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Opalesque Roundtable Series '19

ESG & IMPACT

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Editor's Note

The emerging consensus is that ESG may have a slight plus when it comes to financial performance. But even assuming it's zero, the integration of ESG externalities is still worth doing. And so, as a consequence, the fundamental question is then actually changing from "Why?" to "Why not?".

However, apart from any debate, investors globally demand to invest according this new investment paradigm. In the Netherlands, half of ABN AMRO Bank's private clients already invest sustainably, however admittedly in many cases not for their entire investment portfolio. It's really the asset owners who are leading the way to responsible investment, with more and more institutional investors taking ESG seriously as they are starting to feel the pain and recognize the risks of "business as usual". 85% of PGGM's beneficiaries claim they want ESG (less 'bad') and impact (more 'good'), but at what cost is the question that is often left open (however discussed in this Roundtable).

Admittedly, a lot is hidden under container notions like ESG or SRI, and you can easily fake it pretending that you took all of that into account and then you do the usual thing anyway. This is why this Roundtable also discusses in detail **the need to quantify and measure impact** and how to go about the shortcomings of third party ESG data and scores.

One of the strongest drivers are millennials, who by definition make up the pool where any ambitious company is competing for the best talent. Increasingly, clients and employees want purpose: "If you can't deliver that in the talent war, you're out of the game," says PGGM's CEO.

The reality is that for asset managers and advisors, ESG/Impact/Sustainable investing is a fantastic opportunity to differentiate yourself and to start again with new products, in an industry that is completely mature and increasingly becoming automated. It's an opportunity to reinvent the whole industry at a perfect timing, as the opportunity set keeps unfolding.

"Clients want this, that's not the problem. The challenge is finding asset managers truly investing in a sustainable way," says ABN AMRO Bank. Financial advisors have found that they can completely transform their relationship with clients by engaging with them on ESG and impact investments (page 24).

The inaugural Opalesque ESG & Impact Investing Roundtable, sponsored by ABN AMRO Clearing, took place in Amsterdam with:

1. Marisol Hernandez, Senior Manager, Alternative Investments, Principles for Responsible Investment (UN PRI)
2. Piet Klop, Senior Advisor Responsible Investment, PGGM Investments
3. Vincent Triesschijn, Director Sustainable Investment, ABN AMRO Bank
4. Delphine Amzallag, Global Director Prime, ABN AMRO Clearing
5. Christian Speckhardt, Sustainable and Impact Investment Expert, simpAct Consulting
6. Andrea Marmolejo, Managing Partner, Blue Topaz Capital

The group also discussed:

- Why ESG integration and impact investments are different things (page 4, 10-12, 15). ESG for real alpha generation (page 25-27)

- Is there still pushback or skepticism, and what to do about it? **Why sustainable investing will be the new normal.** Misconceptions abound (page 6-9, 12-13). ESG educational initiatives (page 28-30)

- Is ESG integration strategy contingent? Pre and post investment activities. Why good ESG practices at the corporate level enhances share performance (page 6-9)

- ESG data: Issues and solutions. **Why artificial intelligence and forward-looking scenarios with proxy indicators are the next big thing in ESG integration.** (page 7, 19, 26-27)

- The Power of Persuasion: The "Not Financial Yet" quality and being street smart about ESG (page 11-13, 21-22). Why ideally all companies should quickly convert to ESG-ready (page 27)

- Principles and recommendations from PRI's Fiduciary Duty in the 21st Century report (page 10). What's the difference between ESG scores/ratings and credit ratings? (page 28)

- **The Impact issue & capacity:** Why for PGGM "doing the right thing is discretionary in nature, a choice and a secondary objective", yet still commits to invest EUR 20bn until 2020. The capacity challenge & why impact investments can grow from incubation to mainstream finance (page 12-16)

- How much of an impact do your investments really achieve? **Measuring impact** (page 16-17). **The ESG robo-advisor** and other innovations (page 25)

- How to build an impact investment portfolio (page 17-18). What could be a tipping point for impact? **Why is Blockchain a game changer?** (page 18-19, 22-23)

Enjoy!
Matthias Knab
Knab@Opalesque.com

Participant Profiles

(LEFT TO RIGHT):

Piet Klop, Vincent Triesschijn, Delphine Amzallag, Andrea Marmolejo, Christian Speckhardt, Marisol Hernandez, Matthias Knab

Introduction

Piet Klop
PGGM

My name is Piet Klop, I am from PGGM, which is the in-house asset manager for the second biggest Dutch pension fund, PFZW.

I work in the responsible investment department which focuses on all aspects around ESG integration and impact investments. These are really two distinct different things for us. ESG integration, we believe, is mostly meant to reduce our risks, whereas impact investments are over and above that, i.e. not just about reducing a risk but about increasing our impact.

Risk is outside-in and concerns all sorts of issues "the world" throws at our investments. Impact is inside-out and concerns the effects our investments have on the world.

I am deeply involved with both. We have a team of twelve people that focus on these two areas, which also includes active ownership of our investments, ESG integration and negative screens, and engagement.

Marisol Hernandez
UN PRI

My name is Marisol Hernandez. I'm currently working for The Principles for Responsible Investment (PRI), the world's leading initiative on responsible investment. The PRI has over 2100 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $83 trillion in assets under management.

*I joined three years ago and currently focus on **developing norms for hedge funds to incorporate ESG factors into the investment process.** I led the development of the first industry standard due diligence questionnaire for hedge fund in responsible investment in collaboration with asset owners, investment managers and industry associations such as AIMA, the Standards Board for Alternative Investments, and CAIA, and we are currently working on a responsible investment industry guide for hedge funds.*

In terms of my background, I have over ten years of experience in alternatives and responsible investments. I'm a financial engineer and I am currently reading for a Ph.D. in economics focused on responsible investment.

Vincent Triesschijn
ABN AMRO Private Bank

My name is Vincent Triesschijn. I'm responsible for the sustainable investment activities within ABN AMRO, predominantly the investment activities for high net worth individuals, institutions and charities, but also for retail and corporate banking clients.

We distinguish two types of investment activities. On one hand there is what we call "sustainable investing" where we have strict exclusion criteria together with a strong ESG tilt in portfolios, contributing to the Sustainable Development Goals of the UN. We offer this as a default to new clients. On the other hand we have our traditional investment activities where ESG integration is an important element of the investment processes, as well as engagement with companies that score low on sustainability.

The sustainable investments combined are now about EUR 13 billion in size and the overall investment portfolio is about EUR 200 billion.

Christian Speckhardt
simpAct Consulting

My name is Christian Speckhardt, I am based in Zurich Switzerland and my background is mainstream finance and impact investment.I started my career in corporate and investment banking, moved to credit risk management and had group treasurer positions.

