention to ESG issue is critical to meeting this mandate. Long-term investing is a clear priority for CalSTRS and while the Fund is not a big fan of the term RI (implying that the rest of what you do is irresponsible) it favours the term ESG, environmental, social and governance. That ties in with the nature of The Fund's liabilities. The group of RI leaders has grown somewhat — over the twelve years that CalSTRS has been looking to embed ESG — but there is an element of "preaching to the converted" for the RI investor community. One needs to be preaching to the unconverted.

How is RI embedded in policies and implemented in practice?

"We believe that ESG factors matter. They represent long-term risks to the fund. As a long-term investor, we need to incorporate them." (Chris Ailman, CIO of CalSTRS).

RI policy: In 2009, CalSTRS consolidated its efforts around long-term sustainability into an ESG policy. ESG became a standard section in every single asset class policy. The aim is to take ESG into consideration in every asset class. CalSTRS is for instance investing $2.5 billion into a low-carbon index, has invested over $1.1 billion in ESG themed public equity funds and

is looking to commit another $750 million to that strategy. CalSTRS also owns approximately $250 million in green bonds, approximately $250 million in renewable energy generation and transmission assets in its infrastructure portfolio, has almost $700 million invested in a Private Equity clean tech portfolio, and is focused on creating LEAD and Energy Star certified properties through its Real Estate holdings.

Monitoring of external managers: CalSTRS does an annual survey of external managers to ensure they are considering CalSTRS 21 Risk Factors/ESG in their investment decision making. The Fund uses some ESG-labelled managers, but points out that few of them are able to consistently translate ESG considerations into market outperformance. It is thought that there will be ESG specialist managers in the market for a while longer (about another 10 years) until it gets more generally accepted as good investment sense.

In-house training: A compulsory ESG class has been taught to staff. Now, ESG is considered when asset managers are evaluating companies. CalSTRS acknowledges that there is a real age break; more tenured asset managers do not embrace ESG and don't seem to want to change their evaluation process. The younger they are, the more passionate they are about RI and sustainability. Long-term operational business risks, is the best way to describe ESG issues to traditional managers. SRI, which is often equated to losing money (screening for tobacco, firearms and weapons), is going out of fashion. It is dropping away.

Cross-team collaboration: In implementing the RI policy, CalSTRS did not want a stand-alone ESG team and sees it as important to mix sustainability specialists with PMs and traditional risk people. Rather than an ESG team, the Fund has set up an E-team, an S-team and a G-team. It is still necessary to have specialists on those teams, at least two people from each asset class are represented in each of those three teams. CalSTRS is considering creating an "Energy team", which will look across asset classes. Sources for energy will become more diversified and it makes sense to have a sub-set team that specialises in that.

What tools and resources are used and what are the costs?

CalSTRS has found that it needs a lot of research resources (MSCI, Bloomberg etc., covering all of the ESG issues). In contrast to the negative screening RI history, the emphasis is now on uncovering opportunities, for instance in clean tech and low carbon. Of the three ESG factors, E is a current emphasis and top priority to CalSTRS. While S and G remain important, E is a time-specific issue and investors should react to it.

The resources CalSTRS spends are probably fairly thin compared to some peers, although the Fund has not aggregated the total cost. The customised indexes (negative screening) cost a lot. Extra services are expensive. Governance managers and sustainability managers are the most expensive out there. CalSTRS acknowledges that new products are always more expensive and that the cost will come down over time. There is a clear competitive advantage for asset managers to get in the game now.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

1. Portfolio value first and foremost; this is of singular importance. If CalSTRS does not secure returns and fund current and future pensions, it is not doing its job.

2. Reputation is key, both from top management, Board perspectives and with members.

3. Fiduciary duty: the mandate is to maximize returns at a prudent level of risk. CalSTRS having a 30+ year horizon, has to look at long-term profits and the risks to those profits, hence the relevance of ESG.

Is active management a prerequisite to RI?

It is not a prerequisite, but active ESG investment requires a high level of active prediction, assessment and investment action. As an example, if you want to invest in real estate in Florida, you have to look at sea level rise with a 20, 30 or 100-year horizon. In CalSTRS view, to say you are a responsible investor implies you have a long-horizon and do forward-looking investment analysis.

Active is The Fund's preference, allocating capital towards companies who are making a difference. Passive should reflect RI also, but it is slower. The world is awash with capital. Passive is always going to be huge. CalSTRS is pushing for smart beta solutions. The value to smart beta will probably be time-period specific. That is a challenge. To really implement RI, CalSTRS is of the view that you need to pick the forward-leaning winners.

RI PROFILE of Environment Agency Pension Fund[112]

Background on Environment Agency Pension Fund (EAPF)

UK EAPF is an LGPS (UK Local Government Pension Scheme) open, defined-benefit pension fund with strong employer backing, positive cash-flows and end-of-century pension obligations. EAPF is administered by the Environment Agency and is part of the Brunel Pension Partnership under the new pooling system for LGPS funds. As of February/March 2017, EAPF has £3.3 billion of assets under management in the active fund.

The Environment Agency Board appoints the Pensions Committee and Pension Board, and delegates responsibility for compliance with legislation and best practice, overall strategic asset allocation, investment policy, budgets and the appointment of managers and investment advisers.

Investment strategy and asset allocation

EAPF maximises the returns from investments within reasonable risk parameters. The fund needs to invest in assets which differ in return characteristics from its pension liabilities. As a long-term investor, EAPF invests in productive assets that contribute to economic activity, such as equities, bonds and real assets. Investment objective: a return of +3.25% over the expected return on gilts.

EAPF has delegated day-to-day management of the Fund's assets to a number of fund managers. They have full discretion to manage their portfolios subject to their investment management agreements with EAPF and in compliance with the Fund's policies including the

112 This profile is based on information provided during interview carried out 10th October 2017, and on publicly available information.

Investment Strategy Statement. EAPF has appointed a performance measurer independent of the fund managers to calculate risk and return measures for each manager and the Fund overall.

Why is RI important to EAPF?

"It partly comes out of the culture and make of the organization. Looking after the environment is part of good business." (Mark Mansley, CIO of EAPF[113])

To EAPF, these issues matter, not because of ethics, but more from a long-term risk perspective. RI is part of how EAPF defines fiduciary duty. There is also more awareness, for instance among employees, and EAPF sees a direct link between its RI practices and its good reputation.

EAPF takes RI across all ranges of asset classes and activities. It is intrinsic to how the Fund operates. It started off as an overlay. Since 2010, it has been increasingly integrated into how EAPF views business and runs its asset management operations. EAPF builds RI into its funding and actuarial process. EAPF expects actuaries to recognise the validity of the questions EAPF asks around financial risk stemming from for instance climate change, and to be able to address this in a meaningful way.

EAPF notes that it has a very supportive governance structure with progressive CEOs/CIOs. There is also ongoing dialogue, including training, managing, briefing, with the Environment Agency Pensions Committee. With a relatively small organization, EAPF has fostered a culture that takes a holistic perspective and looks at links and interconnectedness between teams. EAPF also has a clear mandate from the board to engage with the industry, both other asset owners and asset managers. This is not purely altruistic, but EAPF sees that by raising the norm they will get better asset managers. EAPF points out that they are seen as a prestigious client.

How is RI embedded in policies and implemented in practice?

Highest level: EAPF articulated its investment principles/beliefs about three years ago. They encapsulate a touch-point for how EAPF thinks about investing its portfolio. RI is embedded in that. RI is implicit in a lot of the other principles/beliefs (e.g. research and evidence based approach) also.

Strategy: There is more systematic integration of ESG factors. EAPF has for instance worked with Mercers looking at long-term risks like climate change. EAPF is considering diversification in asset allocation and a wider range of asset classes to make its portfolio more resilient to a changing world.

External managers: In 2004/2005 EAPF began implementing its thinking about RI, asking mainstream managers about governance, environment and climate risk. While good answers were scarce in the beginning, this has now changed out of all recognition. There is much more depth of process and thinking behind ESG integration in asset manager operations. EAPF is always looking under the hood to see that it is not window-dressing.

113 At the time of the Interview Mark Mansley was still CIO of EAPF. At the time of printing the report, he holds the role of CIO for Brunel Pension Partnership Limited

Active steward: EAPF talks to companies, to push them in the right direction. All managers are expected to engage with portfolio companies, and have been for nearly a decade. EAPF has parted company with some managers who were not very aligned.

Selection and monitoring of managers: EAPF recently changed its process for manager selection relating to ESG integration. ESG is picked up in a different way and pervades every aspect of what they do. It may be harder to see how ESG is brought into it but there is more consistency. Monitoring of managers: specific benchmarks; carbon foot-printing. Trust and verify. EAPF gives flexible mandates, looking at what they do and asking difficult questions. If EAPF can't see logic to the sustainability aspect — they will push quite hard.

"We are not less interested than we were, but we have embedded ESG even more systematically. That may make it harder to articulate and quantify the exact weight given to RI issues." (Faith Ward, Chief RI and Risk Officer at EAPF[114]).

Real estate (RE), infrastructure, farmland and private equity: EAPF encourages ESG-integration for all real assets. There is an upfront requirement that the manager complies with GRESB for RE and infrastructure investments. The EAPF PE team has done their own survey. In asset classes with a lot of money going in, it can be more challenging to get recognition of the RI controls. EAPF uses the PRI assessment and benchmarking actively: how do managers compare to their peers? Infrastructure remains a challenge for instance on a strategic theme like climate risk. EAPF does not want to buy a high carbon asset which will last over the next 25 years. EAPF is working to get managers to engage with those strategic themes at a level where the Fund can trust them to look after the assets. This remains a challenge but there is some improvement.

