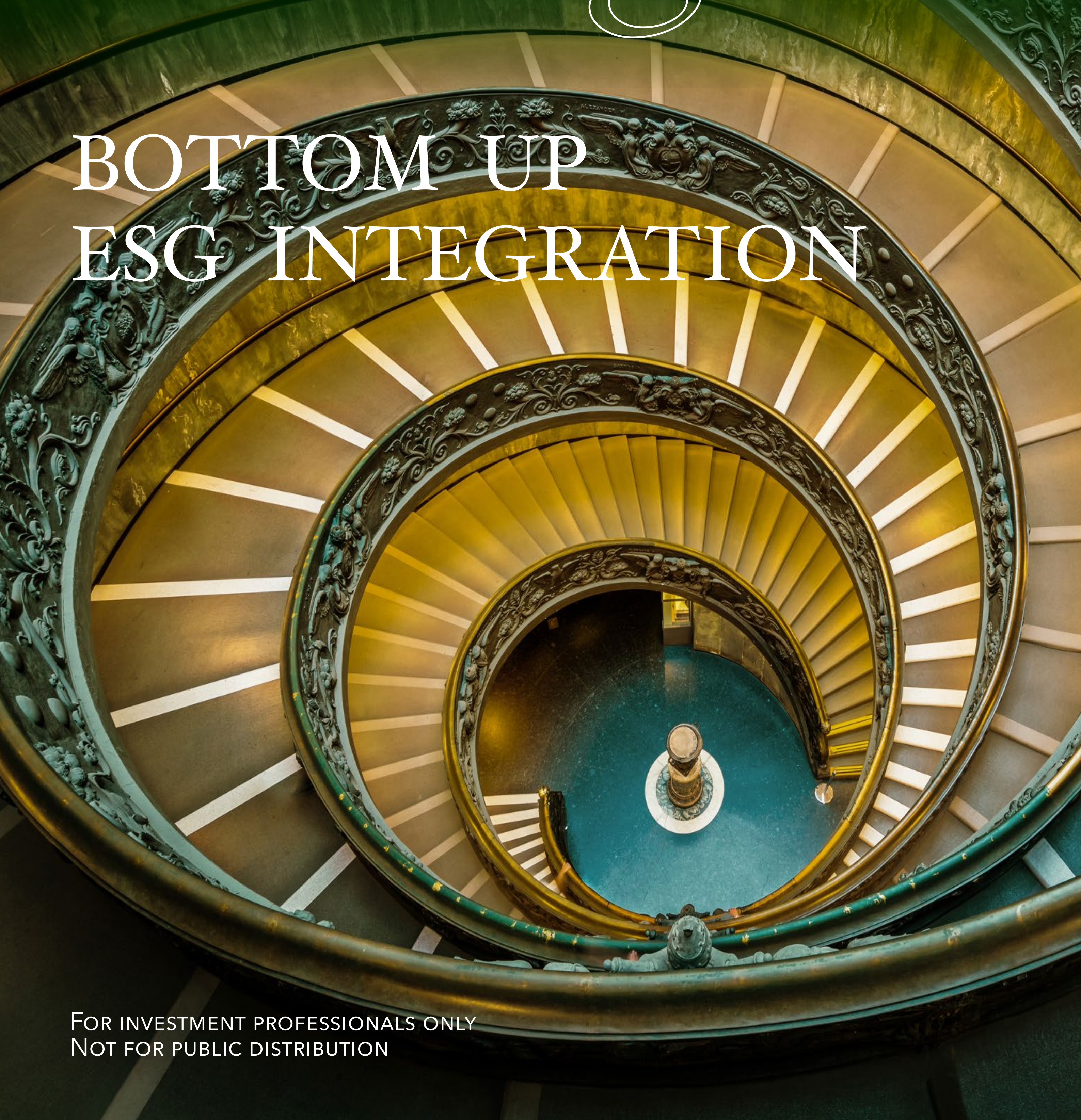
Round Table Discussion
May 2019

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

insights

BOTTOM UP ESG INTEGRATION



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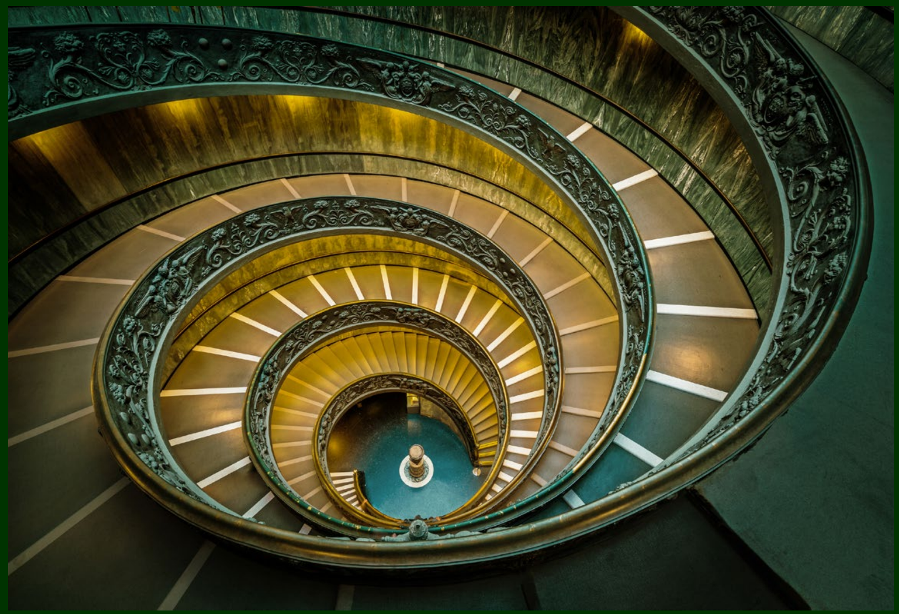

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from the bottom up

Aline Reichenberg
Gustafsson, CFA
Editor-in-Chief
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Only a few years ago, investors would still debate whether integrating ESG in their stock selection process made a difference. Some fundamental investors argued that they took ESG factors into account without calling it so.

Today, the discussion has shifted. Hardly any investor, questions the added value of ESG integration, at least not when entering the Nordic market. Questions still remain, however, especially on the side of the end investor. How can we make sure that ESG integration has been conducted properly? How do we stay away from greenwashing?

Asset managers often describe the integration of ESG into their investment process as a journey, where the ultimate goal is to make a fully informed investment decision to reach an optimal risk-adjusted return. Data represent the first hurdle, as the availability and reliability of off-the-shelf measurements can be insufficient.