In 2006, I decided to enter the impact investment industry and got in touch with an impact investment asset management startup in Switzerland called responsAbility Investments. What started as a small microfinance investment manager became one of the leading regulated impact investment companies with over USD 3bn in AuM and 15 investment products. Over a period of 11 years, I contributed to the development of the organization as CIO and deputy CEO, responsible for debt transaction sourcing, risk management, portfolio management and execution across the three business lines financial institutions, sustainable agriculture and energy/climate. Important to note perhaps that the markets I am active in are private debt and private equity with transactions sourced mainly in developing countries. In this sense, impact investment is different to ESG investing, that is mainly focusing on listed assets.

Early 2018, I started my own advisory company called simpAct Consulting through which I serve the impact investment industry as independent advisor and board member also supporting younger and innovative impact relevant businesses.

Andrea Marmolejo
Blue Topaz Capital

My name is Andrea Marmolejo. I'm based in London where I have set up Blue Topaz Capital five years ago. I advise investors and asset managers on ESG integration and impact investments and I work with asset owners, impact managers and DFIs that want to construct bespoke purpose-led portfolios across asset classes. At the moment I am working with DFID and we are constructing blended capital products geared towards investments in Africa and South Asia to support the SDGs.

My background is in 'hard-core' finance; I was a portfolio manager at hedge funds and private equity firms and have also set up investment funds for third-party clients. I set up my separate company when I decided to commit fully to the areas of impact investing, ESG and sustainability. Since then, I have enjoyed working throughout the continuum across commercial investments, ESG screened investments and impact investing.

Delphine Amzallag
ABN AMRO Clearing

My name is Delphine Amzallag. I am a Global Director of Prime for ABN AMRO Clearing where I joined about three and a half years ago. I have predominantly spent most of my career in investment banking within prime brokerage, so covering hedge funds, financial institutions, and asset managers.

I have also worked at a hedge fund, and back then of course ESG wasn't something that was looked at or discussed. However now, also having a larger perspective from the prime side, this has changed and the theme has become much more relevant and there's a lot more focus around it from both the investor and the asset managers' side.

Matthias Knab Delphine mentioned there's a lot of talk around ESG, sustainable investing and impact, and of course there is also still some pushback.

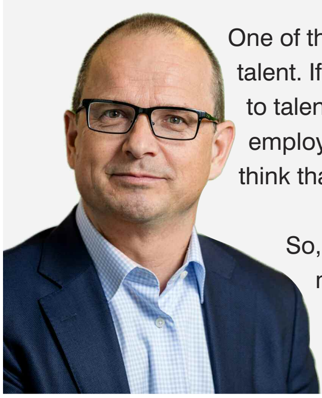
Could you please share how you experience any type of pushback or skepticism, and how you counter that?

Piet Klop: ***There is definitely pushback and I think that will remain the case, at least for some time,*** *because we are looking at externalities which by definition are factors that may have value but no price just yet. And so, it's the sort of thing that one could always postpone or sweep under the carpet for a little longer.*

So, actually, when we hire new people, we actually ask the candidates the question rather poignantly: “Do you actually anticipate and enjoy the sort of pushback that you are bound to get?” One could argue that without pushback, perhaps one hasn't done their ESG job right. We therefore see pushback as a natural, inherent aspect or difficulty about ESG.

What can you do to overcome that? It’s obviously important to do your homework like the data crunching and all that, but we have actually come down little on that. ***Data can be massaged one way or the other so we’re happy to proceed with the emerging consensus that ESG may have a slight plus when it comes to financial performance, but let’s just assume it’s zero. Even then the integration of ESG externalities is still worth doing as the fundamental question changes from “Why?” to “Why not?”.***

At that point it comes down to courage, will, peer pressure, politics, and all the soft drivers that we see conspiring these days in making us take ESG more seriously, and beyond ESG, trying to make more of a positive impact.



One of the strongest drivers by the way turn out to be millennials, because in our business it's also about talent. If you listen to Feike Sijbesma, the CEO of DSM, he kind of boils down the entire sustainability theme to talent when he says, “What our clients want, but also perhaps more importantly, even what our employees want, is **purpose.**” If you can't deliver that in the talent war, you're out of the game, he says. I think that’s an important driver at PGGM too.

So, for sure it’s data and facts on one hand, but with all sorts of other drivers we are confident in our mission of providing “Pensions with Purpose”, and that seems to be quite important to our stakeholders.

Marisol Hernandez: The push back from investors and investment managers come from the **lack of education and understanding** about what responsible investment really means and how it can be applied to different investment strategies.

One of the first **misconceptions** is that the exclusion of companies reduces the investment universe, therefore it decreases returns. This comes from the fact that when responsible investment started, it was mainly a what is called a norms-based approach used by investors based on their values or international agreements or initiatives (such as UN Treaties, Security Council sanctions, UN Global Compact, UN Human Rights Declaration, OECD guidelines, etc.) who didn’t want to have exposure to certain companies or sectors. However, we are moving now more towards a systematic approach where ESG factors are integrated across all the investment process and it’s called ESG integration. There is also a thematic investment approach, which can have different forms such as impact investing, green investment, so the SDGs can also be targeted via that approach. All these approaches can be done pre investment.

There are also post investment activities such as active ownership. This is also a key factor for asset owners. How an investment manager can be an active owner if the holding period of the security is less than a month or 3 months? This is a function of the holding period of the security and the capital allocated to that. These are some of the things we are working on right now, trying to define a number of aspects and then help managers to find different approaches. We are certainly not saying things like, “This is right or this is wrong,” or, “if you're not doing that you aren't a responsible investor.”

We work in the same way with asset owners. I was just at a pension conference yesterday, and of course the issue you hear most about is around their funding deficit. If a pension fund has a 20% deficit, they might tell me: “Look, one of my key drivers to invest is that I need to be able to pay my liabilities. How can I now consider ESG factors when I am under that pressure making my investments?” *So also here I tell the asset owner that ESG today is not about restricting investments but giving you **additional information** you can use, that helps you to make a better, well-informed decision.*

This information can be used as a risk factor or as alpha factor, so this depends of your investment strategy and your risk profile on how you strategize the asset allocation of your portfolio.

Also, asset owners and investment managers need to be aware that **ESG data**, at least for now, has issues like it's biased and doesn’t have long term periods and they will need to do a proper due diligence on any ESG data type they will be looking at.

ESG is of course about a behavioral change in the end. It’s something that it won’t happen overnight, and the key drive change is education.