What tools and resources are used and what are the costs?

EAPF uses voting and engagement, leveraging efforts through collaboration with, amongst others: Aiming for A, IIGCC, PRI, TPI (Transition Pathway Initiative) and CDP (Carbon Disclosure Project). EAPF is actively involved and takes on roles with various networks and collaborative platforms.

With an RI team of two staff, EAPF combines light use of in-house resources with onus on managers to do the work. The Fund systematically pushes the responsibility down the investment chain.

EAPF does carbon foot-printing on public equities and bonds.

EAPF does not use a lot of external research tools, to keep costs down. The Fund engages Hermes EOS for voting and engagement on its passive investments.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

EAPF does not break out which part of the performance might be attributed to ESG integration. They see that as counterproductive. At EAPF they do what they think is right to secure long-term returns. Because of the Fund's pedigree and reputation in RI, they get access to managers that they otherwise would not have access to. EAPF are convinced that their

114 At the time of the interview Faith Ward was still in this role. At the time of printing the report, she holds the role of Chief RI Officer for Brunel Pension Partnership Limited

approach to sustainability has added considerable value. Employees are attracted to the Fund because of its reputation in this area. EAPF is able to attract high calibre candidates into an organization that is not at the highest end of the pay scale in the industry.

Is active management a prerequisite to RI?

EAPF has done a lot in the passive space and has been able to engage managers that really know their stuff. In general, EAPF thinks that lines are blurring between active and passive. Active is well suited to RI but there is plenty to do through passive investing, particularly smart beta. EAPF does some smart beta and is looking to improve benchmarks. It makes sense to take a low-cost, systematic approach to investing. EAPF's core passive holdings have been shifted to a low-carbon index. The Fund is looking at passive approaches in other areas.

RI PROFILE of ERAFP[115]

Background on ERAFP

ERAFP (Établissement de retraite additionnelle de la fonction publique) manages the French public service additional pension scheme (RAFP). As of December 2016, ERAFP has €26 billion of assets under management. ERAFP's mission is to pay an additional retirement pension to civil servants who have been employed by the State, local government and hospitals. Intergenerational fairness and the sustainability of its management are important considerations.

Investment strategy and asset allocation

ERAFP believes that seeking to maximise immediate returns will work against its own interests, and therefore evaluates each of its investments in light of its impact in three main areas: social issues, governance and the environment. Furthermore, ERAFP invests in all sectors of the economy and in all asset categories.

Why is RI important to ERAFP?

The first question to ask is, what is the mission of a pension fund? Basically, a pension fund mission is to invest the contributions it receives in assets in a way that guarantees that even in the improbable case it would be put in run off, they would suffice to pay the last benefit owed to the last beneficiary. As ERAFP is a very long-term investor, with liabilities stretching 40-50 years ahead, it cannot ignore the risks that could derail its mission. Those risks belong to three broad categories: Social Issues, Governance, and Environment.

If you consider social issues, it is obvious that in a globalised world the way a company monitors its supply chain is important. When an accident happens at a provider's plant, even if it is in a far distant country, it quickly becomes your problem. Good governance at company level is critical to a long-term investor. Bad governance can tarnish business brands and

115 This profile is based on information provided during interview carried out 5th September 2017, and on publicly available information.

should be carefully managed. There are enough examples of recent malpractices; Wells Fargo, BP and VW, to mention a few.

Environment is becoming more and more important. Climate change has been recognised as a threat. ERAFP cites the "Risky Business" project[116] founded by H Paulson, M Bloomberg and T Steyer as a game changer since three very senior people with impressive credentials clearly state that climate change is impacting corporate America with a direct consequence for American investors. Long-term investors might already be holding stranded assets. In ERAFP's view, this is a scary prospect for pension funds since that means that some of those assets could depreciate soon with a risk that their global valuation post loss would not suffice to match the pension fund's liabilities.

Investors with long-term liabilities should review the sustainability of the business of their investees. It is clear for example that investing in any power plant using fossil fuels must be assessed considering the risk that at some point Governments or regulators will prohibit that source of energy or at least charge it with a tax meant to make it pay for its negative externality.

Although annual performance is a useful indicator, it is reasonable to assume that the closer the performance calculation is to the length of commitments, the more relevant will be the information produced by that calculation.[117] One way to reduce short-term investment behavior, is in ERAFP's view, to have large institutional investors consider the performance on a longer period than the past year. The last ERAFP's annual report discloses an annualized internal rate of return calculated over three and five years.

"Pension Funds should always be run with the long-term in mind. If you are not managing your liabilities in a responsible way you have no choice but to go for the quick buck. This is a risky bet since we know that short-term management focused on maximizing the immediate return put too much pressure on companies." (Philippe Desfosses, CEO of ERAFP)

How is RI embedded in policies and implemented in practice?

As early as 2005, ERAFP's board of directors decided to implement an investment policy that consistently and permanently factored in the pursuit of the public interest. This led to the adoption in 2006 of an SRI Charter[118] that specifies the orientations, vehicles and resources needed to apply this socially responsible investment policy. The SRI Charter applies to all of the Scheme's investments and takes into account the specific features of each asset class. It is centred around five values: "Rule of law and human rights"; "Social progress"; "Democratic labour relations"; "Good governance and transparency" and "Environment".

ERAFP is not interested in maximizing the immediate return but the sustainable return (achieved without compromising the ability of investees to thrive). The Fund aims to avoid investing in stocks of companies that do not get that the world is changing fast and that they can better adapt to it. A further aim is to seize the opportunities that the transition toward a more sustainable economy, and a less carbon intensive one, entails. Improving what

116 https://riskybusiness.org/

117 See page 26 of ERAFP's latest annual report: https://www.rafp.fr/en/sites/rafp_en/files/publication/file/ra2016exe-06-planches.pdf

118 https://www.rafp.fr/en/sites/rafp_en/files/publication/file/rafp-charte_isr-2016-uk-web-page.pdf

already exists is not enough; ERAFP believes that they need to invest in new and disruptive technologies to stay below the 2-degree temperature rise. Long term investors can bring the long-term patient capital needed to fund those disruptions.

Every investment decision taken in every asset class will consider social issues, governance and environment. All mandates clearly state that it is mandatory for the asset managers to implement ERAFP's SRI Charter. The SRI performance of the Fund's portfolios is reviewed every semester, based on extra-financial research providers' analysis. ERAFP meets with managers every semester.

The benchmark is of the utmost importance, and the SRI performance of all ERAFP portfolios is compared to the SRI performance of a benchmark representing the portfolio's universe (in terms of geography and sectors).

What tools and resources are used?

ERAFP's SRI approach concerns not only all of the Scheme's investments but also applies to all the investment phases, from the first stage of asset allocation to the post-investment stage of monitoring the companies whose shares are included in the portfolio. ERAPF adopts a best in class approach:

- excluding no business sector, but promoting the most responsible issuers within each sector and, more generally, within groups of comparable issuers;
- showcasing progress made;
- monitoring and supporting issuers that have adopted a continuous improvement approach.

In each sector, the portfolio's companies are ranked per their evaluation based on 48 ESG criteria. The criteria weighting system is adapted to the characteristics of each sector. The application of the best in class principle results in the inclusion in the guidelines of quantitative rules that make it possible to determine the eligible investment universe. For equities and corporate bonds, the bottom quartile in each sector is excluded. ERAFP also excludes issuers that are rated less than half of the average on at least one of the five ERAFP SRI charter's values.

ERAFP maintains close contact with asset managers (bi-annual meetings) to follow and check the implementation of our ERAFP's Best in class approach. Moreover, with the implementation of ERAFP's new SRI charter in 2016, asset managers are expected to closely monitor controversial practices that issuers may be exposed to.

The Fund is an active shareholder through dialogue, voting, collaborative initiatives and coalitions (PRI, IIGCC, EITI, ShareAction, CDP etc.). Asset owners talk to each other and can leverage off each other's knowledge and share views. ERAFP also engages with public authorities. ERAFP considers that leadership starts from the top, and that a strong commitment from the top is critical both in the investor and the corporate world.

ERAFP has two-member RI team. A small team is considered sufficient, because cross fertilisation across the organization is encouraged.

Another important tool for ERAFP, is choosing the right benchmark. The Fund is of the opinion that if you develop and design your own benchmark, you can be effective as a long-term investor.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

Financial performance: ERAFP started investing in stocks 10 years ago. On aggregate, the Fund has outperformed significantly in terms of IRR (internal rate of return) even though there are some differences from one mandate to the other. ERAFP's home-made SRI index is the best performing. On average, this has added 250 bps/year to performance. The home-made SRI index is low carbon and based on the maximisation of the sharpe ratio of the investment universe.

Sustainability performance is also evaluated. ERAFP looks at the way the asset managers have been able to improve, or not, the SRI rating of the portfolio.

Emissions: Carbon intensity has been measured since 2013. In 2016, the carbon footprint measurement covers 89% of ERAFP's total assets. Year after year, the carbon footprint has been complemented by other indicators. In 2017, ERAFP also publishes the result of green share, intensity of contribution to the climate transition, avoided emissions and energy mix alignment with a 2°C scenario for some of its portfolios.