Another concern for fundamental investment firms, which have been performing well for many years without a formal ESG framework, is to integrate the new lens to enhance the current process without disrupting it. In some instances, it may involve training, in others, a gentle nudge from a specialised centralised ESG team, issuing internal warnings for companies that have scored poorly on a set of ESG metrics.

However, the analytical process works, engaging with companies is also an integral part of the ESG journey. Fundamental investors and analysts are used to interrogate companies on a range of issues. To add ESG on the agenda can seem tedious, but nowadays, companies have opened up to sharing data, and even learn from their investors' requests.

In an industry usually rather secretive and protective of the carefully assembled information based on which investments are made, collaboration has become more commonplace, in regards to ESG.

Around lunch, on a bright February day in Stockholm, we discussed the opportunities and challenges of bottom up ESG integration. We are now glad to be able to share the key insights of this conversation in the following pages, which we hope you will enjoy and, in turn, share with your peers.

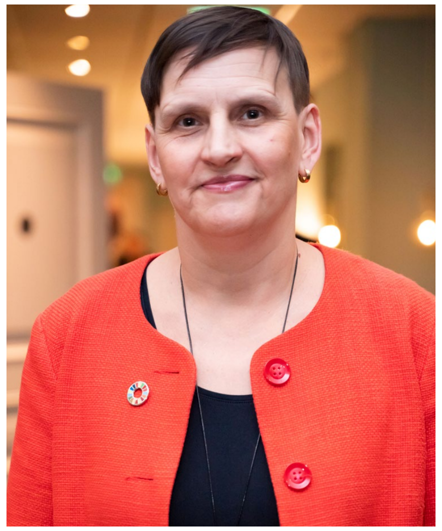
who is who?

"Since 2015, UBS has treated sustainability as a key component of its strategy."

Martijn Oosterwoud
Head of SI Investment Specialists
Executive Director
UBS Asset Management

Martijn joined UBS Global Asset Management in February 2017. Prior to this, he worked at RobecoSAM in Zürich, as head of Client Portfolio Management globally. In this capacity he was responsible for the commercialization of the RobecoSAM investment strategies as well as the interaction with clients on sustainability research for the Robeco group. Previous jobs include head of research for the Amsterdamse Investerings Bank and Fixed Income product specialist at ING Investment Management (NN IP)

Martijn graduated with a MSc in Monetary Economics and holds an investment certificate of the University of Groningen.

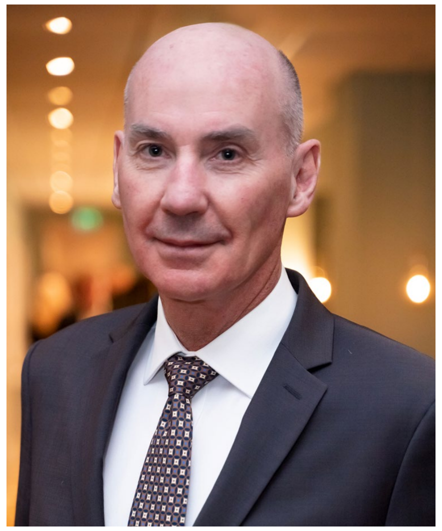


"I was with AP1 for 26 years, creating an ESG strategy for AP1 and moving AP1 to where they are today."

Nadine Viel Lamare
Director
Transition Pathways Initiative (TPI)
and independent consultant

Nadine joined the Swedish buffer pension fund AP1 in 1992 as performance analyst. She then navigated the organisation in several roles until she became successively Head of Corporate Communication in 2001 and Head of Sustainable Value Creation in 2009, a role she held until last November.

Nadine holds an MBA from the Stockhlm School of Economics, she is a Certified European Financial Analyst (CEFA), and has completed a Harvard Business Schol executive education program in Corporate Social Responsibility (CSR)



"We have 20 years of experience looking at non-financial information for companies."

Robert De Guigné
Head of ESG Solutions
Lombard Odier
Investment Managers (LOIM)

Robert joined Lombard Odier in June 2007 as deputy chief investment officer for the Institutional Investment Unit. He then became deputy CIO for LOIM's equity and convertible long-only strategies and later, head of socially responsible investing. Prior to joining, Robert was a managing partner and co-founder of hedge fund management specialist AQTIS. Previous positions include head of research and information systems at CPR Asset Management, head of EAFE & emerging equities portfolio management at AXA and international equities manager at State Street Global Advisor.

Robert earned an MBA in international affairs from ESC Reims – CEFA and holds an engineering diploma from Ecole spéciale de Mécanique et d'Electricité in Paris.

"We have roughly SEK 23 billion under management. However, we are only two people employed by the pension fund."

Claes Ahrel
Managing Director
Telia Pension Fund

Priori to joining Telia Pension Fund in 2014, Claes was Senior Portfolio Manager in the asset allocation team at Swedish buffer pension fund AP4 for 7 years.

Claes also worked as Chief Strategist at Länsförsäkringar from 2003 to 2007. Previous positions include portfolio management at Nordea, Alfred Berg and Handelsbanken.

Claes studied accounting and business /management at the University of Lund. He is also a Certified European Financial Analyst (CEFA).

"Our mission is to help clients reach their long-term financial goals, and therefore, we have an obligation to understand the long-term sustainability of the companies in which we invest."

Maria-Elena Drew
Director of Research, Responsible Investing
T. Rowe Price

Maria-Elena joined T. Rowe Price's London office, in 2017, to strengthen the organisation's efforts in integrating responsible investing.

Previously, she was Executive Vice-President at Goldman Sachs in London, driving responsible investment internally after having spent several years as an analyst covering hard-hat industries.

Before joining Goldman Sachs in 2008, Maria-Elena was an analyst at Putnam Investments and Delaware Investments. She graduate from Smith College.

"We do ESG compliant investments from a purely commercial perspective."

Jonas Andersson
CEO and
Chief Investment Officer
Navare Invest

Prior to joining Navare Invest as CEO and CIO in 2016, Jonas spent close to nine years as a Senior Private Banker for the Family Office division of SEB's private banking practice. Previously, he was Group Head of Active Trading for Discretionary Asset Management at Handelsbanken. He was also Head of Advisory Asset Management at Handelsbanken Kungsträdgården Asset Management.

Jonas holds a Bachelor of Business Administration (B.B.A) from Uppsala University with a specialisation in accounting.