At PRI we are focused on educating and providing the right tools to investment managers to start considering responsible investment in their portfolio. We are currently working on an **industry guide** with over 90 firms, and around 60% are not yet signatories of our principles. That aspect was very important to me to learn more about the view, perceptions and challenges of those firms, starting out with a simple question such as, “What does responsible investment really mean for hedge funds?”

This industry guide aims to set the baselines for hedge fund managers to choose different approaches to integrate ESG factors in their investment decisions.

Andrea Marmolejo: It’s interesting to see that there is still a debate on whether ESG is accretive in terms of returns – I think there’s more and more evidence that it is.

Initially, ESG was used as a way of managing downside risk but today it is also increasingly used for alpha generation. There is now a lot of evidence that confirm that actual financial returns improve as well as risks come down, making a significant impact in the risk adjusted returns.

From a **corporate point of view,** having worked on innovation and sustainability initiatives, corporations are heavily impacted by how they deal with customers, communities, the environment and all stakeholders, as these influence customer loyalty, employee retention, and brand value. So even at the corporate level, share performance can be enhanced by adhering to good ESG practices.

So I believe that the best ways to deal with push-back is by shining light on concrete data, and by analyzing the potential risks of not taking ESG into account in a world that is increasingly fluid.

Vincent Triesschijn: I agree with Piet about the change from "Why ESG?" to "Why Not?", and there was an interesting report about exactly that change by McKinsey end of 2017 with the conclusion that **sustainable investing will be the new normal.**

It's important to differentiate between ESG where there is generally less pushback and SRI where you have exclusions that could also hit in terms of performance. And with impact investment, you are looking at completely different profiles and certainly more biases. I found that a lot of the studies that have been done on the performance and risk return side were all focusing on ESG alone and not so much on SRI and impact investing.

Delphine Amzallag: When I speak to Hedge funds, the main focus of discussion is always about absolute returns and an emphasis on alpha. When we start to discuss ESG with them, I get the feeling these are viewed as a cluster of ideas but with no real definition, does it mean excluding stocks, sectors and countries which inevitably could impact their strategy and can be considered undesirable and constraining in achieving their ultimate investment objective .

So I wonder how much is ESG integration strategy contingent?

Some strategies can implement an ESG aspects into their portfolio easier than others such as the long only equity manager but I find that others are struggling especially as they rely so much on outside data and I find that investors who are mostly driving this requirement are also getting their head around the integration into various strategies..

I was wondering, which strategies do any of you see investors asking for in terms of ESG? Would you agree that, at least within the hedge fund universe, it's more the investors driving an ESG agenda as opposed to the managers themselves? And do you see these investors softening or hardening their views or demands on ESG?

Andrea Marmolejo: I think that **investors are starting to take ESG seriously as they are starting to feel the pain.**

They are definitely committed to financial returns, but just by looking around at one of the most obvious aspects of ESG – climate – I think that, in one way or another, everybody is starting to recognize that things are a bit off-track. And the more information becomes available on this issue and gets absorbed, people will understand that the effects of climate change will unfold exponentially – there won't be a soft landing, that is unfortunately not how it works.

There are many reasons why people are now recognizing that they have to change their point of view. It's an imperative for the longer term. Regulation is helping to get these issues noticed, but at the same time investors' assets are at stake, and that is why investors are becoming more interested in getting this right.

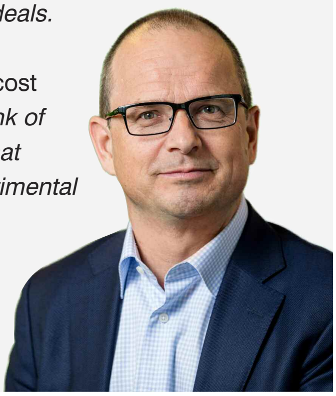
Delphine, you are right, *I agree that the pushback on ESG tends to be more on the asset management side, which I find quite remarkable because for an asset manager, ESG is a fantastic opportunity to differentiate yourself and to start again with new products, in an industry that is completely mature and increasingly becoming automated. Really, I have never understood the pushback from that side. This is an* ***opportunity to reinvent the whole industry*** *and for a service provider this is perfect timing.*

Vincent Triesschijn: What we see with our private clients is that already a third of our European clients are investing in a sustainable way. It's hugely popular since a few years.

In the Netherlands even half of our clients invest sustainably, even though in many cases not for their entire investment portfolio. Clients want this, that's not the problem. The challenge is finding asset managers truly investing in a sustainable way.

Piet Klop: I want to take out discussion a step further.

I think a lot is hidden under container notions like ESG or SRI. I mean, ***you can easily fake it,*** *let's be honest. You can easily pretend that you took all of that into account and then you do the usual thing anyway. And so, Vincent, I tend to be less than impressed by these client surveys. On our end 85% of our beneficiaries claim they want ESG (less 'bad') and impact (more 'good'). But at what cost is the question that is kind of left dangling there, right? So that's why we constantly communicate that there is this overlap between financial and social returns where we need to source our investment deals.*



Part of me thinks that for real change and impact we should honestly communicate that this could cost you. *Another part of me however thinks that if we really want to achieve scale and get out of this funk of slow solutions to fast problems, we need to go big and we need to go fast. And making anything that smells like a tradeoff between return and impact and lesser return for more impact, is probably detrimental to that idea of scale. You can't scale things that are concessional.*

So, we trying to maintain, as long as we can, that you can have both your cake and eat it.

Marisol Hernandez: And to answer Delphine's question about integrating ESG into different strategies, at PRI we have five groups working on the industry guide; one for equity, hedge, global macro, relative value, event-driven and "other" which covers private debt. From those, relative value is more challenging. Also, we are currently not developing any guidelines for structured products or derivatives, and I think that will be the next step.

In terms of asset owners, they are leading the way to responsible investment. I can confirm that also the work we are doing with hedge funds is mainly driven by asset owners. We have an advisory committee who oversees all the work that we do, and when we produce any normative document, for example the RI DDQ and the industry guide, it's the result of a dialogue and engagement between investment managers and asset owners.

Additionally, asset owners are more sophisticated, and the allocation of institutional capital to alternative investments will be driven by why and how the investment manager approaches responsible investment. This is now part of RFPs, manager selection and due diligence process.

Vincent Triesschijn: There's always a lot of discussion about our **fiduciary duty**, you probably all recognize this. Fiduciary duty can be considered in two different ways, one is looking at the optimal risk-return profile, but on the other end, fiduciary duty should also integrate ESG and take a look at impact investing, et cetera. There are always a lot of discussion on this.