ERAFP measures the effective impact of applying ESG criteria in the context of best in class, shareholder engagement and steady reduction of the portfolio's carbon footprint. This is a growing priority for ERAFP's stakeholders. From now on it will be taken into account, be regularly monitored and disclosed in ERAFP's annual report and could lead to adjustments in the implementation of the principles of ERAFP's SRI Charter.

Is active management a prerequisite to RI?

ERAFP points to the fact that many pension fund boards spend a lot of time determining their allocation between active and passive, but much less time is spent on what kind of benchmark should be used. ERAFP is critical of adopting a market cap index as benchmark, because it means you are "buying" all the assumptions that back the Efficient Market Theory. For ERAFP, market cap is wrongly coined the neutral benchmark when it is backward looking and leads an investor to buy all the biases it is bearing. This is one of the reasons why ERAFP embarked with EDHEC Risk Institute and FTSE to define a risk-weighed index,[119] which is now on its second generation. The index is open source. The Fund is considering extending the use of this index currently used for only one of its mandates to other similar mandates.

ERAFP is of the view that active management allows its asset managers, selected by ERAFP for their SRI expertise, to apply their SRI convictions when they invest within the framework of the Fund's SRI best in class approach.

119 http://www.edhec-risk.com/indexes/erafp

RI PROFILE of Australian Government's Future Fund[120]

Background on the Future Fund

The Future Fund was established in 2006 to assist future Australian governments meet the cost of public sector superannuation liabilities from 2020, by delivering investment returns on contributions to the Fund. It is managed by a Board of Guardians (Board), supported by a management team, which is responsible for investing the Future Fund managing AUD 159.5 billion of assets, (AUD 135 bn in the Future Fund and AUD 25 bn across the Disability Care Australia Fund, the Medical Research Future Fund and two Nation-building Funds). The Board operates independently from Government and tailors the management of each fund to its unique investment mandate. The Board's role is to generate high, risk adjusted returns over the long-term.

Investment strategy and asset allocation

The investment approach for the Future Fund is based on one investment team working together for the benefit of the portfolio as a whole, entitled a 'one team, one portfolio strategy'. The organization makes sure that teams collaborate and bring together the appropriate expertise from across the organization, responding nimbly and innovatively to opportunities.

The goal for the Future Fund portfolio is to achieve at least CPI plus 4.0% p.a. over rolling ten-year periods. The Fund is invested in a broad range of asset classes: public equities, private equities, property, infrastructure and timberland, debt and alternatives. The Future Fund is externally managed.

Why is RI important to Future Fund?

The Board incorporated ESG risk management into its "Statement of Investment Policies" in 2008/9. There was a clear focus on governance issues from the beginning and this has subsequently been further refined to a more holistic approach across all relevant ESG considerations.

By integrating ESG into the investment framework, the Board is taking a materiality, investment-driven approach. Over time the organization has progressively extended the integrated ESG across its program and this focus continued. *"There is a realisation that by actively looking at and integrating ESG factors — we are ultimately going to be better investors."* (Joel Posters, Head of ESG at Future Fund).

How is RI embedded in policies and implemented in practice?

Original mandate from 2006: Best practice in governance and managing reputational risk was central to the original mandate. ESG integration is formally part of the Statement of Investment Policy for the fund, which outlines tools and mechanisms.

External manager mandates and follow up: The Future Fund is externally managed and a lot of the heavy lifting on ESG is done by external managers. Expectations towards managers

120 This profile is based on information provided during interviews carried out 6th and 21st September 2017, and on publicly available information.

have historically centred around corporate governance but now are now more broadly around E+S+G. There is a formal process for on-boarding of new managers, to assess whether the Board and management team are comfortable with the external manager's ESG integration capability and commitment. After that, periodic reviews are carried out.

Investment committee: All major transactions go through the organization's Investment Committee and in the templates for these transactions everything is accompanied by ESG commentary. As such, ESG is totally integrated into the investment framework. Dedicated analysis required on ESG as part of the Investment Committee assessment. This is performed at an early stage. The commentary provided to the Investment Committee then feeds into and is refined as part of the subsequent submissions to the Asset Review and Manager Review Committees.

What tools and resources are used?

The Board has established its own in-house corporate governance principles, as well as due diligence templates around manager interaction to ensure managers cover issues adequately. These templates are tailored to asset class and investment style (where appropriate). The organization has its own due diligence tools assisting deal teams to identify and manage ESG issues in their investment decision making. This is embedded with the templates used for investment committees. For the listed equity active portfolios, the organization runs portfolio analytics to measure the ESG and carbon risk in the portfolios. These are used to engage with managers in a more informed fashion.

The management team supporting the Board has 50 investment management staff and they are all tasked to integrate ESG. There are two people on an ESG team, guiding those 50 staff. The ESG team reports directly to the CIO. The organization looks at ESG factors across asset classes.

The organization subscribes to data-feeds: MSCI, Glass Lewis, Sustainalytics, Ownership Matters, Trucost. When the Board does deals, the ESG team guides the due diligence led by the sector teams and may bring in additional service providers depending on the ESG issue under considerationAt the end of the day; it is not enough to have two people: The whole team and the whole organization "needs to own it and live it" and that's across the sector teams, the investment & transaction teams.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

The organization sees ESG integration as an integral part of good investing.

When the analysis on the bigger deals is undertaken; focus is applied on the things that move the dial, teasing out the material factors. The organization doesn't necessarily track the risks avoided by integrating ESG. They look at it more holistically.

Is active management a prerequisite to RI?

It is not an easy question. The portfolios run across a number of different asset classes with different strategies, which may affect the capacity to manage the way ESG is managed.

However, the organization considers that they have the tools available to integrate RI regardless.

The investment program is moving towards more passive on the public equity side. From a pure corporate governance perspective, it doesn't make a big difference, except in long-short portfolios where ownership rights are technically no longer the Board's.

It is also noted that investors have increasingly sophisticated tools at their disposal, e.g. the institutional investor market is exhibiting new products around tilting passive portfolios on carbon or ESG factors in Smart Beta approaches. For passive managers, management makes sure they are comfortable with the way those external managers are doing things, employing a due diligence questionnaire for each asset class that is discussed with the managers in person or by phone.

On property, infrastructure and private equity, an active management approach is employed. The Board is often a large investor and maintains long term partnerships with its investment managers which means it has a meaningful influence on how managers deal with ESG. It also typically pursues enhanced governance arrangements with managers to enable it to better raise issues with manager (eg Limited Partner Advisory Committee representation in private equity funds). Smaller investors in fund-of-funds structures have less influence.

RI PROFILE of Government Pension Investment Fund[121]

Background on Government Pension Investment Fund (GPIF)

The GPIF in Japan manages and invests the Reserve Funds of the Government Pension Plans entrusted by the Minister of Health, Labour and Welfare, maintaining a total of $1.3 trillion of assets under management. This is in accordance with the provisions of the Employees' Pension Insurance Act (Law No.115 of 1954) and the National Pension Act (Law No.141 of 1959). GPIF contributes to the financial stability of both Plans by remitting profits of investment to the Special Accounts for the Government Pension Plans.

Investment strategy and asset allocation

The overarching investment goal of GPIF is to achieve investment returns required for the public pension system with minimal risks, for the benefit of the pension recipient from a long-term perspective, thereby contributing to the stability of the system. The Fund's primary investment strategy is the diversification by asset class, region and timeframe — taking full advantage of the fund's long-term investment horizon.

GPIF, a universal owner and a super-long-term investor believes *"it is essential to minimize negative externalities (e.g. environmental and social issues) and to contribute to the sustainable growth of the overall capital market."* (Annual Report Statement, 2016).

121 This profile is based on information provided during interview carried out 29th September 2017, and on publicly available information.

Why is RI important to GPIF?

GPIF does not use the term RI internally but prefers ESG Investment. RI is not a politically correct phrase and it might offend the traditional investment team; implying that they are irresponsible. GPIF's focus on integrating ESG in the investment process has a strong risk aspect.

"We see ESG as critical and relevant factors for the long-term sustainability of our portfolio. A lot of business practice falls into short-termism and ESG is the most effective way of ensuring a long-term outlook. We are focused on how ESG is integrated into the Investment Chain." (Hiromichi Mizuno, EMD and CIO of GPIF).

How is RI embedded in policies and implemented in practice?

GPIF is currently revising their Investment Principles to include a clear reference to ESG beliefs and Stewardship. While ESG was not on the fund's radar three years ago, GPIF now consider these elements central to their core operations.

There is no political influence on GPIF's decisions around ESG integration although the Japanese government has been pushing hard on corporate governance to combat short-termism. GPIF sees broad ESG integration as the most effective tool to combat short-termism.

The Universal Owner Theory communicates the message very clearly and GPIF sees a need to convey that through the investment chain. For GPIF the integration of ESG is about affecting their investment managers. It is vital to integrate ESG factors into medium to long-term thinking and into the Risk Adjusted Return on Investment (RAROI).

What tools and resources are used?

GPIF developed Stewardship Principles in June 2017 with a focus on 1) letting managers understand the principles, 2) process for implementation:

- Vital to integrate ESG in the investment process: corporate value creation, performance
- Materiality of ESG issues at company level
- Proactively engage on critical ESG issues
- GPIF asks asset managers to be signatories of the PRI (since GPIF itself joined in September 2015) or to adopt "Comply or Explain". Some asset managers are not members as they have chosen to explain why not. GPIF has set up a new form of assessment for managers through a new framework, which involves interviews throughout the year with questions and detailed discussions. There is an ongoing evaluation of managers' capabilities, know-how and expertise. GPIF sees that they are maturing and getting better at assessing asset managers on these factors.