From left to right: Tommy Mikelsen, Martijn Oosterwoud, Velida Jahic, Claes Ahrel, Filipe Wallin Albuquerque, Selina Pattyranie, Nadine Viel Lamare, Maria-Elena Drew, Roberg De Guigné, Jonas Andersson, Aline Reichenberg Gustafsson, Henrik Fahlåker, Kim Hansson

Bottom Up ESG Integration

Nio Rum
Stockholm

20 February 2019

starter

Where an ESG journey begins

When starting to look at sustainable investing and ESG integration more specifically, every institution and asset manager needs to take into account a different background. Some have ethical considerations embedded in their DNA, some have had to confront difficult conversations before actively entering the field. In every case, the initial impulse will shape the journey and bring about different hurdles. Each participant starts by outlining their unique starting point.

"We have implemented ESG scoring on companies for investment purposes since 1997," starts **Robert De Guigné.** "We have 20 years of experience looking at non-financial information for companies. Over the years, we have collected raw data from companies, as well as traditional and alternative sources and have built a common internal database. Using this database, we also developed our own sustainability scoring methodology, which we have improved based on our practical experience."

"UBS's Global Sustainable strategy is a flagship of how sustainability can positively contribute to the quality of investment decisions."

"Over the years, we have collected raw data from companies, as well as traditional and alternative sources and have built a common internal database."

"I was with AP1 for 26 years, creating an ESG strategy for AP1 and moving AP1 to where they are today." says **Nadine Viel Lamare**. "I started my ESG journey as head of communications in 2002 and my role involved managing communications regarding every bad investment that we had in our portfolio in terms of ESG. Over the years, the focus changed to engagement related to ESG, and then ESG integration in investment decisions, starting in 2009."

"One of the struggles with ESG is convincing managers, particularly internal ones, to get on board. External managers have to do it because you pay for it, so they listen, whereas internal ones are more difficult to convince."

"I decided to leave AP1 at the end of last year, because I thought there are so many other organizations that need help. I decided to set up my own consulting business, working with small pension funds and other different organizations. I have also taken on a role as Director at the Transition Pathway Initiative (TPI). We provide free-to-use data for investors to assess the extent to which their companies' strategies are aligned with the transition to a low-carbon economy and addressing climate change."

"It was easy to identify a company that was an extreme outlier, but it was harder to really hone in on the nuances of ESG integration."

"Since 2015, UBS has treated sustainability as a key component of its strategy, including for its wealth management, asset servicing, retail bank, but especially for the asset management," **Martijn Oosterwoud** begins.

"Starting in 2017, we created a team, with over 18 specialists, which focuses on the overall integration of ESG into every investment decision. UBS Asset Management is a very large organization. We are active in different asset classes including fixed income, real estate, private equity and infrastructure debt, so we have a lot of expertise. We are now combining this expertise with the sustainability tools we have developed since 2017."

"We also have a very long track record on sustainable investing, based on our global sustainable equity strategy, with over 20 years outperforming global capital markets. UBS's Global Sustainable strategy is a flagship of how sustainability can positively contribute to the quality of investment decisions. There is definitely a long way to go, but I think we have achieved already a lot."

"Originally Telia was the old state monopoly telephone company, so the pension fund's liability is quite large as the fund covers many of the retired employees," **Claes Ahrel** says. "We have roughly SEK 23 billion under management. However, we are only two people employed by the pension fund, so we decided not to do direct equity investments. Instead, we outsourced the portfolio management to external managers who invest in selected asset classes on our behalf."

"That means that we have a low-cost approach where we seek out funds. Internally, we do the fund selection process, the asset allocation process and the risk management. The rest we outsource."

"Sustainability has been very important for the Telia Pension Fund from the beginning, in 1996. We had requirements on the type of assets we could own when we first started selecting asset managers. That means that we do not have any chemical weapons or other unethical assets in any portfolio (as I know of) because we were selective early on."

"At T. Rowe Price, we have over a trillion of assets under management." starts **Maria Drew**. "The vast majority of them are actively managed portfolios in equity and fixed income."

"We started our ESG integration journey in 2007 when T. Rowe Price set up a standalone governance team. My colleague Donna Anderson, the head of our governance team, is still running that team today. She is based out of our Baltimore office. In 2010 we became UNPRI signatories and in 2013 we started to embed Sustainalytics into our in-house research platform."

"That was our first step on formalizing the Environment and the Social side of the equation, but we felt that we were not really getting enough traction. It was easy to identify a company that was an extreme outlier, but it was harder to really hone in on the nuances of ESG integration."

"In 2017, T. Rowe Price decided we needed to set up a team to focus on the environment and the social aspects as well as the ethical side of the equation. This is when I joined the firm."

" It is very easy to be impressed by a fund manager presenting a product idea with fantastic potential."

"We set up our team in late 2017, and in 2018 we rolled out a rating system that covers more than 12,000 corporate entities. We also started providing a lot more research for our analysts and our portfolio managers. Our key thrust is that we are a resource for the analysts and the portfolio managers as ESG integration has to be done by the person who is doing the financial analysis, setting evaluation, deciding the position size. We are there to help them do ESG integration, not to do it on their behalf."

Jonas Andersson introduces his ESG perspective, heading a single-family office: "I worked for Handelsbanken for almost 20 years and for another 10 years within wealth management at SEB. These days, I head a small investment company. The founder made his money in the oil tanker industry, but we are actually trying to reposition ourselves. We do ESG compliant investments from a purely commercial perspective. As we see it, it is not possible to be a sustainable business if you are ignoring the ESG themes, particularly the environment. I do not think anyone would be prosperous in trying to start a new coal mine compared to other opportunities that are out there."

"It is good that investors are pushing the portfolio managers to be more ESG compliant in general. The two incentives work well together. However, we do not have to sacrifice returns in order to be more ESG compliant. We are not exclusively focused on ESG so we can look at other investments, but I truly believe that using ESG as a filter can help us identify good investment opportunities."

In an smaller organisation like Novare, time resources are scarce and, as a CIO, Andersson has to focus his attention on the elements that will make a difference. In his experience, the most important element of a successful integration of sustainable investment practices is discipline.

Optimizing under time constraints

"We are a small organisation," **Andersson** says, "so we need to think twice without getting carried away. It is crucial for us to take the time to consider whether an investment is good from all perspectives. It is very easy to be impressed by a fund manager presenting a product idea with fantastic potential."

"Lack of time is one of the main issues we face," he continues. "The other difficulty is knowing what to look for in this space. There are a lot of databases, but that does not solve all the issues for us. These tools can be useful for listed investments, such as equities and bonds. However, we also do Venture Capital and real estate investments, where the reach of these tools is more limited."

At Telia Pension Fund, **Ahrel** faces similar issues when it comes to time resources. For him the key component of a succesful strategy is to keep a steady keel over the long run, and to keep an eye on the managers at all time.