Marisol Hernandez: *We have actually done the PRI's Fiduciary duty in the 21st century report which concluded that investors should consider all financially material factors as part of their duty to beneficiaries, regardless of their origin. Far from fiduciary duty being a barrier to considering sustainability issues, the report finds that there are positive duties on investors to incorporate them – a belief supported by a growing number of policy makers and regulators.*

The principles that underpin fiduciary duty are:

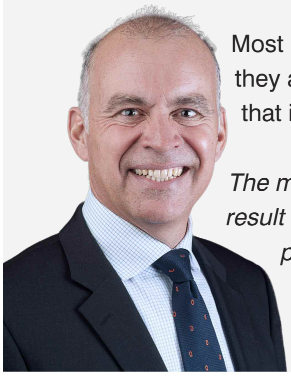
1. that financially material ESG factors should be incorporated in investment decision making;
2. that investors should consider ESG factors consistent with the time frame of the obligation; and
3. that investors should understand and incorporate the sustainability preferences of their clients and/or beneficiaries.

In terms of regulations, PRI plays an active role and we have been involved in a series of regulatory developments. For example, in Europe we act as an observer of the High-Level Expert Group for the EU Commission, in which nine out of 19 are PRI signatories. Four out of the ten recommendations provided by this group will go to the European parliament this year which includes a common sustainability taxonomy, clarify investor's duties, investor disclosures and low carbon and positive carbon benchmarks.

It may be better if investors can come to an agreement with investment managers before telling them, "You have to do it!" as an obligation.

Christian Speckhardt: I believe that ESG will certainly become mainstream soon, despite some of the confusion that still exists around standards and implementation strategies.

I would like to add however that there is a clear distinction between the various ESG integration strategies, which I see as the current evolution stage of the listed sustainable investment space, and impact investment, which is mainly about private markets, intended measurable positive impact in connection with the SDG-framework and characterized by relatively low volumes and liquidity and mainly focuses on developing countries. *Although impact investments integrate ESG risks in their investment assessment process, the approach is fundamentally different.*



Most leading wealth and asset managers have integrated or are in the process of integrating ESG. Often, they are pushed by their nextgen client base. Furthermore, there is sufficient research available, evidencing that investing sustainably does not reduce returns, in contrary.

The more moderate "market" or "close to market" returns of impact investment products is in my view not a result of the embedded social benefit. I don't support the view that social return is eating up financial performance. I strongly believe that financial success can boost impact through scalability for example, and that both – impact and financial performance – is going hand in hand.

Private debt and equity impact investing is however costly and requires a more hands-on approach, is executed in challenging jurisdictions of developing markets, is rather small in transaction size and involves country and often exotic FX risks that need to be mitigated. All this adds up in cost. Furthermore, research on the impact narrative and the impact measurement and reporting is adding working hours.

As the impact investment activity grows and the transactions become more mature and larger, the cost side becomes more favorable. And impact investments often show a lower correlation to listed markets and low volatility which is seen as a plus for portfolio diversification. Impact investment needs longer investment periods and some passion. The sector itself – apart from microfinance perhaps – is still in a pretty early stage.

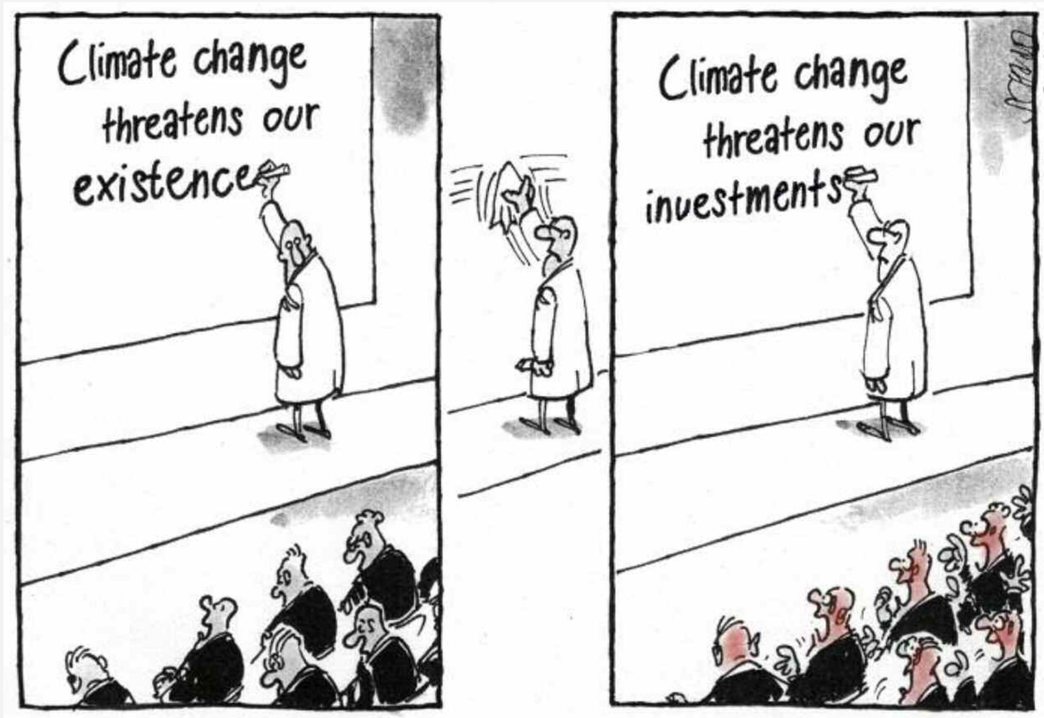
Andrea Marmolejo: I agree. When we look ahead long term, a significant portion of global economic growth will surely be coming from emerging markets and in particular from the **billions of under-served populations** that are not catered to right now. Increasingly corporations are looking at this segment and this opportunity, but again, these are **long-term investments,** and if you judge a long-term investment on what it is doing for you during the first couple of quarters, that is not going to give you the real answer.

The different time horizon of some impact investments should be better understood and considered, particularly when discussing financial returns. It's not at all clear that even in so-called concessional impact investment you are actually giving up return – you may be in the short term because of the smaller size, the need for incubation services, technical assistance, etc, but you are still building a business and developing demand for your products going forward.

Delphine Amzallag: Piet, I wonder how you or an institution like PGGM are reflecting on this in the short term or long term and quantifying the return considerations in your investments?

Piet Klop: Thanks Delphine, I'll get to that, but first, a few things that I want to say in support of what Christian had said. I believe ESG is going to be mainstream pretty soon.