In October 2016, GPIF created an in-house Stewardship Team which sits within the Public Market Investment Department. The Stewardship Team has two full-time staff and four part-time staff. Some staff work across teams; sharing time between the Stewardship Team, the Investment Strategy Team and the Alternative Investment Team. GPIF wants to affect the investment teams. GPIF has high ambitions and will likely add some staff.

GPIF recently added an Engagement Manager role. The fund does not look to engage with 2000 Japanese companies but rather with 40 external managers. GPIF's approach to improving the Investment Chain is to create more clarity. In the UK, companies are not required to report quarterly and as a mandatory requirement quarterly reporting is not helpful as GPIF does not want asset managers to manage the money with a short-term approach. But the reality that GPIF itself is required to report quarterly does not align with that. If GPIF alone stopped quarterly reporting, the fund may get criticized for a lack of transparency. GPIF believes there is a need for asset owners to come together to encourage less frequent reporting and manager rebalancing.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

An important outcome for GPIF is the influence on the asset managers and the investment chain. GPIF focuses on making its message clear. GPIF is picking up a general asset manager response where there is no one arguing against ESG integration. Whether asset managers believe it or pretend to, for marketing purposes, is less important.

GPIF places importance on asset managers' internal corporate governance. GPIF expect managers to have top corporate governance internally in order to credibly address corporate governance and other sustainability issues with companies. There is currently some inconsistency.

Is active management a prerequisite to RI?

GPIF has a unique approach: putting more pressure on passive managers to step up on stewardship than active managers. On average, active managers hold for 1-2 years and ESG factors are less relevant for that time horizon. When GPIF chooses active managers, the Fund expects them to deliver alpha and does not want the managers to engage or vote to benefit their short-term alpha at the potential cost of long-term sustainability.

Stewardship is a challenge for active managers. GPIF believes ESG is much more relevant for passive investing and about 90% of GPIF's assets are in passive. Passive is like owning equity in a sustainable portfolio and managers should be more concerned with that. Stewardship needs to be in line with the time horizon.

RI PROFILE of Ireland Strategic Investment Fund[122]

Background on Ireland Strategic Investment Fund (ISIF)

The Ireland Strategic Investment Fund (ISIF or the Fund), managed and controlled by the National Treasury Management Agency (NTMA), is an €8 billion sovereign development fund. It has a statutory mandate to invest on a commercial basis in a manner designed to support economic activity and employment in Ireland. The fund's predecessor was the National Pensions Reserve Fund (NPRF).

122 This profile is based on information provided during interview carried out 26th September 2017, and on publicly available information.

The Fund differs from other pools of capital in that it has a long investment horizon and therefore can act as a permanent or patient source of long-term capital. It has flexibility up and down the capital structure, with ability to meet changing capital needs and gaps in the marketplace.

Investment Strategy and Asset Allocation

ISIF has a mandate similar to that of a Sovereign Development Fund, which reflects a shift from being a sovereign wealth fund focused solely on wealth creation. The rationale for the sovereign development fund approach can be seen in the economic impact of the Fund's investments.

ISIF has a "Double Bottom Line" objective, which is measured both by investment returns and by economic impact achieved.

Key to the Fund's approach is to develop strong partner relationships that are long term and strategic in nature, to be constructive in strengthening the Irish economy and helping Irish companies to grow, and to achieve value and resolve specific challenges. The active involvement of entrepreneurs, business owners and co-investors is critical to the unique investment process and deal flow of the Fund.

ISIF has committed over €3bn to investments in Ireland across a wide range of sectors including healthcare, technology, construction, manufacturing, energy, infrastructure and financial services, with the balance of assets invested globally.

Why is RI important to ISIF?

A key trigger for ISIF's (and its predecessor NPRF) RI commitment was the formation of the UN-backed Principles for Responsible Investment (PRI) in 2006. The concept of integrating Environmental, Social and Governance (ESG) factors into the investment process just made sense. While it had been a challenge to align ESG factors with the legalistic fiduciary position of trustees of pension funds — PRI solved this conundrum. As a founder signatory of PRI, the Fund wants to live up to its commitments. Ten years on, developments have not made the Fund change its view on ESG, particularly for long term investment.

Being active in the RI space has helped ISIF deal with stakeholders and public dialogue. There is a strong alignment of what the Fund is trying to achieve in RI and the overall Fund mandate. Initially RI may have been seen somewhat in a defensive sense, but in more recent years the Fund has developed a stronger approach to active responsible investment.

How is RI embedded in policies and implemented in practice?

RI is embedded in ISIF's Business Plan and Investment Strategy documents. There is high-level board approval of a Sustainability and RI policy[123] (published July 2016) which addresses sustainability and RI at an overall Fund level, acknowledging that the approach to ESG integration across a range of sectors and asset classes will change and develop over time.

123 http://isif.ie/wp-content/uploads/2016/07/Sustainability-and-Responsible-Investing-Policy-July-2016.pdf

ISIF is a member of the International Forum of Sovereign Wealth Funds (IFSWF) and looks at the Santiago Principles as a guide to Fund organization and governance, whereas the UN PRI, in ISIF's view, reflects more what you want to achieve and how to go about that.

ISIF has a domestic mandate and a global portfolio. For the global portfolio, which is winding down over a multi-year period as Irish investment opportunities are identified and executed, ISIF uses managers that are PRI signatories. The Fund sees it as less of a challenge to integrate ESG factors into the global portfolio, compared to the domestic investments given the wider range of product and services available for global listed assets. The global portfolio is more short to medium term but has exposure to a wider range of ESG risks given its global remit. ISIF has restated its commitment to active ownership with voting and engagement on the global portfolio and also hired a portfolio analytics service to assist with assessment of ESG risk exposures.

On the domestic side, ISIF's goal is to embed ESG systematically across the portfolio. The Fund is looking at developing an ESG framework. Environmental Resource Management[124] has been appointed to help with this. This will be a tool to guide investment in various sectors and to identify the relevant ESG risks in the pre-investment due diligence stage. ISIF is aiming to establish systematic ESG monitoring for the domestic portfolio, but without it becoming so overly cumbersome that it dominates the investment process

What tools and resources are used, and what are the costs?

ISIF uses global service providers to cover engagement/voting (Hermes EOS) and research (Oekom and ISS-Ethix Climate Solutions, formerly part of South Pole Group). The Fund uses carbon foot print and transition analysis alongside more standard ESG methods. There is a lot of data in these reports and they are looking at how best to use it going forward.

ISIF has a small RI team and relies on third party providers for extra capacity. There is collaboration with the investment managers on specific ESG issues. ISIF is aiming to make the cross-team collaboration more comprehensive.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

ISIF sees RI as a trust-builder. When the Fund has been transparent on these issues, stakeholders tend to be less concerned about potential RI issues.

Is active management a prerequisite to RI?

ISIF is conducting more and more investment in private markets, which by definition are active. The Fund applies ESG integration to both active and passive mandates. In relation to passive, ISIF believes that ESG factors can drive overall market returns higher.

124 https://www.erm.com

RI PROFILE of Local Government Super[125]

Background on Local Government Super (LGS)

LGS is a mid-sized Australian pension fund with USD 7.6 billion of assets under management operating in a competitive pension environment. It is a default fund for New South Wales local government employees and has a stable membership. LGS primarily uses external managers for its fund management operations. LGSS Pty Limited, the Trustee of the Fund is solely responsible for management and control of the Fund, including the safekeeping of assets and ensuring LGS operates in accordance with the LGS Trust Deed and superannuation law.

Investment strategy and asset allocation

LGS primarily uses external managers for its fund management operations, except for its property portfolio which is managed internally. Its asset allocation is currently as follows: Australian shares: 22%; International shares: 24%; Fixed income: 28%; Absolute return strategies, including hedge funds: 12%; real estate: 7%; private equity: 6%. LGS uses well known investment indexes as benchmarks across all asset classes. However, LGS adopts an active investment philosophy across the entire fund — looking to outperform these indexes. Being an active investor is one of LGS' Investor Beliefs.

Why is RI important to LGS?

There are three main reasons: 1) Risk/return management and enhancement 2) member alignment, and 3) ability to attract new members.

Historic developments: In 2001, with strong trustee impetus — and from a financial best interest perspective — tobacco was taken out of the LGS portfolio. The divestment screen was later extended to gambling, weapons and old-growth forests. 2010: The screen was extended to international equities. LGS was confident that they were not losing any money as the LGS Board tracked the performance of the overlay and did portfolio research on tracking error and volatility. 2010: LGS contracted MSCI to do research to facilitate discussion with LGS managers around ESG integration. LGS also carried out a carbon footprint analysis. 2012: LGS started investing in green bonds. 2014: LGS introduced a negative screen on carbon.

In total, close to AUD 1bn or 10% of the fund is currently invested in low carbon investments across 5 assets classes, spanning listed and unlisted asset classes. This includes $450m in green property and $150m in green bonds. LGS carbon foot printing is only conducted on its listed equities at this stage and it is 15% below benchmark of tCO_2/$m FUM basis.

LGS informal philosophy: Comparing investments with similar parameters (risk and return), LGS will tend to choose the one with positive environmental and social outcomes. It is not always that easy and there is a lack of investment products in the market, combined with preconceptions around the validity of ESG integration from the external asset consultants.

125 This profile is based on information provided during interview carried out 29th August 2017, and on publicly available information.

How is RI embedded in policies and implemented in practice?