"As Robert metioned, ESG integration is a journey," he says. "We started that journey in 1996, but we are far from done. It keeps evolving. At least once a year we have a deep discussion with all of our managers. And between those meetings, of course, we look at what they are doing, day to day. We have to check the portfolios."

Transparency requirements

For Ahrel, transparency is an fundamental requirement when selecting external managers: "For me, it is very important to be able to see that a portfolio manager actually has the product they are selling. We need communication to be transparent, especially in the hedge fund industry. Things have improved nowadays. Earlier, many managers did not even want to disclose their positions. We stopped working with portfolio managers who did not keep us in the loop."

"At least once a year we have a deep discussion with all of our managers. And between those meetings, of course, we look at what they are doing, day to day.

"We see our relationship with managers as a partnership rather than remaining simple clients. That also affects the way we integrate ESG into our investment process because it has to be incorporated in the daily routines. This is often easier said than done."

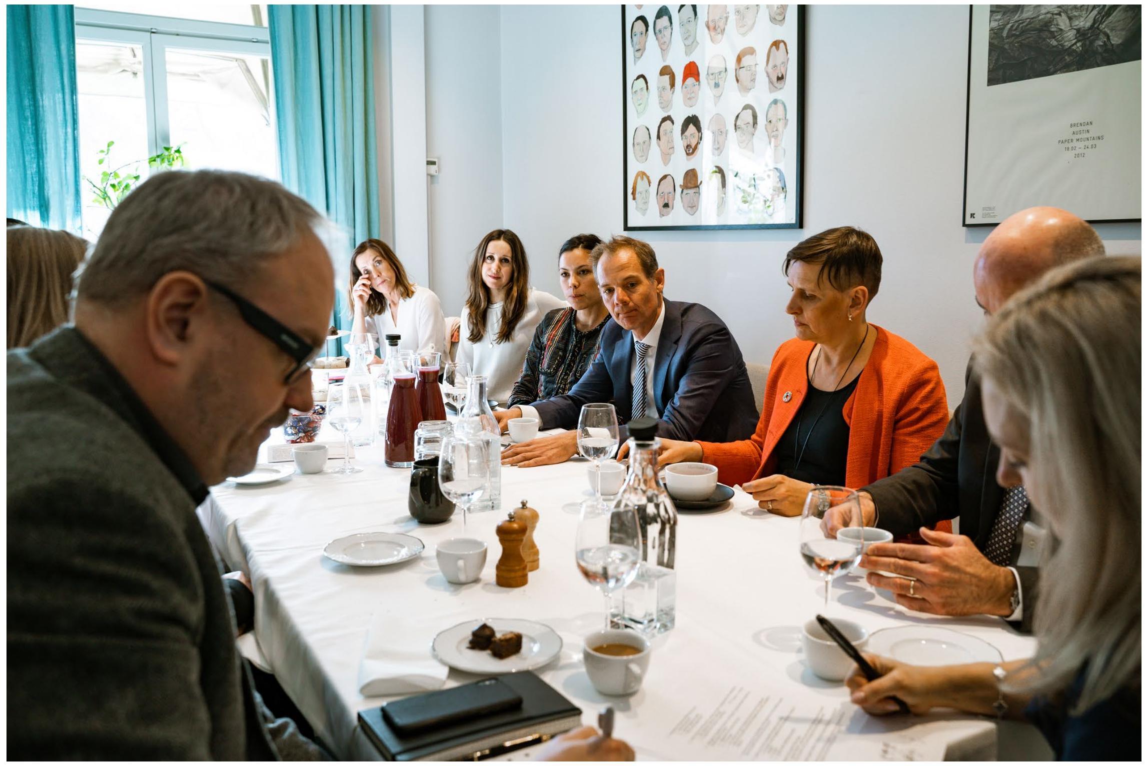
" ESG has become a marketing tool. The first thing managers tell us when they present their product is that they are 'ESG compliant'."

"Telia has undertaken a broad ESG integration across the entire organisation, and that has allowed us to achieve high scores in all aspects. Given that the level of knowledge about ESG compliance can sometimes lag in some parts, I also think that the pension fund has a mission to show what has actually been done."

"Going forward, we are planning on doing more in-depth reviews of all portfolios this year. We want to see that asset managers have been as active as they have promised. It will not be about merely checking boxes. They will have to show concrete examples of how they integrate ESG, and how it relates to their performance. We also look at the way the asset managers integrate ESG and what their culture and internal practices can tell us about their commitment to ESG. The fact that they mention ESG is definitely no longer enough."

Jonas Andersson agrees. "ESG has become a marketing tool. The first thing managers tell us when they present their product is that they are 'ESG compliant'. But we need to dig deeper and check that this is actually the case. Is a company fulfilling its potential or would they benefit if their product was more resource efficient and contributed to making the world a better place? I think that is a better way to consider ESG than just doing exclusions."

Integrating ESG in an existing strategy



"For us it is all about collecting the relevant data, building robust analytical tools and make that information available to all our teams."

For **De Guigné**, "there are two ways to approach ESG integration. Some companies were set up from scratch to work in sustainability, like Robeco SAM for example. These firms started from scratch and all the people they hired are focused on sustainability. When everybody is aligned with sustainability it is easier to integrate."

"T. Rowe Price, UBS and Lombard Odier IM already have existing teams. We are not going to fire these teams to replace them with sustainable asset managers in place, whose performance is not guaranteed anyway. Instead, we need to convince the people we already have to integrate ESG into their existing teams without compromising returns and disrupting the risk profile of our portfolio. That is the tough part, and why we call it a journey."

"For us it is all about collecting the relevant data, building robust analytical tools and make that information available to all our teams. We can then establish a framework for our portfolio managers to integrate sustainability into their investment decisions."

"At Lombard Odier IM, we look at sustainability using a three-pillar model. The first pillar is the sustainability of the financial model. There is nothing new about this. As asset managers, we need to make sure that the financial model is correct. We are not going to invest into unprofitable businesses. The second pillar is the sustainability of the business practices of the companies we are investing in. We have to make sure that these companies are managing their business appropriately, treating their staff fairly, using resources efficiently and that they have good governance structures."

"The third pillar of our approach is the sustainability of the business model. At Lombard Odier IM we believe there are several major structural trends, including demographic changes, climate change and inequality, that will disrupt many of our established norms. This will affect whole sectors and, in our view, no company will be unaffected.