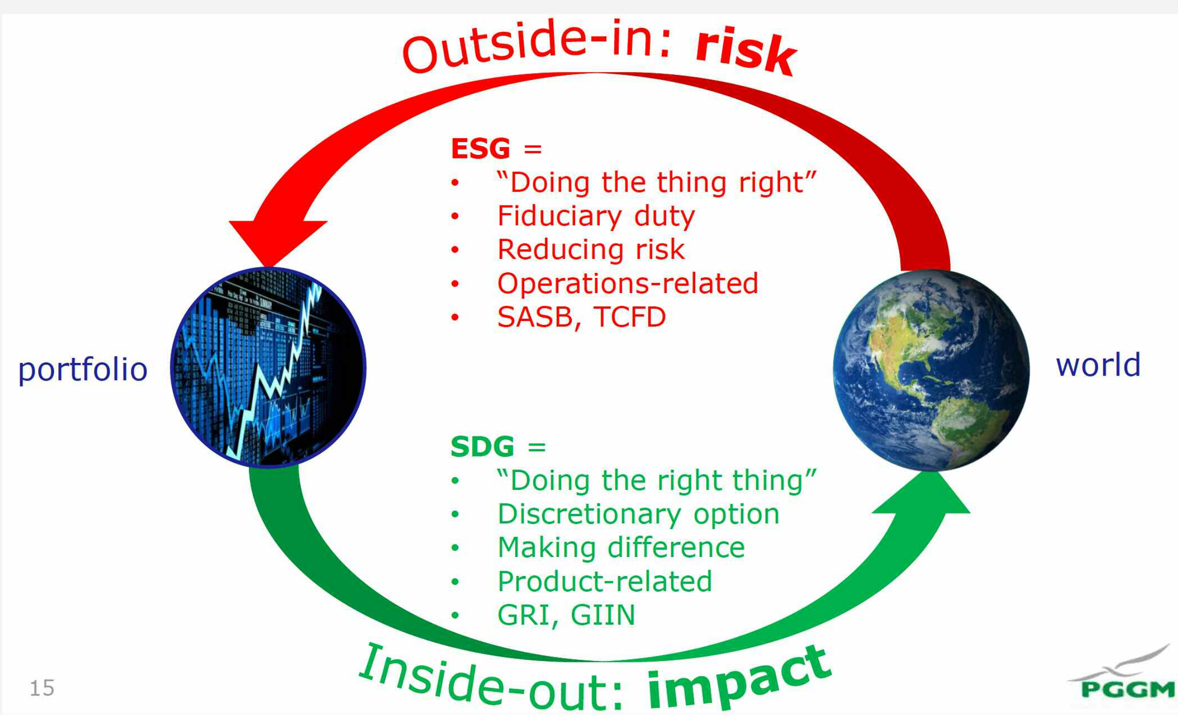
Here is a slide that support the point I am about to make:



When we speak about ESG, we try to present issues <u>not-yet-financial rather than as non-financial or extra-financial</u>. That little trick tends to draw in a whole new audience. When you keep talking about non-financial aspects, a lot of people simply switch off. "It's not financial? Okay, I'm out. That not my job. I'm here for returns." But make it ***not yet financial****, all of a sudden there is a new dynamic and an incentive to outsmart the investor next door.*

Little things like that can make a lot of difference, and thanks to that, we'll see this mainstream pretty quickly.

In the following slide here, we clearly define ESG as part of a fiduciary duty, doing the thing right, as supported by initiatives like SASB and the TCFD.



I think when it comes to impact, things are different, partly because – at least, as we see it now – it's not really our fiduciary duty to solve the world's problems. We like to contribute to that, but it's not our prime responsibility.

Doing the right thing is therefore discretionary in nature. It's a choice and in our case a secondary objective. I think that's an important thing to keep in mind. We simply can't trade financial return for impact when beneficiaries rely on us for their average pension of some €400 a month. We can't come back to them saying, "Sorry it's €300 this month because we wanted to do wind power and it didn't work out so well."

We actually had a few well-intentioned misfires. Obviously you don't want that, also because it scared off our board of trustees for years.

So, there's nothing easy about impact. It is cumbersome. It takes extra effort and there are a lot of questions we have to overcome before we can really make a feast of this.

And yet, we have a clear **target of €20 billion** that we are supposed to have invested in solutions – that's what we call it – by the end of 2020.

Name and target had an irresistible ring to it: *twenty billion in 2020*, what are you going to argue about? And investing in solutions, you can't possibly be against that. And 20 billion by 2020, what do you want? 18? 21.5?

We have to be a little street smart when it comes to communication on externalities and impact. Not-yet-financial, 20-2020, etc., can also help you at the level of the board of trustees. Of course, all this is more art than science but the point is that it's effective, and this is what counts.

Our trustees probably also look over our shoulders to see what our peers are doing. Another important driver for PGGM/PFZW arguably is what APG/ABP are doing. And if you'd ask APG, they probably will say the same thing about PGGM. That way we can actually lift each other up, and I think that's very much what we have been seeing over the past couple of years.

When it comes to impact the next step is to find ways to make the new & small investible for large institutional investors. Right now we haughtily dismiss everything that's not 50 or 100 million euro already. Or if there's not a 20-year data or track record, then don't bother, try the other guy. But that way, we'll always be investing in yesterday's economy, no? New ideas rarely a 100 million investment opportunity right away or come with 20 years of data.

At PGGM we currently are trying a few things to deal with that funny handicap of being big and having a rather ambitious 20 billion euro impact target. Within private equity for example we now have a 500 million 'submandate' for investments in solutions where we can consider fund proposals at smaller ticket sizes.

Summing up, yes there's this distinction between ESG and impact and yes, impact is difficult, maybe even more difficult for a bigger asset manager. And yet thanks to these different drivers, that's where we want to go because ultimately, we believe that in 5 or 10-years' time, the future of this industry lies in making at least plausible, but preferably measure, the kind of real-world outcomes that investments have. We believe that over that period you should be able to justify all your investments not just on the financials, also on the socials. And we want to be at the forefront and good at it.

It's like what Andrea said, it's a massive opportunity and this is how we can build a brand and market position. If in the Netherlands our mandatory pension system goes one day, PGGM will need a profile, a unique selling proposition. This could be it. So, it's a massive opportunity indeed. Our own people want it and our beneficiaries say they want it.

Andrea Marmolejo: Thank you for your comments Piet, It is very interesting to hear how a huge institution like yours is trying to do impact investing.

I am very impressed by your efforts to invest directly in impact investing opportunities. In my opinion, I don't think that anyone is really saying that an investor of your size should go small, but thankfully there are a large number of **funds of funds** that could allocate funds further down the value chain and could also provide a lot of background knowledge about the opportunity, the actors, the investments, et cetera.