RI is embedded in LGS key governance documents, including in investment policy statements and risk statements. ESG is one of the investment beliefs (risk/return), alongside long-term focus. Active management as a close companion of RI, is another key investment belief and therefore, by implication, a belief that markets are at least partially inefficient — and one can therefore gain an information advantage. LGS increasingly uses customised mandates.

LGS has developed a good organization and governance structure: The Head of RI reports to the CIO and is part of the investment team. The RI team has one full time and two half timers. RI is embedded in all role descriptions for all staff at LGS. The Head of RI is involved in all investment team recruitments.

The RI team works with all committees under the LGS Board; including the Investment Committee, the Risk Committee and the Audit and Compliance Committee. This is complemented by an in-house Governance team that ensures policies and practices comply with all superannuation legislation and regulations.

LGS is rating managers on ESG with increasing scrutiny. There are expectations of performance and LGS sees managers with stronger ESG capabilities as more likely to meet the LGS investment objectives. While LGS is looking at performance correlation, they do not aim to get it down to a scientific level. LGS uses external ESG ratings, PRI surveys, proxy voting and engagement records and indicators around ESG integration to gauge management performance.

What tools and resources are used, and what are the costs?

LGS' "Wheel of responsibility": ESG integration and active ownership are the main pillars, applied both pre-and post- investment. Transparency in all operations is vital.

Company engagement: LGS engage companies through various channels; including direct engagement with board and executive; via fund managers; through involvement with Australian Council of Superannuation Investors (ACSI), Responsible Investment Association Australasia and the Investor Group on Climate Change. LGS carries out voting internally on Australian shares.

Positive thematic investing: 10% of total assets are allocated to low carbon/climate change, including some also on the social infrastructure side. LGS has a listed international equities strategy with Impax focusing on environmental leadership.

LGS also places importance on External ESG research and Industry-collaboration through e.g. IIGCC, PRI, and ACSI etc. LGS will selectively consider seeding new innovative strategies.

LGS sees it as challenging to get adequate resourcing around engagement. There are agency issues in the market and short-term perspectives. LGS is looking for smart ways of doing engagement; mainly through a collaborative approach. Stewardship is an addition to RI in general. Stewardship brings universal ownership and a long-term capital allocator perspective. From LGS' perspective, it allows investment in companies with some ESG risks rather than just divesting.

LGS does not see RI and ESG integration primarily as a cost, it is just as much about upside: "RI is simply the price one pays for superior investment decisions and performance." (Bill Hartnett, Head of Sustainability at LGS).

What are the outcomes (on portfolio value, on trust, reputation, and standing)?

LGS sees an overall positive effect on their asset management operations from RI. They are able to quantify some positive investment results on the thematic strategies. LGS has an extremely good net promoter score and high member retention levels within their industry. They are getting some new members without doing marketing through LGS' strong pedigree.

RI is fundamental to LGS' fiduciary duty. LGS is observing that sustainability as a competitive advantage is more prominent in the market place.

Is active management a prerequisite to RI?

LGS sees active management as very important to RI operations. Passive investors inherently carry a lot of the unsustainable companies and/or industries, as well as agency issues. Benchmarks are based on companies' listed regional stock exchanges. These stock exchanges were primarily established to allow companies to list and seek capital and creating significant wealth for the sponsor. As such this is an imperfect model for long term investors. It does not give optimal diversification. In LGS' view, companies' historic growth (which is the fundamental basis upon which common market capitalisation-type stock market indexes are formed) is a sub-optimal factor to base investment decisions on. Passive strategies also make it difficult to introduce negative screens. Passive investment strategies mean that it is difficult to avoid down-side impact of technological disruption creating stranded asset valuations, while it is equally hard to catch the up-side opportunities, as disruptive ideas and companies are not yet fully reflected in the major benchmarks.

"The world's stock markets were not created with people's long-term retirement needs in mind." (Bill Hartnett, Head of Sustainability at LGS).

Active ownership can be done with a passive portfolio, but passive investing keeps on funding old industries with high ESG risks and that perpetuates the problems. On the flip-side, a strong and effective active ownership programme, is a defence for passive investing. LGS points out that active ownership can be done on companies that you have divested from and that there are examples of that being the more effective means of active ownership. LGS has a negative screen, which has only cost 30 basis points of tracking error. It is not in LGS' interest to be in a lot of egregious companies.

LGS is cognisant of the fact that the size of the Norwegian GPFG creates capital allocation issues, and that size in itself prevents the level of active investing that for instance a small fund like LGS can do.

RI PROFILE of New York State Common Retirement Fund[126]

Background on New York State Common Retirement Fund

The New York State Common Retirement Fund (NY State Common) is the third largest public pension plan in the US with an audited value of $192.4 billion in assets. It is held in trust for the retirement security of more than one million members of the New York State and Local Retirement Systems. As a long-term investor, NY State Common has an investment approach which capitalizes on market opportunities and weathers market ups and downs. The Fund is widely regarded as one of US best-managed and best-funded pension plans.

Investment strategy and asset allocation

NY State Common aims for the best risk-adjusted returns needed to achieve and maintain fully funded status. The Fund believes that asset allocation is the single largest driver of its performance and risk profile. The Fund's asset allocation is updated at defined intervals through a rigorous process to reflect changing market conditions and long-term views and is subject to a disciplined rebalancing process to ensure strong returns. The Fund's primary investments are in global equity, global fixed income, private equity, real assets and real estate.

Manager selection is a key determinant of returns on actively managed assets. NY State Common monitors its managers on an ongoing basis to ensure they remain consistent with the strategy they promise and the returns that are expected. The Fund takes risks to generate stronger long-term performance, but only do so where there is compensation by expected return. The Fund considers environmental, social and governance factors in its investment process because they can influence both risk and return.

Why is RI important to NY State Common Fund?

New York State Common Fund is a defined-benefit fund. It has an obligation to its current retirees, plus 30 to 40 years obligation to state workers, and it has a different perspective on long-termism.

"To us, sustainability and long-termism are inextricably intertwined." (Gianna McCarthy, Director of Corporate Governance at NY State Common).

Systemic resilience over time is essential to NY State Common. The Fund is heavily invested in passive US markets and needs those markets to be sustainable and healthy. NY State Common sees climate change as a systemic issue to financial markets that will spur more funds into action.

How is RI embedded in policies and implemented in practice?

As a founding member of the UN-backed PRI, the Fund's commitment to sustainability is a long-standing one. ESG factors can influence risk as well as return, and this forms part of NY State Common's investment philosophy. In 2015 an ESG Strategy review was undertaken by the Fund's management and asset class heads over a six-month period, which allowed it

126 This profile is based on information provided during interview carried out 20 September 2017, and on publicly available information.

to implement ESG across the operations. External manager engagement, assessment, and coaching has become more robust and plays an important role in overall ESG integration.

The process of implementing sustainability cannot be done in silos and requires communication and collaboration. Actions are carefully deliberated and ultimately based around how well they fit with the overall structure of the Fund. The Fund's Trustee, New York State Comptroller Thomas P. DiNapoli is a major driver for the Fund's initiatives.

NY State Common published its first *Environmental, Social, and Governance Report*[127] in March 2017, which articulates the evolution of the Fund's approach to sustainable investment practices. Following the ESG Strategy review in 2015, NY State Common has taken the following actions:

- Establishing an ESG investment philosophy to guide the integration of ESG factors into the investment process.
- Developing a method to assess the materiality of ESG factors for each investment.
- Creating an ESG Risk Assessment to evaluate the ESG policies and performance of the Fund's external managers.
- Other initiatives, including creating a Risk-Aware Low Emission equities index and the formulation of guidance for the Fund's Sustainable Investment Program (SIP).

What tools and resources are used, and what are the costs?

Engagement and voting: NY State Common engages with companies, both bilaterally and collectively through collaboration with other investors. The Fund communicates by letter with approximately 1000 companies. The Fund sees shareholder proposals (proxy voting) as a very important part of company engagement and votes its shares in-house, and files on average 50 shareholder proposals per year at its portfolio companies.

Because of its largely passive strategy, NY State Common has to engage at a systemic, universal owner level. It cannot avoid the risks in individual companies, so must work to ensure that the overall market is functioning well. NY State Common is highly dependent on a robust US market. The Fund has successfully addressed political spending at portfolio level, which was radical at the time but now considered best practice by many. The Fund uses shareholder engagement to encourage companies to set clear goals for ESG improvement, while leveraging relevant information, such as data on companies' emissions, to push companies to improve their ESG performance. One of the Fund's strategic partners annually measures the carbon footprint of the Global Equity portfolio of NY State Common. In the context of systemic resilience, public policy engagement is also a priority for the Fund.

Dialogue with consultants and managers: NY State Common is using its consultants to educate managers. The Fund's assessments of external managers' ESG capability has been systematic and more rigorous since 2015.

Resources: The Fund has modestly increased the portfolio of the Corporate Governance (CG) group recently. There are five staff on the CG group per September 2017, which will increase to six shortly. Integration of ESG factors can only happen through buy-in from all colleagues. RI cannot be isolated from the rest of the fund. The Fund uses the resources that it has very

127 http://www.osc.state.ny.us/reports/esg-report-mar2017.pdf

well and there is continuous interaction between the CG team, asset classes and portfolio managers, including training and informal discussions around RI and ESG integration. More money has been put into research and measurement. The Fund was a project partner in the recent Mercer study "Investing in a Time of Climate Change".[128]

Strategic partners/relationships: NY State Common is seeking strategic partnerships with asset managers. As an example, in January 2016 the Fund launched, in collaboration with Goldman Sachs Asset Management, a customised low-carbon index in its Global Equity portfolio (currently $ 2b).