"The investment teams have to consider whether an investment they are considering is financially sustainable, whether the business practices are sustainable and whether the company

has a sustainable business model. If they obtain green lights in all three pillars, they can pursue the investment. We let portfolio managers free to find the proper way to integrate sustainability in their portfolios using our toolkit of scores and raw data, but a comply-or-explain process is applied. If some portfolios hold controversial companies, managers need to explain. This is very useful and encourages dialogue with companies and increases transparency."

"We still own problematic companies because we are able to engage with them and encourage the transition."

Jonas Andersson is curious about portfolio managers' reaction to this approach. "Have they embraced these new tools as a way of enhancing the possibility of finding new investment or as a filter that stops them from pursuing certain investments?"

"That is an interesting question," De Guigné answers. "If you think about it, the first pillar is what they have been doing all along, so that is not problematic. The third pillar, the sustainability of the business model, looking into opportunities and at what sectors will experience changes, is also something that was already part and parcel of the analysis. The new challenge created by the framework is the second pillar, the sustainability of the business practices. What do you do if the other two pillars are green-lighted but the business practices are red-lighted? Normally, managers would not notice it and would just pursue the investment. But now the problem is made apparent to them and they have to address it. They will have to engage with the company and get all the details, all the extra-financial information. So they are in a position to ask the companies about their carbon footprint, they emissions targets and the independence of their administrators, for example. They can start a conversation with the company and push them to do better, but if that does not work, they can stop going further."

"We let portfolio managers free to find the proper way to integrate sustainability in their portfolios using our toolkit of scores and raw data, but a comply-or-explain process is applied. "

"And if they get the right answers from these companies, can the portfolio managers invest in companies that are transitioning?" asks Jonas Anderson.

"Thanks to our comply-or-explain approach, we will notice that they have a potentially problematic investment," explains De Guigné. "Managers will have to make their business case. If they can explain, and show us that this company is indeed transitioning, that is fine. We should support and encourage companies. This is why we have moved from pure exclusions towards underweighting sectors. We still own problematic companies because we are able to engage with them and encourage the transition. Take the case of carbon emissions. Many managers and investors have knocked utilities, materials and energy sectors from their portfolios to lower their carbon emissions. We believe that, instead, we should be rewarding best practices and pushing companies to pursue them."

Preserving the independent investment process

At T. Rowe Price, the investment process relies on each portfolio manager's individual expertise and, to a large extent, on the independence that exists between the decision making processes of the managers. ESG integration is a coordinated effort, but it needs to ensure that the individual investment styles can continue to co-exist.

"Our ESG specialist teams provide research tools as well as written research, which our analysts and PMs can integrate as appropriate to their investment process, says **Maria Drew**. "As each portfolio manager uses financial, valuation, macro and other factors uniquely within their investment process, each portfolio manager also uses ESG factors in a manner that is unique to their investment process. For example, an investment grade credit portfolio manager will have a much lower risk tolerance for both financial and ESG risks than a high-yield portfolio manager. Each portfolio manager should rely on their own parameters and investment process. We think that having that independence is crucial."

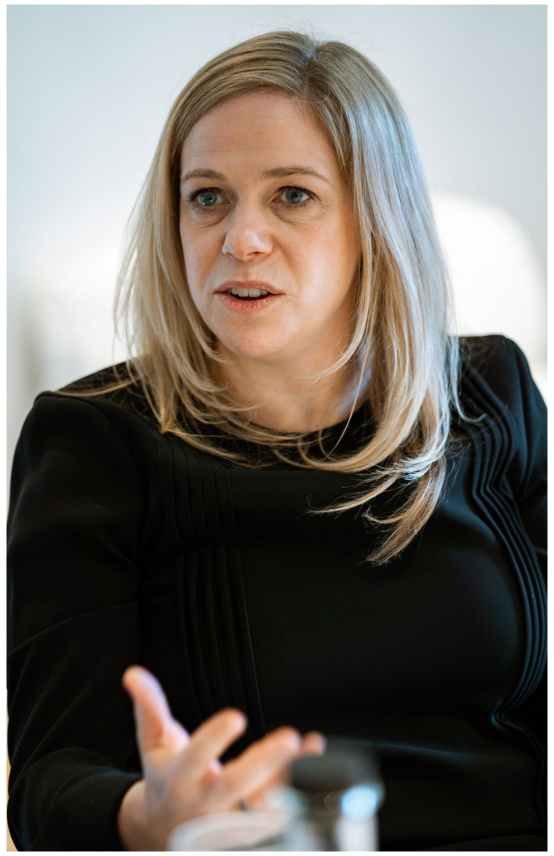
Ensuring Accountability

"We also have to ensure accountability for ESG integration in the investment process. ESG integration is an item in the year-end review of our analysts and portfolio managers. We do not have firm targets that they need to hit, but they need to show that they are integrating ESG factors into their investment process as appropriate to their mandate."

Data alone is not the answer

Martijn Oosterwoud: "At UBS, we have been working on the database already for many years. What we definitely discovered is that data in itself is not the answer to ESG integration. Our philosophy is that the sustainability profile is part of how we review the investment case. We look at both the risks, which are definitely more prominent in every investment analysis, but also at the opportunity side."

"We try to connect the quality of the business model that we are investing in with the sustainability characteristics of how that is operated. That leaves us with two options. We could find that we do not think that the sustainability profile adds to the business case. In that case it could still be an attractive investment case but not from the sustainability angle. In that case we could engage with the company and try to unlock value through actively driving the company towards a more sustainable profile. We could of course also find that the two are aligned and work positively, giving the company a competitive advantage over its peers."



"ESG integration is a coordinated effort, but it needs to ensure that the individual investment styles can continue to co-exist."

"However, this is not something that can be captured by a single figure. A simple ESG number does not tell you a lot about what is driving the business case, about its strengths, weaknesses, opportunities and threats. Analysts must make their own qualitative analysis, write it down in the investment research notes and link that to the investment case that they are making to the portfolio manager. That is then reviewed and discussed."

"The sustainable investment analysts can help other analysts and portfolio managers see the value of this analysis in building an investment case. We have also benefitted from the fact that a number of teams have already been very focused on this for a long time and can share their insights with the rest of the group."

main course

The three prongs of ESG integraton: Risk avoidance, opportunity seeking & engagement

While ESG integration often starts with risk-avoidance, the journey often leads to the discovery of new opportunities. To seek ESG opportunities becomes a way to identify tomorrow's outperformers.