But more importantly, I do have a different concept of ESG. While ESG screenings refers to best in class, I also think that ESG is moving more and more towards identifying companies that are actively doing good. This is necessarily the case as 'best in class' is a moving target where companies screened are increasingly trying to generate positive impact to support SDGs and to impart a sense of purpose into their organization. And I think that for big investors, big pension funds and insurance companies, the ask when it comes to impact investing is perhaps a lot more about ***engaging with the companies*** *in their portfolios.*

So, if a pension fund invests in corporates in Europe, they could find out more about their supply chain, for instance. So, big pension funds do not need to go to areas where they can't reach, can't understand or it's too narrow, too granular, or too small, "But hey, if they own Unilever, how about they ask them a few more questions?" And like Unilever, there are lots of others, right?

It is amazing what pension funds could do for impact investing without ever calling it impact investing, and without trading any amount of return for the desired impact. It's about engaging with companies you have invested in, and raising the bar, particularly on all that relates to their supply chain. That can potentially change the lives of billions of people in emerging markets.

Vincent Triesschijn: Allow me to point out here that basically all investing has an impact, a negative impact and/or a positive impact.

Andrea Marmolejo: And the biggest companies have the most impact.

Going for the tiny dairy in the middle of Africa, that's great, but if you have the option to really work with Danone, or with Unilever or Procter & Gamble, you probably do not need to take the trouble to go for the smaller investments and can leave those to other smaller players.

Vincent Triesschijn: I think we really need to differentiate here between institutional or professional investors and retail investors. From that perspective you also cannot simply say that it's easier for smaller investors to do impact investing because it's difficult to offer illiquid strategies to retail clients.

We face a lot of difficulty, especially with millennials that come to us saying they want impact investing. Impact investing can mean a lot for them, it has also become a form of status symbol. You can be like Bill Gates in a way. But then we struggle to find the right strategies for them, having a retail status.

Marisol Hernandez: There will be assets flowing in from investors wanting more ESG or impact investing, and we already faced a **problem of capacity** in the previous crisis. One of our messages to the newer hedge fund firms or the smaller and medium sized firms is to be prepared for these inflows and be able to satisfy that demand.

We are currently working on "The Mandate Development Project" which basically encompasses the type of information what will go in the investment management agreement (IMA) on how an asset owner can consider ESG across different asset classes. This will also facilitate not only the manager selection process, but also monitoring and reporting for fund managers.

Christian Speckhardt: I would like to share a thought with you. We talked about the differences between ESG/sustainable investments and impact investments.

Although I said that ESG and impact investment is fundamentally different today, there will be a point in the development of an impact investment theme where impact investment may become ESG investment, or let's better say where the impact theme grows out of the impact investment space towards "sustainable mainstream".

Let's have a look at microfinance. In the early '90s, microfinance was still mainly an NGO topic and not really commercially refinanced. Commercial refinancing through the impact investment industry started around 1995 and really took off around 2005. Microfinance became a growth success thanks to the real need of the services in the markets, the relatively simple, profitable and scalable business model and due to access to refinancing. Financial sector development – microfinance is about the development of a sustainable retail banking sector in new markets – became a reality. Later, in parallel of the development of the necessary infrastructure, like the regulatory environment, credit bureaus, etc., many microfinance institutions transformed into banks, and could now refinance themselves also through local deposits and savings in local FX.

As a next development step, some of the larger institutions have started issuing locally listed bonds. Now as the sector maturity has increased, microfinance banks achieved capital market readiness. Investing in these listed bonds has become emerging market financial sector investments with some liquidity, attractive for local and global mainstream institutional investors. There was no mission drift in the microfinance bank's strategy, so the investment is still "sustainable". But the investment category has shifted gradually from impact investment towards sustainable/ESG investment.

The catalytic work of the earlier stage impact investment industry has succeeded. If successful with other impact themes and related companies, in agriculture, renewable energy, etc., the impact investment and development finance industry may hand over capital market ready companies to the mainstream financial markets. This will however still need a lot of time.

I am convinced that the incubation and acceleration role that impact investors play is very important and that "making the small investible", as Piet said, is one of the key core competences of the impact investment industry.

Piet Klop: There are obvious limits to how small we can ever go, and I agree with Christian that pure impact will always be the domain of a different brand of investors, the ones that are prepared to trade returns for impact. PGGM simply is not the World Bank. We joined and supported the Impact Management Project for the very reason of coming up with a framework that can serve as a large umbrella covering various investors that one way or the other create impact. We mentioned that even in listed equities you can create impact. Just avoiding the worst is impact, screening out tobacco is impact.

We have a **wide range of levers** that we actually do pull, because if you are big enough, you can or must do a little bit of everything. Perhaps you have seen the mapping of our portfolio according to the Impact Management Project framework.

There are a couple of things that spring to the eye. First of all, most of our efforts sits in the left top corner which is, “Don’t be evil.” Going to the right for pure impact, the dots a lot smaller indeed.

This was a huge eye opener also internally. While we do believe or at least hope that we are directionally right, the challenge now is to **quantify the amount of impact.** And we´re a long way from answering the questions of who is benefiting and for how long, and what are the chances that the negatives will outweigh the positives when you hit the ground.

So, there are many things that we can’t do, and maybe some of it we will never be able to do. As for our exposure to underserved ideas and smallish investment opportunities, there´s funds of funds and bonds. And perhaps I barely dare to name it: **securitization.** That could be an option too. If you standardize, bundle and securitize impact investments different types of investors may be drawn in. It’s ten years past the financial crisis, so maybe it’s time again to reconsider securitization and do it differently for a positive real world outcome.

As you can see, we try to achieve real impact. However, with a €20 billion target, you also need to go through liquid and primary markets too. Then the question is, "Do we actually have impact there as a capital provider?" Unilever does, whatever it does, with or without us, and we have only marginal influence over that.

We do have a €2.5 billion separate mandate for investments in solutions through listed equities for which we compiled a universe of companies with positive impact on our selected themes based on their sales or market share. With that we signaled to the market that impact matters, investing more in companies that have that impact proposition in one way or the other.

We also insist on those companies measuring that impact to counter greenwash. These things don't necessarily grow the impact pie, but they do serve a purpose. Our core message here is that impact matters, and measurable impact matters even more. It may not be our impact but the impact of the companies that we invest in. We try to communicate that distinction following the Impact Management Project which presents impact by the investee and impact by the investor as two different things.

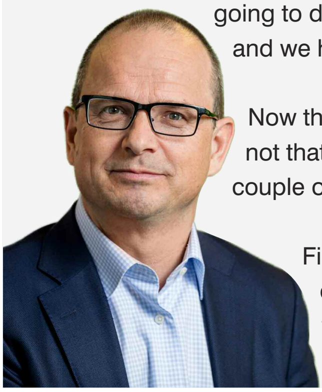
This is how we believe how we can roll with the impact investment community which sometimes criticizes us for greenwashing or missing the real impact for the ticket sizes we are pursuing. This way we can combine all the different strands of impact.