What are the outcomes (on portfolio value, on trust, reputation, standing)?

NY State Common has only over the last couple of years done sustainable investing at scale: It is hard to measure the relative impact of RI on performance. The Fund achieved an AAA rating with the Asset Owner Disclosure Project[129] for climate-aware investing.

External recognition of its leadership is important to NY State Common. The Fund communicates expectations to the market. Even those initially sceptical are increasingly open to a new outlook on risk and return through a sustainability lens.

Is active management a prerequisite to RI?

RI is integrated into the process of all the Fund's investments. It is part of the decision making. Active management is something the Fund seeks in public market investment only when it believes the managers can outperform passive strategies.

The passive, low-carbon index strategy launched in January 2016, was designed, to have a tighter tracking error than other indexes available in the market (25bps). The rationale for the strategy is that Climate remains a real risk and the Fund's portfolios need to become climate resilient. This is seen as part of the Fund's fiduciary duty. The strategy has received support from across the organisation. NY State Common may scale up this strategy or add further tilted indexes.

RI PROFILE of New Zealand Superannuation Fund[130]

Background on New Zealand Superannuation Fund (NZ Super)

As of October 2017, NZ Super has NZD 37 billion of assets under management. The NZ Government uses the NZ Super to save now in order to help pay for the future cost of providing universal superannuation in the ageing New Zealand population. In this way the NZ Super helps smooth the cost of superannuation between today's taxpayers and future generations. The Guardians of New Zealand Superannuation is the Crown entity charged with managing and administering the Fund.

128 https://www.mercer.com/our-thinking/investing-in-a-time-of-climate-change.html

129 http://aodproject.net

130 This profile is based on information provided during interview carried out 5th October 2017, and on publicly available information.

Between 2003 and 2009, the Government contributed NZD 14.88 billion to the Fund. Contributions are scheduled to resume before the end of 2017. From around 2035/36, the Government will begin to withdraw money from the Fund to help pay for New Zealand Superannuation. The Fund will continue to grow until it peaks in size, as a proportion of GDP, in 2073. It will continue to exist for many decades after that.

Investment strategy and asset allocation

NZ Super is a long-term, growth-oriented, global investment fund. The Guardians must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:

- best practice portfolio management;
- maximising return without undue risk to the Fund as a whole; and
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community

NZ Super has a broadly diversified portfolio of financial and non-financial assets. Global equities, New Zealand equities, fixed interest, property, infrastructure, private market assets and cash. NZ Super invests around 20% of total assets in illiquids, including timber, rural land, property, infrastructure and private equity.

Why is RI important to NZ Super?

As a starting point, RI was about avoiding prejudice to the reputation of the NZ Super Fund as per the fund's mandate. "N*ow it is much more about best practice portfolio management."* (Anne-Maree O'Connor, Head of RI at NZ Super).

The Fund's RI focus is also part of maximising returns without undue risk. In 2008, investment beliefs were articulated stating that companies can benefit from managing ESG risks. NZ Super used academic research around ESG materiality to inform their beliefs. More evidence has come out since, and NZ Super has updated their beliefs to clearly recognise the importance of ESG to long-term returns.

The Fund is seen as a leader internationally and at home, but has been subject to social media campaigns. NZ Super recognises that their own society is their strongest critic. NZ Super put resource into their communications. The NZ Super Board advocates real transparency (if you want don't want to talk about it, should you be doing it?). Legislation creates arms-length governance between NZ Super and government. However, the Fund regularly get questions from parliament. The A+ rating NZ Super got on governance, policy and strategy from UN PRI in July 2017, has been useful in the context of dialogue with the government and stakeholders. Achieving an A or A+ for RI governance against the UNPRI benchmark is also an expectation set by the Board to the management team.

How is RI embedded in policies and implemented in practice?

Policies: RI is embedded in NZ Super's Statement of investment policies, standards and procedures. In order to make the policies effective, there is a need to spell out standards and procedures and making it a part of complying with NZ Super legislation.

NZ Super adopted the UNPRI early, as founding members. The NZ Super Board wanted an international standard to benchmark to and the UN umbrella was helpful as it was seen as credible. The UNPRI commitment has helped guide the Fund's RI efforts. NZ Super had to have an ethical policy and a voting policy under their Act. These were brought together under an RI Policy.

Implementation: It is key for NZ Super to Identify ESG issues with the mandate/type of investment in question. This includes due diligence of managers, annual RI review and rating of managers, and integration of key concerns or good performance into investment team's annual conviction review.
NZ Super also adopted a comprehensive Climate Change Investment Strategy in 2016 which integrates consideration of climate change across the portfolio through reducing carbon exposure, analysing climate risks, engaging with companies and seeking investment opportunities in climate change solutions.

Organization: The internal RI support team sits within the investment team and has three full-time staff. Investment professionals include ESG in their engagement with managers. NZ Super say they have gone through 3-4 different structures to where they are now. With a small RI team, one can support the larger investment team. The Head of RI at NZ Super has a position on the Investment Committee. The Fund concludes that you cannot do RI well without dedicated resource in-house, covering a broad suite of asset classes and funds.
Next three-year strategy: NZ Super aims to integrate RI/ESG integration very explicitly in the investment teams' responsibilities and operations, making it part of the culture. RI will be a normal part of asset management going forward — that is the objective. The RI team members also play a role in analysis of new investment opportunities. The RI team has a position on the new investment group which identifies operational risks and reports through to the Risk Committee, which gives a separate governance mechanism in addition to the investment team role.

What tools and resources are used?

NZ Super has established RI guidelines for different asset classes. As they go into new asset classes, the aim is to develop RI guidelines as best as possible. The closer one gets to a direct investment, the easier it is to identify ESG factors that are relevant — for instance forests, farms, building houses. NZ Super has strong relationships with NZ investors. When co-investing; NZ Super ensures that in the partnership agreement there is a high-level commitment to best practice on E, S & G.

NZ Super is increasingly trying to integrate ESG requirements in mandates with new managers. Mandates will have a broad clause (pre- and post- investment) relative to ESG factors. The Fund does an RI manager rating yearly. This is not the RI team's responsibility, but the team that manages managers. The RI team supports and agrees the rating. If there are any red flags, the manager may fall below a certain level on the Fund's conviction rating. Managers' ratings are reported every six months to the Investment Committee and every year to the board. The managers can hone their RI skills, which benefits not only NZ Super but the wider Asset Owner community.

Having the board, CIO and CEO all lined up is fundamental. Even if a fund's RI ambitions are small — with top-level support, other things can grow.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

That is hard to value. An important part of the RI efforts at NZ Super is about risk avoidance. It is hard to measure risk avoided until it hits you if you get the risk management wrong. At NZ Super, there is an acceptance that good risk management adds value and makes for good investment. NZ Super's ESG belief about the value add is based on sound research. It is about creating parameters for a better run portfolio and knowing your portfolio. One of the main objectives for the Fund is to maintain independence and decision-making power.

The RI efforts also build trust and protect the Fund's reputation. NZ Super publishes all of its holdings. They acknowledge that there is criticism, but overall, NZ Super gets good support. The Fund also has very good returns.

Is active management a prerequisite to RI?

It is not a prerequisite but it improves the ability to integrate RI. Apart from the smart beta type investments coming up, or tilting according to ESG factors like carbon emissions, passive portfolios leave you with exclusion, engagement and voting as RI tools. With active investing you can also do real ESG integration in stock and asset selection, by managing investments and analysing the value of a company through that broader risk/return lens.

RI PROFILE of Ontario Teachers' Pension Plan[131]

Background on Ontario Teachers' Pension Plan (OTPP)

Ontario Teachers' Pension Plan (OTPP) manages Canadian $176 billion of assets and is Canada's largest single-profession pension plan. With a global presence, OTPP invests in more than 50 countries globally, maintaining offices in Toronto, London and Hong Kong.

At the heart of The Fund's model is a strong, independent Board that ensures OTPP is run like a business. The pension plan is jointly sponsored by the Ontario government, through the Minister of Education, and the executive of the Ontario Teachers' Federation (OTF). The OTF represents teachers, while the government represents employers. The joint sponsorship arrangement gives members (currently 318,000) and the government shared responsibility for funding the pension plan.

Investment strategy and asset allocation

OTPP is a global investor and one of the world's leading pension plans. Recognized for its independent governance and history of performance, the Fund invests responsibly on behalf of its members. OTPP strives to balance agility and innovation with a strong risk management culture while developing strategies and building partnerships for the long term. Where they invest, the goal is clear: to deliver excellent service and sustainable pensions to their members.

131 This profile is based on information provided during interview carried out 31st August 2017, and on publicly available information.

Ontario Teachers' investment portfolio is primarily managed internally with professional in-house investment teams. It is broadly diversified across geographies and asset classes. The teams are supported by a Portfolio Construction Group that develop a total fund investment strategy designed to increase the likelihood of meeting OTPP's pension obligations, as well as a Strategy & Risk Group, which guides implementation of investment strategy, oversees investment risk management, and contributes to the development of a collaborative investment planning process. The central asset groups include Capital Markets, Infrastructure & Natural Resources, Private Capital, Public Equities and Real Estate.

Why is RI important to OTPP?

Sustainability ties in with how OTPP manages the plan and its long-term liabilities. The Fund has a long-term orientation that extend 30-40 years out when thinking of risk. ESG risks can manifest over the short, medium, and long term, and the Fund needs to think about the impacts over the life of an investment. Climate Change is a particular focus for the Fund as risks cut across multiple sectors of the economy and multiple time frames.