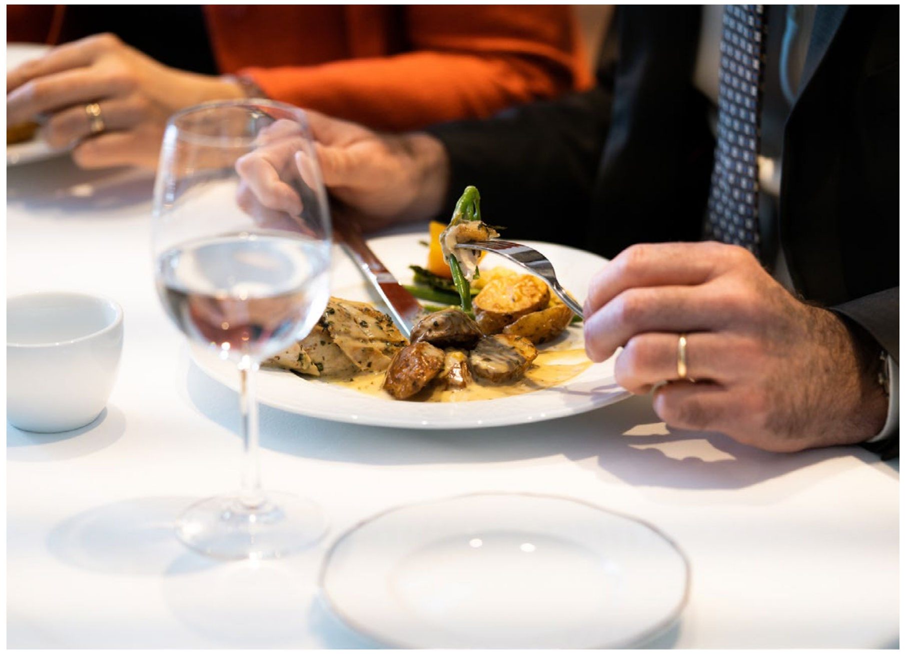
During her time at AP1, **Nadine Viel Lamare** has experienced some of the shift towards more opportunity focused strategies, but the transition is slow.

Seeking opportunities requires expertise

"I would say that for most people, ESG is still about risk and less about opportunities," she says. "Using ESG for risk-avoidance is easy, but to be able to use an opportunity-seeking approach, a manager must be solution-oriented. Even though there may be a lot of opportunities focusing on solving global issues, they are often pursued by mid- or small-size companies. Portfolio managers need to have an investment process that allows them to focus on finding these opportunities. Unfortunately, most organisations still lack that kind of specialised expertise and resources to looking into new areas. They manage large portfolios, so it is easier to invest in listed companies and, mostly, large caps."

Investment-driven engagement

The opportunity side of ESG investing often appears more clearly to portfolio managers and analysts when they engage with companies. The three ESG dimensions provide the right framework to bring questions to the attention of certain companies. The opportunity then resides in the fact that engagement unlocks new discussion areas, which may ultimately add value to the target company.



"At T. Rowe Price, our engagement process is very much investment-driven," says **Drew**. "Our focus is on actively managed portfolios, so we do not pick a theme and go out and invest around that. Instead, we choose to engage with companies when an issue arises - either with a prospective investment or one that we are holding."

"We prefer to have our analysts and our portfolio managers driving the engagement process. We think it is much more impactful if the portfolio manager who owns the company is going to the management and bringing up this topic. The issue can be raised in a meeting fully devoted to that topic or at a meeting alongside other financial questions. The important thing is to show that this is an important issue for T. Rowe Price. The role of our ESG specialists is to point out what engagements should take place and help push our analysts and portfolio managers think about some of these issues further."

A resource-intensive activity

"I know from experience that if you want to successfully engage with a company and impact the way it does business, you need to be on top of the issues," says **Viel Lamare**. "That is not obvious for an asset manager or for an ESG generalist. It requires looking at the sectors and organisations to understand all the details, in order to become a constructive partner for the company. If we show companies that we understand their business and that we may be able to contribute because we also see what other companies are doing, they actually start looking forward to meeting with us."

"An added problem for large funds is that they cannot engage with hundreds of companies. Even if you are selective with your engagement, it is not possible to have high levels of engagement with all of them. That is not a reason to withhold from engaging, however. Sending a letter to management can also have an impact. If every investor writes, the message will come through. But if you really want to be successful in your engagement, you have to be very thorough and only do it where it is really needed. It takes time and the trust of other partners to push the agenda forward."

Leveraging size in engagement

According to **Oosterwoud**, UBS takes yet another path. "We have a central stewardship team that draws on the sustainability information that we collect on the different firms." Size also matters he continues. "As a large asset manager, when we engage with companies, we can leverage our size to influence them. We have US$ 800 billion worth of assets and we can be very effective when we combine the fixed income holdings with the equity holdings."

Oosterwoud is keen to emphasise that engagement is not always just about a dialogue with the investee company. "We collaborate with different asset owners as well as insider institutions such as the UN PRI to push firms to pursue more ambitious practices."

"We also try to be selective with our engagement in order to conduct it properly. At the moment we focus from a thematic perspective on gender equality and carbon. We think these are topics deserve much attention and we can achieve a significant difference. Shell, for example, has been responsive to active ownership. Imagine if Exxon-Mobil were to come on board as well. I think that would be the biggest win of all times, if we manage to make them a bit more sustainable."

However, Oosterwoud believes that it is crucial that investors speak with one voice. "We work closely with the wealth management team to make sure that there is no confusion in the message we are sending. The message to management must be consistent. If we do this, then we can engage with other asset owners to create majorities and put demand to management that is cannot refuse."

"We work closely with the wealth management team to make sure that there is no confusion in the message we are sending."

Staying away from green washing...

"Everyone is so aware of the ESG factors nowadays, they make sure to mention it in their presentations, but the underlying processes should reflect that commitment. "

For **Claes Ahrel**, the focus should remain on ensuring that both asset owners and managers are clear about what it is that they want to see delivered. "You want managers who stand up for their beliefs and you want to see that they are acting as promised," he insists.

"It is about making sure that they walk the talk," adds **Andersson**. "Everyone is so aware of the ESG factors nowadays, they make sure to mention it in their presentations, but the underlying processes should reflect that commitment. It reminds me of a time when I visited a company who proudly pointed out how they had put sustainable bamboo floors throughout, but next door, the staff cafeteria was still covered in bright plastic. This is an example where the organisation had not yet properly internalised the story they were serving their investors."

De Guigné agrees: "Exactly! When everybody says that they are fully ESG integrated that cannot be the case. There is some greenwashing going on. We have to do some triaging and, to do so, we need to look into the data and get as granular a view as possible. At Lombard Odier IM, this journey started when we improved our methodology and moved from simple ESG ratings towards raring companies based on consciousness, action and results so we can get a much better picture of where companies are on the journey towards sustainable business practices. Around the table, others have developed different systems but we are all fighting to try to distinguish between those who walk the talk and those that do not."