Matthias Knab Piet, can you share with us what is your actual process of building an impact investment portfolio in some broad strokes? Or, what would be your recommendation to say a larger type of investor like a pension or family office that wants to into this space as well?

Piet Klop: We actually did have a very distinct process, which took a fair amount of time in pension land. It started with the realization that even though we like to be among the world's most responsible investors, nobody could quite articulate what problem we were trying to solve. When I joined PGGM seven years ago, that was exactly my first question. Then it took a few years before we distilled the themes on which we wanted to make an impact given all the world's troubles. We actually did that just before the UN came out with its SDGs.

We settled on four themes. I think it's important to focus on themes that people can really identify with, in our case the PFZW board of trustees and behind them the 2.7 million beneficiaries. The first theme, climate, is perhaps obvious as people can see the financial impacts of climate one way or the other. Then healthcare, which is logical if you're the pension fund for the healthcare sector. The other two, water and food security, resonated as people in the Netherlands feel we are good at these things; they are sort of a national pride.

So, in combination, it's fiduciary duty, identity and capacity. It makes perfect sense, right? Since Unilever claimed they were going to double their sales half its footprint we thought "Hey, we can do one better. We quadruple our impact, and we halve our carbon footprint." So that became policy, including the 20 billion in impact by 2020.



Now that we threw our hat in the ring, we are trying to retrieve it. That's really is a voyage of discovery. It's not that someone has prepared a cookie cutter approach that we could just simply copy, but there are a couple of things that keep us on the straight and narrow.

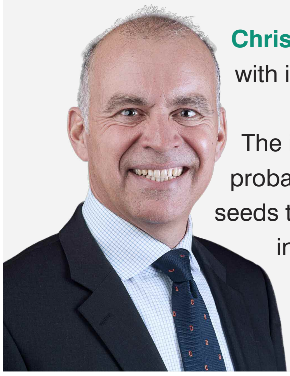
First of all, we can't go concessional – everything goes through the same investment process. We are quick to shake off allegations that are low-barring our impact investments. And we haven't. Exactly the same process. We also got ourselves a few new mandates, green bonds for example, which are a good fit for a pension fund – big and boring. And then we have that €2.5 billion distinct listed equities mandate which is very closely tied to and constantly evaluated on a mainstream benchmark. We are not prepared to lose money over any of this, and I think that's another key.

In short, it's distinct themes that resonate, a target people can aspire to, and measurement of tangible impact. The latter is important for integrity, and for communication purposes, externally and internally. It's helps it become a thing people want to be part of. What are you going to talk about at the next birthday party? That we spend half our lives looking at a Bloomberg terminal? That's not life, that's a terrible job, unless you can explain that whatever you do serves a bigger purpose.

All of those things helped us to turn this corner, but it started from the very realization that you can be responsible for all you want, but if you can't explain the bigger purpose rather than the dreary process you miss something.

Vincent Triesschijn: I totally agree, Piet.

The only thing I'm struggling with is that you see so many contradictions in the industry. For example, many claim to go from ESG to SDGs, and you see some 1,200 to 1,300 people attending the GIIN conference, but then, similar to your earlier chart, when you look what is actually invested in pure impact, it's about 200 billion globally. It's really small at the moment.

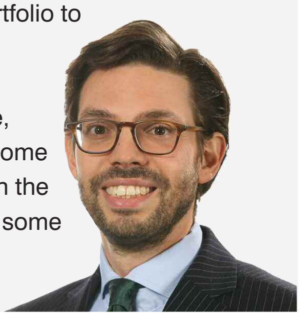


Christian Speckhardt: I agree with this statement, also realizing that responsAbility Investments represents with its USD 3bn in AuM already 1.5% of the market.

The impact investment market is still at an early stage. Nevertheless, given its catalytic nature, it will probably never show a size which is very significant to the global institutional investor market. However, the seeds that the impact industry is planting will grow and "mainstream" over time, and the final outcome can indeed be significant. I tried to illustrate this with the example of the development of the microfinance industry, from being a small NGO topic to becoming a global sustainable retail banking business.

Vincent Triesschijn: Right, and so I am wondering if there is something like a tipping point from where on impact can really become as big as we all want.

There are also contradictions when it comes to fundamental aspects such as is impact investing an asset clause on its own, or when it comes to demands that people or institutions should allocate something five percent of the portfolio to impacts, but also that will never get us there.



I think we need a different mindset and a different way of thinking, so not impact investing as this niche, but impact investing in all asset categories with a plan to grow it over time in all these categories. For some categories that's easier and with others more difficult, but the main thing is that there's no consensus in the markets yet, and so I'm really wondering what could eventually be the tipping point – maybe you have some ideas?

Andrea Marmolejo: I would like to mention a potential tipping point, but first I wanted to make a quick comment on Piet's recount on PGGM's journey to define their four themes.

In my opinion, the SDGs have come to fill a big gap for impact investing as many investors wanting to make a positive impact really wondered what to invest in. There are so many problems in the world that need to be addressed that selecting investment themes has been difficult for most investors. Also, people change their minds on the impact priorities along the way. At the beginning of the impact investing cycle, some ten years ago, we found ourselves saying "Look, you did say you would care about this. I showed you a company that offers a compelling solution to those issues, and you don't want to invest?"

So frankly, SDGs have made life a lot easier because the UN took the trouble to find out what are the most pressing issues we need to tackle. There are very few people that would argue with the SDGs now. From the point of view of a service provider, an asset manager and even an asset owner that responds to beneficiaries, I think that if you support the SDGs you can't go wrong. I also sympathise with PGGM's desire to be authentic and I have seen investors asserting their identity by focusing on clusters of SDGs.

In terms of Vincent's question about what could be the tipping point for this industry, I think that *any work that we could do to measure the impact (positive or negative) that we make with our investments will really speed up the process. And something that is going to change this industry completely is **blockchain** or rather, the use of a distributed ledger.* I am not talking about a currency even though currency could increase gender equity amongst other things, and equity for the bottom billion.

Blockchain is starting to be used in the supply chain where through SMS individuals at the bottom of the pyramid will be able to report absolutely everything that is happening to them. This technology can be taken down to the most granular level, like, "I just sold 15 lemons and I got paid this much. I am a female, and this is my picture, this is my son, and this is my goat!" – all of this information will sit in the blockchain. At the moment, these people have no identity, they are not recorded anywhere, and of course they have no bank account. They have no track record of their sales throughout their life, nor about the amount of money they paid back to micro finance companies every month, etc. With blockchain, we will see a huge transformation of our understanding of the supply chain and of our own impact, as investors and consumers. This is already underway, I am aware of a few European corporates that have started beta projects identifying their supply chain through blockchain that are working extremely well. This process will take place over the next three to five years if not less.