Responsible Investing considerations are integral to their investment processes. It is about identifying, assessing and managing ESG risks across the plan. In OTPP's view, if you are not examining the connections between RI and performance, you aren't considering all the risks you are undertaking in an investment.

How is RI embedded in policies and implemented in practice?

Governance, environmental and social factors are included in OTPP's investment beliefs. The Fund points out that ESG impacts on investments are facts more than a belief. Responsible Investing is about assessing risks and opportunities as broadly as possible, so that the Fund can make well-considered investment decisions and remain effective stewards of the investments over the time that they are held.

OTPP has established Responsible Investing Guidelines, Corporate Governance Principles and Proxy voting guidelines. They publish all votes on their website. The Fund published their first RI report in 2016[132] and will continue to do so annually. OTPP acknowledges that RI issues are always emerging and ESG standards are constantly being established or refined, thus the Fund is committed to continual learning and applying knowledge in new ways.

Good governance and board oversight at company level is key to how OTPP approaches RI. The Fund manages a lot of assets internally and when assessing ESG risks/opportunities in investee companies, governance and management quality is a natural starting point as they form a strong foundation for the effective management of E&S risks.

OTPP points out that building the culture is an important element in implementation. Tone from the top and shared understanding of RI is critical in embedding it into everyday practices. Managing ESG factors has always been a part of its investment practices, although it wasn't always labelled as ESG. It took a while to reach a common understanding of the terminologies, and to build out consistent and systematic frameworks to evaluate these risks.

132 https://www.otpp.com/documents/10179/772241/OTPP_RI_Report2016_ENG.pdf/0475233f-83dd-4a73-a406-c34b56f09fec

Portfolio managers at OTPP conduct ESG assessments and scan the portfolios for emerging risks and engage with companies to get further clarity where needed.

"Material ESG risks must be looked at and assessed. A systematic, but still flexible framework is needed; it is more sustainable and more effective." (Deborah Ng, Director Strategy and Risk at OTPP).

What tools and resources are used, and what are the costs?

OTPP has defined five main principles guiding its RI actions:

- Integrating environmental, social and governance factors into our processes
- Being engaged owners
- Evolving our responsible investing practices
- Seeking relevant information and disclosure
- Collaborating with like-minded peers

Risk assessments: OTPP uses external ESG research and subscribes to MSCI, Sustainalytics, Reprisk etc. For direct holdings, the Fund has established a Risk-register for each company, which covers a spectrum of financial and non-financial risks, including ESG risk. This provides a basis for regular monitoring and management of risks throughout the life of the investment.

Resources: The Fund has an RI team with four full-time staff. In addition, there are two staff dedicated to voting and engagement on governance issues who work from the public equity department. All portfolio managers at OTPP have a good, solid awareness of RI.

Advocacy and collaboration: OTPP works through international ESG collaborations including CDP, SASB (Sustainability Accounting Standards Board) and GRESB (Global Real Estate Sustainability Benchmark); governance organizations such as Canadian Coalition for Good Governance, International Corporate Governance Network (ICGN), Asia Corporate Governance Network. OTPP also supports groups such as the International Centre for Pension Management and the Pension Investment Association of Canada, which cover a broader range of areas beyond ESG.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

OTPP is proud of its risk management culture, which covers a broad spectrum of risks including liquidity, credit, ESG risks. You can't measure the losses you have managed to avoid. The Fund believes its RI efforts result in strong, stable returns over time.

Reputation is important. The Fund's reputation and collaborative approach opens doors to potential investment partners, and allows access to engagement with company boards and management. Members are very interested in the Fund's investments. OTPP has a very homogenous member group — 75% are women — who are mindful of ESG, climate change, and labour issues.

Is active management a prerequisite to RI?

OTTP sees active management as an enabler for effecting change. But you can also be an active RI investor by index investing selectively, e.g. through ESG indexes, though the Fund prefers to take a more engaged and informed approach.

RI PROFILE of PGGM[133]

Background on PGGM

PGGM has a cooperative structure and operates as a non-profit institution. PGGM Coöperatie U.A. is the only shareholder in PGGM N.V. and was established by the social partners in the health and social sector. PGGM has three distinct business arms covering Advisory, Asset Management and Pension Fund Administration. The PFZW Pension Fund, representing 2.6 million plan participants, provides €185 billion of the €206 billion (June 2017) assets under management by PGGM.

Investment strategy and asset allocation

As an asset manager for pension funds, PGGM supports its clients in fulfilling their task of providing a stable, good pension for their beneficiaries, now and in the future. PGGM has set itself three important challenges: to devise a new sustainable pension contract, to communicate openly and honestly with its clients' participants, and to ensure costs are transparent. PGGM is convinced that financial and social returns go hand in hand.

PGGM provides its clients access to internal and external management, active and passive management, discretionary management and pooled mandates. Clients have the opportunity to invest in many different asset classes, consisting of both liquid and illiquid investment categories. Alternative investments play a key distinguishing and supplementary role. These investments have contributed significantly to a higher and more stable return over the past decade. Clients of PGGM have direct access to unique investment opportunities in Private Equity, Infrastructure, Private Real Estate and Hedge Funds.

Why is RI important to PGGM?

"RI has always been a strong investment belief here. It's part of who we are. We firmly believe that if you take account of the broader stakeholder community, then in the long run, you will do better in terms of financial returns, risk management and impact." (Eloy Lindeijer, Chief Investment Management, PGGM, and a member of the Executive Committee).

It also has to do with the DNA of the health care sector: PGGM's members are doctors, nurses, health sector workers etc. They want to see the Fund contribute to a better society, and as their fiduciary and asset manager PGGM has to be aligned with that and generate good market returns.

133 This profile is based on information provided during interview carried out 13th October 2017, and on publicly available information.

How is RI embedded in policies and implemented in practice?

PGGM has established RI beliefs and foundations[134] in consultation with its clients. The RI framework seeks commonality within the PGGM funds while providing scope to meet clients' specific policy requirements through internal and external management.

PGGM has an expectation that all investment teams integrate RI into their investment process, thus reaching all "nooks and crannies" of the portfolio. PGGM is evaluating how to further integrate ESG factors into their index-based strategies.

PGGM has 11 global investment funds set up for the health care sector that are open to other clients. The Fund also selects external managers and implement segregated mandates outside its core fund offering, but with a clear aim of consistency within the core investment platform to ensure efficiency. PGGM has approximately 180 external managers as a part of their fund-of-fund offering, in areas of private equity, listed real estate, high yield, and emerging markets local currency debt. These managers must all have ESG policies in place. PGGM has issued guidelines explaining their requirements in this area. This is combined with a protocol for acceptable fees and tax structures.

PGGM views itself as an extension of its clients and therefore sees a role in contributing towards better standards of transparency and investment behaviour. For example, PGGM doesn't charge performance fees as a principle and follow a non-profit fee model that allows investing in operational excellence while maintaining a prudent risk-based capital position. By design they aim to be transparent and fully aligned with the interest of the ultimate asset owners.

"Through our own behaviour we should set the standard we would like to see for the whole investment chain." (Eloy Lindeijer, Chief Investment Management, PGGM, and a member of the Executive Committee)

What tools and resources are used, and what are the costs?

Engagement: PGGM engages both companies and regulators across asset classes. In active teams it's integrated into their processes and the RI team assists them with this. For the about €30 billion in broad index-based strategies, the RI team engages with companies and regulators on client-specific themes. For companies in breach of the Global Compact, PGGM uses an engagement overlay service (GES). In selected cases the RI team steps in and works with GES or takes over from GES.

Collaboration: PGGM collaborates with many investors across the world, either through organizations such as Eumedion, IIGCC, PRI or ACGA, or directly with selected peers. Collaborative engagement is one of the instruments used to further integrate ESG across asset classes

Public affairs agenda: In the Netherlands PGGM chairs a Group on Impact Measurement (taking the UN SDGs as a basis) for the Platform for Sustainable Finance created by the Dutch Central Bank. PGGM is also a member of the Pension Federation as well as Eumedion, which

134 https://www.pggm.nl/english/what-we-do/Documents/beliefs-and-foundations-for-responsible-investment_may-2014_pggm.pdf

is focused on corporate governance. Internationally PGGM is a member of the FSB Task Force on Climate-related Financial Disclosures as well as the Focusing Capital on the Long-Term initiative (FCLT). FCLT seeks to get both portfolio companies and investors to lengthen their horizons. Also, PGGM shares a small office with APG and the Dutch Pension Federation in Brussels to facilitate and coordinate lobbying on issues regarding European capital markets and pension regulation and supervision.

Exclusion and impact investing: PGGM excludes certain parts of the investment universe considered not aligned with their identity e.g. weapons of mass destruction. On the other side of the spectrum, PGGM has an explicit impact mandate to invest €20 billion by 2020 in four themes: Access to healthcare; Contributing to managing climate change; Water security; and Food security. These four themes are linked to five UN Sustainable Development Goals (SDGs). The impact mandate is about good risk management and allows opportunities with positive societal impact to be better identified. There is no concession on returns. PGGM has a target of halving the carbon footprint for PFZW by 2020, in asset classes where this is feasible, starting with listed equities.
PGGM investment management has roughly 400 staff, excluding investment advisors, across its front office, risk and operations. The strong growth in assets under management as well as PGGM's direct investment style in private markets (in areas such as credit risk sharing transactions, direct infrastructure and co-investments in private equity and private real estate) has led to a growth of internal staff by about 100 over the past five years. Such internalisation has allowed total investment cost levels to fall relative to total assets under management by about 20%.