"One of the main issues that our portfolio managers had reported when we were previously relying on a third-party vendor was greenwashing," says **Drew**. "A company would receive a low rating, and we would find that the company lacked disclosure of the right policies but they had no track record of incidents. The issues of greenwashing and lack of disclosure were big contributors to our decision to build our own proprietary model to create ESG ratings for our investments."

... while avoiding SDG washing

If ESG integration often starts from a risk-avoidance perspective and evlove s into value-adding engagement opportunities and other opportunity seeking strategies, the world of so-called impact investing is yet another step further along the sustainable investment spectrum.

The Sustainable Development Goals were developed as a framework by the UN to drive attention and potentially investments to solving the global challenges they outline.

In the fast-growing field of impact investment, the SDGs quickly became a set of relevant targets. How can they be most effectively used in the domain of ESG-integration? Is it possible to take the SDGs into account without tipping into SDG-washing?

A place to start

"I have been working in sustainability for twelve years and I am still waiting for some international standard of reporting to be agreed upon as a guide to what is sustainable," says **De Guigné**. "I think I could still wait 20 more years in vain. The only international framework that we have that have been issued by a well- known organization are the SDGs. It is the only internationally recognized standard that we have today. Let us try and use it and try and figure out how we could start to deploy it. Because if we wait for something more advanced to be agreed upon we will be soaked to our knees in five degree scenarios or six degree scenarios. We need to try to see how we can work with what we have because the standard is there, whether you like it or you do not like it, it is there, let us use it."

Accidental washing

"I do not want to say that anyone engages in SDG-washing on purpose," add **Viel Lamare**. "I think that the market is simply not mature enough. It is a difficult process. One needs to understand the SDGs and map KPIs or data onto them in order to understand the ESG performance of the business. But this is easier said than done. The type of data used is very important. SDG positive revenues data may hide unsustainable production processes, like the use of child labour or corruption. Because people do not understand these pitfalls, the process is not necessarily conscious

"The only international framework that we have that have been issued by a well- known organization are the SDGs. It is the only internationally recognized standard that we have today."

SDG-washing. However, in most cases, SDG-based investment processes are not comprehensive enough to offer genuine solutions targeting the goals."

"On the other hand, the SDGs are meant to guide sustainable development and growth. So if asset managers are going to use the SDGs to evaluate their investments, they should be supporting this goal. But there is no additionality in buying shares of listed markets. Nothing is added if we buy shares in a very sustainable company. But investing in infrastructure projects in Africa really makes a difference. So I think the SDGs are tricky but they are very useful framework. We all need to have a holistic approach."

De Guigné agrees. "You are right," he says. "It undermines the point of buying an electric car company if they have children working in the factories or at some point in the supply chain. We do need to have a holistic approach."

A communication tool

"I think that the SDGs play an important role in labelling the products both for us internally as well as when we speak to investors and to companies," says **Oosterwoud**. "For example, three years ago we started developing a product for one of the largest Dutch pension plans around investing in sustainability challenges, such as climate change, food security, healthcare and water. These are strongly linked with some of SDGs around climate action, renewable energy and sustainable cities. They were not necessarily set up for this purpose, but we do think we add a lot in terms of measuring what contribution the companies we invest in are making."

A door to drive engagement

"I also agree that the problem lies in the additionality," Oosterwoud continues. "That is one of the reasons why we put a lot of focus on the engagement with our companies. Engagement allows us to tell companies where we see most opportunities for growth, what metrics we have developed and where their technologies can most effectively be employed. This information is very valuable for the companies, because they want to explain to society what their contribution is. It is also very important to our investors and it allows us to understand the actual business case for these companies."

"We think it is time and resources well spent, but it is very resource-intensive. We work together with a number of academic institutions to develop very granular measures because we need to understand every product line and what the positive impact could be on society. We also put a lot of effort in converting and applying these measures to different regions where the impact is different. In any case, the quality of our investment decision benefits from our work. It enhances the discussions that we have with companies, and it satisfies one of our key client demands. Using the SDGs adequately are still work-in-progress, but the goals create a very good framework to label some of the topics that we should be looking at and where we want to see positive impact."

Cultural shifts in ESG-integration

"As investment managers we want to create products that our clients want, so we want to adapt to what they are asking for and satisfy this growing demand."

Jonas Andersson is keen to hear about the different approaches to sustainability on both sides of the pond. "Maria, given that you have one foot in each of the US and the UK, both personally as an American living in the UK and T. Rowe Price as an asset manager what do you see that there is a big difference in attitudes? How are US-based investors compared to European investors? And also in the management teams, are there visible differences between European and American portfolio managers? – I ask because we believe we have come further in Europe, especially in Scandinavia. But I am not sure whether that is just us having a high opinion of ourselves or actually an accurate description of reality."

"I would agree that Scandinavia has come further in sustainability integration than many countries," **Drew** answers. "The difference that we see is not so much on the physical location of a portfolio manager, but rather who their clients are. Asset-owners have done a tremendous job in pushing ESG integration and SRI products forward."

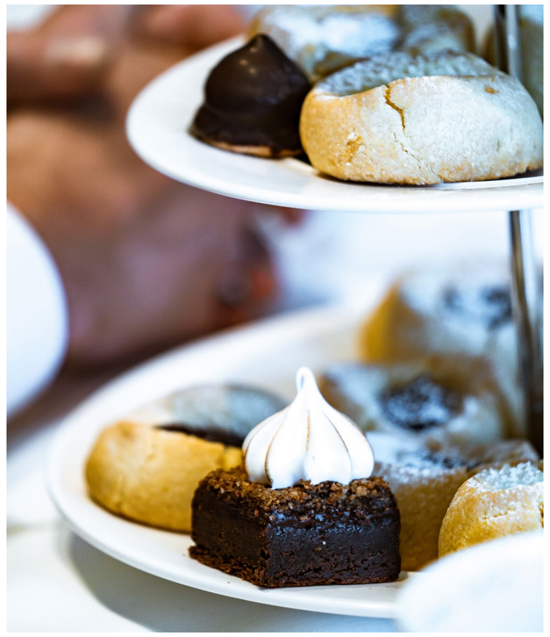
"As investment managers we want to create products that our clients want, so we want to adapt to what they are asking for and satisfy this growing demand. Portfolio managers that have a lot of clients in Europe, in Scandinavia, in Australia and in Japan were thrilled that we were investing a lot more money into our ESG integration capabilities and this new rating system that I described earlier. It was really easy to get them on board."

"For portfolio managers that have more U.S.-based clients, which tend to be less oriented towards ESG integration, this was new. When I first spoke to some of those portfolio managers, some of them did not quite understand what ESG integration was. They thought it was mostly about ethical investing. A very common reaction I faced was that they would say, 'Oh, you will not want to talk to me because I own oil and gas,' or, 'I own tobacco,' or some other dirty industry. So I would have to sit down with them and spend time explaining that ESG integration is not about telling them what they can and cannot own but rather about identifying potential problems or opportunities with these investments."

"There is a simple way to overcome this scepticism that I learned at my previous job and have used successfully at T. Rowe Price. I find that the best way to illustrate the power of ESG integration is to identify a company that has a major embedded risk. Then, when that company has a problem, you can go back to them and remind them how ESG integration would have highlighted this risk ahead of time. If at first, they did not take that risk very seriously, they will the next time you identify one. All you need is to have one really good example. It is quite easy to get an ESG convert this way."

dessert

The power of rules & regulations



In June 2019, a revised directive, the Shareholders Rights Directive II (SRD II) is entering into force in the European Union. In parallel, the European Commission is proposing a number of new regulations which will shape sustainable investing in the short term. While the new rules will certainly increase transparency to an extent, they will also constrain a number of investment practices and add an administrative burden for asset owners and asset managers alike. What will be the net effect? Are the new regulations welcome?

"I am looking forward for the SRD reform as well as to the action plan of the European Commission," states **De Guigné**. "I think it is very ambitious, and it is really redefining a lot of rules in the financial industry. It will have wide-ranging effects on everyone, including index providers, consultants, asset owners, asset managers, everybody is in the loop. The European Commission is trying to implement regulatory changes without forcing the rules too radically. I believe that we need them to take those steps."

"I am sorry to say that I really think the regulations are needed," adds **Ahrel**. "I have been working in this business as a portfolio manager, mainly focused on equity funds, for more than twenty years. In all those years, ESG was always an important part in every investment decision I made. However, I have to say that that is not the way all the portfolio managers work."

"I also agree that progress is happening very slowly. We need regulations to help us navigate these very challenging issues. Going forward, I hope that these regulations will also help us move away from quick aesthetic fixes and superficial greenwashing and towards the issues that matter most."

"I would also want there to be more focus on the development of ESG in the USA, China and emerging market and what we can actually do about it from here as consumers and investors. I hope that is where we are moving towards. Unfortunately, I think we need the regulations to help us move in that direction."

A word of caution

"We probably need the regulation, but I fear that, with regulation, sustainable investing may become a tick-the-box exercise," says **Viel Lamare**. "I am afraid that it will allow people to stop actively thinking about the problems on

their own and instead shift towards a mentality where all that matters is making sure to comply with the rules."

"We will still have to dig into the details when we speak with asset managers in order to understand really what they do, because they will all check the boxes. Forcing everyone to check the boxes is might be necessary. But the devil remains in the details and in understanding what kind of processes are in place."

"We will still have to speak with the asset manager to understand whether they really see the value of ESG, how they see it, how it is actually integrated in their processes, and why it is integrated and so on. This will be even more important when everybody will have gone through to check the box exercise anyway. This extra diligence and engagement will be more crucial than ever. Regulation will probably raise the minimum bar and that it is good to create some kind of awareness, but that will not solve the problem."

When it comest to SRD II, **Oosterwoud** believes in the fact that pension firms in Europe will have to disclose how they are engaging and what kind of sustainability efforts they are doing is likely to force them to push the bar up: "I think we are already seeing that happen," he says. "In fact, in some countries on the 13th of January, when IORP II was implemented we got questions from pension firms asking, 'What does that mean for us, and how can you help making sure that we comply with this?' I think it a positive thing, even though I am not always 100% sure regulation is the answer. But in this case, it may help raise awareness and force people to take much-needed action."

"In the Netherlands, and perhaps even here in Scandinavia, it seems that some of the larger asset owners, who have the resources and style to focus on integrating ESG have done so and are very active. But there is a large group of smaller and medium sized pension plans and institutional clients that are trying to shy away from adopting sustainable investing practices. They probably lack the means to do socurrently, as the financial industry in general does not offer them the right tools to do what would be necessary. If the regulation forces that change to some extent, that is something that should be considered positive."

In contrast with Oosterwoud's point, **Drew** believes that company disclosure is another aspect that still merits increased attention. "We would prefer to see more of a focus on what companies are disclosing," she says, "because that is really one of the keys to help us better integrate ESG and the lack of focus there is a bit of a problem."

coffee

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* (as of 30 September 2018)

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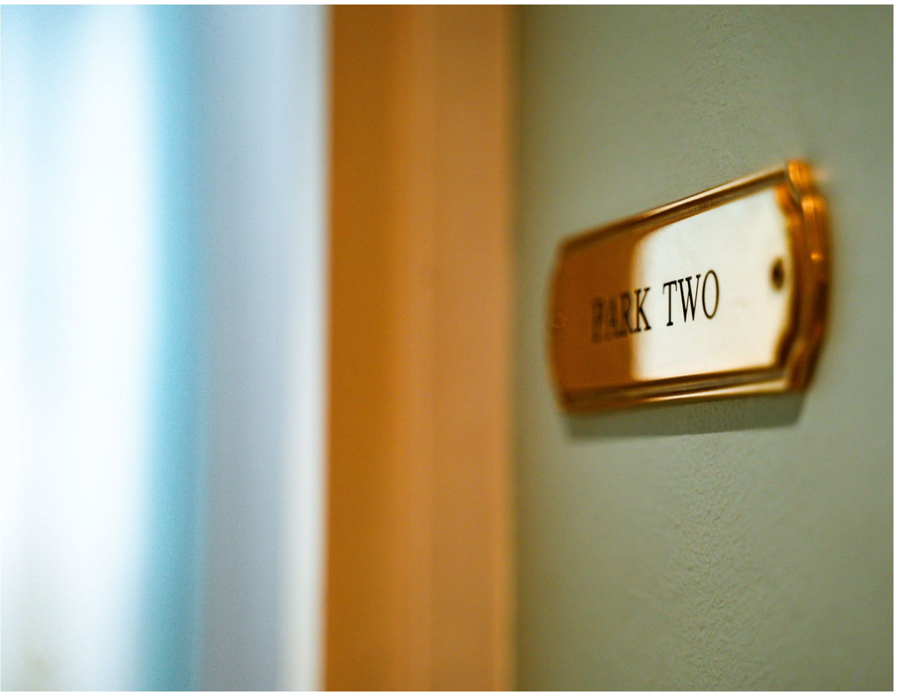

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