External managers and Treasury and Trading: PGGM expects all managers to integrate ESG factors and to have credible ESG policies in place. This system is also applied to the Treasury and Trading function. PGGM ranks its brokers on transparency issues, risk culture and ESG policies. Brokers that score higher on PGGM's "Sustainability Ladder" can get access to more business. All internal teams and external managers are evaluated on a Selection and Monitoring Framework that covers seven areas, including an ESG rating.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

On performance: PGGM's track record on performance is good. After costs for the past 40 years, PGGM has achieved an annual investment return at the aggregate balance sheet level of about 8% on average for its main client PFZW. The past decade their investment returns have dropped to 6% on average. With Quantitative Easing, future returns have been brought forward with higher valuations, so PGGM expects to see 4% returns after costs going forward. PGGM believes that ESG integration will contribute to better risk-return in the long run, as is also evidenced by an increasing body of empirical research. However, markets are adaptive and will occasionally overshoot, so PGGM evaluates beliefs and framework on a regular basis.

On ESG attribution (how much of the performance can be attributed to ESG integration): PGGM's ESG instruments and models have developed over time. The best way of assessing ESG attribution, is to compare performance of the different approaches over time to the broad index performance. Factor-based trading approaches have worked well for PGGM. The next frontier would be to further integrate ESG data in such systematic trading strategies.

On trust and reputation: For 11 years in a row PGGM's main client, PFZW, came out as a leader in RI and internationally the Fund gets strong recognition as an investor.

Is active management a prerequisite to RI?

PGGM does not think that traditional active management in the listed space is a pre-requisite for ESG integration, or is even helpful for RI efforts. It is alpha, short-term, and volatility-driven and it is based around performance-fee models that PGGM does not really like. The debate is on-going over efficient markets and to which extent ESG externalities are priced in. In developed listed equity markets it is very difficult to outperform the broad index by means of stock picking. This makes passive index investing a very attractive strategy for pension funds. However, it is also possible to diversify risk and return from a fiduciary perspective with a much smaller number of individual stocks.

PGGM is looking at active management in listed markets from a new lens; New Active Management which focuses on protecting the pension investments from systemic issues (e.g. market bubbles) and externalities (e.g. climate related risks) which have not yet been priced. PGGM starts with the question: Can you factor in ESG to improve the risk-return characteristics of a portfolio? PGGM's answer is that by actively selecting stocks that score better in terms of ESG factors and societal impact, both financial and non-financial returns can be further optimized. These types of investment strategies are not tested by time, which creates a dilemma for pension plan trustees looking to balance investment management cost, financial returns, societal impact and overall portfolio risk levels. In PGGM's experience, implementing different investment approaches in parallel can help bridge this gap and build confidence in innovative, responsible investment strategies.

RI PROFILE of Public Investment Corporation[135]

Background on Public Investment Corporation (PIC)

Established in 1911, PIC is one of the largest investment managers in Africa today, managing assets of over R1.928 trillion. The PIC, a registered financial services provider, is wholly owned by the South African Government, with the Minister of Finance as shareholder representative.

PIC invests funds on behalf of public sector entities, based on investment mandates set by each of these clients and approved by the South African Financial Services Board (FSB). The Government Employees Pension Fund (GEPF[136]) is PIC's biggest client. PIC's goal is to not only meet, but exceed its clients' expectations and shareholder's investment objectives through thorough research, careful risk analysis and stringent compliance practices.

Investment strategy and asset allocation

The PIC is a long-term investor with an investment strategy that takes into consideration a long-term view of the macro environment. PIC's main investment objectives are to achieve

135 This profile is based on information provided during interview carried out 1st December 2017, and on publicly available information.

136 GEPF is Africa's largest pension fund with more than 1.2 million active members, in excess of 400 000 pensioners and beneficiaries, and assets worth more than R1.6 trillion.

strong long-term capital returns above clients' benchmarks, underpinned by robust risk management and incorporation of sustainable environmental, social and governance practices while contributing to the broader social and economic development of South Africa and the rest of Africa.

Why is RI important to PIC?

Essentially, it is about the environment, social and governance (ESG) risks and opportunities. If you can mitigate the risks and capture some of the opportunities that exist, it will ultimately have an impact on the financial returns, as the PIC desires sustainable returns in the long term. RI also links to PIC's vision for inclusive growth and its developmental investment mandate. In considering any potential investment, PIC focuses on the ESG components, the sustainability, the inclusiveness and the social impact it is going to have. It is also relevant to look at opportunities for crowding in by other investors. PIC has conversations with investees around the actual deliverables going way beyond just CSI (Corporate Social Investment) projects. There is also an active drive to address inequalities through investments made.

How is RI embedded in policies and implemented in practice?

Policies and guidelines: PIC initially had a strong focus on corporate governance in the early years, predominantly on listed investments. In 2014 there was an approach to embed ESG across investment processes for all asset classes, hence the formulation of respective policies. PIC has bespoke ESG policies for various asset classes — listed, fixed income, equities, state-owned enterprises (SOE's) as well as for unlisted investments. PIC has bespoke matrices for listed investments, which differ per sector: a matrix for State-Owned Enterprises and a matrix for unlisted investee companies that all go through an annual review to remain relevant. PIC holds the belief that any investee company with strong governance would adopt best practices when addressing environmental and social issues. PIC also has ESG guidelines for its external managers. The investment process that is implemented across the asset classes has to give effect to policy principles in terms of daily processes and investment deals. It is a bit easier to dictate terms on the unlisted side given instrument types, and PIC can often go beyond what listed entities might give.

Engagement: PIC engages proactively with investee companies. If an AGM is coming up, the PIC informs companies in advance of any resolutions that it is not in support of at the upcoming AGM. For instance, in Australia — if you vote two years in succession against a matter, take remuneration policies, the whole board has to stand for re-election — investee companies then engage the PIC to not be voted against. That can result in a commitment to deliver changes in policies/matters that are acceptable to PIC over a given time frame. In these instances, PIC works with companies to achieve the change that the PIC is looking for. PIC used to be more public about its engagements with companies but has since adopted "a quiet diplomacy" — electing to engage companies behind closed doors. It is PIC's experience that companies do not want to be named and shamed but rather to be given the opportunity to amend things they can do, before a potential public disclosure of a negative view. PIC's mandate does not allow for investment outside of some clearly defined negative screens (gambling, ammunitions, child labour). There are positive results in terms of this proactive engagement.

"At all times we need to remember, this is a journey and not an event." (Rubeena Solomon, Executive Head: Investment Management at PIC).

Publicly disclosed proxy voting and reporting: PIC publicly discloses voting, which becomes a mechanism that drives companies to be seen to be doing the right thing and not lagging. PIC reports quarterly to its clients on its voting, active engagements, and monitoring.

State-Owned Enterprises: Given the governance issues of late amongst the various State-Owned Enterprises in South Africa, PIC has formulated a new a policy with the primary aim of influencing the adoption of best corporate governance practices wherein it invests. For any potential investment, PIC compiles an independent ESG due diligence report for consideration by the approving committees. ESG is factored into legal agreements, including associated penalties. The issues are then actively monitored and engagement is maintained post deal conclusion. These issues include setting key performance indicators, for example, driving job creation, transformation (Black Economic Empowerment is an important factor), driving change of management, skills development of employees, shifting towards racial and gender diversity (board/management/employee levels). The achievement of targets can only be assessed after a period of time, initially the portfolio could be more red than green, but by the time PIC exits the investment, it is expected that all targets have been achieved.

What tools and resources are used and what are the costs?

PIC's RI team still remains relatively small. Due diligence is conducted by PIC's in-house teams. However, in extremely specialised instances external specialists are appointed to conduct the due diligence. Initially, when PIC started recruiting, they could not find what they wanted in the market and this required upskilling to get to the right skills levels. PIC encourages close collaboration across teams, between the RI team, deal team and portfolio managers. PIC tries to stay abreast of trends in the market to be able to identify the risks, and how to mitigate, monitor and measure these. PIC points out that a certain amount of creativity and innovation is needed to tackle new problems and trends.

What are the outcomes (on portfolio value, on trust, reputation, standing)?

PIC expects to remain a beacon of good corporate governance and to improve corporate governance within companies wherein the PIC invests. As a bondholder, your rights are far more limited than an equity holder. For example, an equity holder has right to vote at an AGM while a bond holder only has a right to interest payments and no voting rights. Some other investors have expectations for PIC to be far more vocal, but that is not the PIC's approach and until that changes, PIC will continue with quiet diplomacy.

PIC has had good financial returns on ESG matrices and the social impact has been great. The PIC's objectives are aligned with national development plans. It is important to PIC to live up to its own policies and to be aligned with clients' needs. PIC places importance on having robust internal filters to allow for issues to be discovered and dealt with early.

Is active management a prerequisite to RI?

An active management approach allows for proactive considerations of ESG factors into your investment philosophy and process. Notwithstanding even as a passive investor, you can still

drive proactive ownership and try to influence ESG factors that will impact on investments decisions.

PIC has both active and passive components, but tries to engage with all investee companies to get them to the standards that the PIC believes would be best practice. PIC votes at AGMs for investee companies in its portfolio and wants to see certain behaviours from companies. If companies are to be benchmarked against their competitors, they will not want to be seen as laggards relative to those competitors.

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