But it doesn't stop here. In a few years-time, we will probably see headlines like "Honey producers responsible for the death of 300,000 children between the ages of 9 and 12 in X,Y,Z countries" – I am making this up, of course, but the point here is that if you will be able to gather very **granular information in the blockchain from the ground up and apply AI from the top down,** we will probably find out some things that are going to shock us all. With these technologies comes much more transparency and accountability, and there will be a number of wakeup calls coming through.

Also, the type and amount of data we will have coupled with these technological innovations, will allow for a whole different type of research outfits to produce and publish these analytics. It's not going to be up to the World Bank or the big banks to report on these but independent, smaller research outfits will be leading this wave.

It is very likely that consumer behavior and investment behavior will change radically, particularly for millennials, but I think also throughout a larger spectrum. I expect this will change our point of views from "okay, let's do positive impact because we want to be good", to something like, "Oh my god, I'm not touching this (product), I'm not doing this (investment) because I would then be harming other people in a very concrete way." So, Vincent, I think that increased transparency will get us to the tipping point.

Delphine Amzallag: ABN AMRO Clearing also has an opportunity to drive this initiative forward and has been on the forefront when it comes to building safe and transparent financial markets, and we will continue to lead the way. We actively engage to improve the transparency of ESG criteria in listed instruments. We achieve this by engaging in multilateral dialogues with clients, regulators, exchanges and other stakeholders. This is illustrated by our partnership with the Sustainable Stock Exchange initiative and our advocacy in industry bodies such as the FIA.

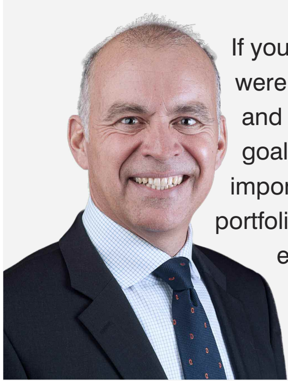
We also work a lot with different innovative ideas using blockchain in our processes for example and providing banking as a service to help shape the future of investment and banking and help support the client in the right direction.

Christian Speckhardt: Trade finance will be completely different in the future thanks to the technologies and developments that Andrea just mentioned. This will be very beneficial for smaller sustainable agriculture producer organizations in developing countries for example. First applications are already existing, by the way.

Going back to our discussion about how institutional investors could create sizeable impact portfolios, I do agree with Vincent that the definition and practice of impact investment, as we have it today, leads to a pretty small impact investment universe.

I am sure that this will change significantly over time. Not only because impact investment will develop and further grow, but also because there will be new investible instruments that go beyond ESG investing. Take the green bond market as an example. This is a sizeable and liquid market. And it is not only about financing green projects of traditional "non-sustainable" international organizations. The development bank industry is increasingly using this instrument and is establishing relationships with large asset managers of insurance companies for example. Furthermore, large blended finance vehicles and funds, established with public money, seek to crowd in private sector funds into the lower risk tranches. All this goes beyond the still small traditional impact investment funds that we do know today.

I believe that you can call these new instruments still impact investment rather than ESG. But the term impact investment is then getting a new dimension, and volumes are getting institutional.



If you extrapolate the various developments of impact investment and ESG, there will probably be a point were the approaches are merging a bit, where borders between the categories will become less clear. ESG and even green bonds is something temporary for me in a much larger global movement towards the SDG goals. Excluding coal investments and integrating ESG into a mainstream portfolio is only a first and very important step. Even green bonds are perhaps not called that way anymore in 10-15 years. In the long run, portfolios will become more and more sustainable and "future smart", in parallel with a more sustainable economic development and in line with what the UN offered as reference points with the SDG framework. Regulation will support this movement.

Vincent Triesschijn: I really like that idea and think there could be a role for the family offices and retail clients, especially on the blended finance side. For instance, we have a philanthropy desk and I could imagine that you could have philanthropic funds that could kickstart these and with very small amounts. This could have a major effect in making non-bankable projects bankable.

Piet Klop: Maybe I can illustrate something that we did that may add up impacts along the value chain. It started from my previous job at the World Resources Institute. We thought of water as a big and emerging topic that could hit us on the risk side but it also presented opportunities on the other side. What we started to develop was a **risk atlas,** because we thought that companies just reporting their water use makes no sense to investors. It's like the telephone book, full of numbers, but no meaning. Is this water use a problem, yes or no? We couldn't tell.

So, we wanted to make sure that water use gets understood as water risk, and then you need to know a whole lot more. You need not just to know what water is being used by a particular company, but also where it's being used, and who else claims that water. Ultimately, we came out with a risk metric of water dependence as the amount of water that you need over water security. How secure and sustainable is that water supply? With a management factor of sorts you already have a proxy for water risk that your company or your investment is exposed.

That was back in 2009 or so. And thanks to partners like Goldman, General Electric, Coca Cola, it eventually made it to the Bloomberg Terminal. And I think this is a *very interesting example of something which started small, being dependent on philanthropic money and NGOs, but it built itself up and now it's like a mainstream tool for analysis of either water risk or water investment opportunities.*

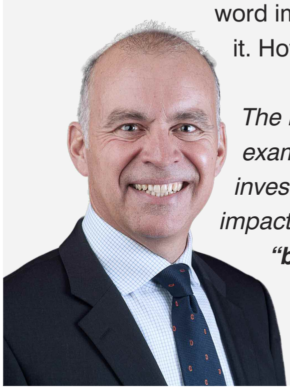
And this is why I also agree with Christian, we still need that laboratory of good ideas that can start small. And find the ways and patience to slowly nurture these ideas. Not to ignore them but not smothering them in money either (which has happened too, think micro-finance).

So, just to make that point again, real impact tends to start small and we need to be careful to give a time to build itself up. From a good a good idea to a risk consideration, to an opportunity and then, eventually, it will arrive as a larger theme. But this won't happen overnight, and we need the entire chain for that.

Vincent Triesschijn: I like the development of tools, like the transition monitoring tool that is even for free.

Still, when the oil price is anticipated to go up, everyone invests in oil companies, that has not changed. So, I think these tools are very welcome and we should promote the use of them.

Christian Speckhardt: I completely agree with what you said. In the current early stage of impact investment, where even the word impact is used as a term, you must talk about the impact you achieve and therefore measure and report it. However, you need to keep things lean and pragmatic too.



The impact industry has to mature and professionalize further to maximize its own impact. I give you an example. If we only emphasize impact and tell nice anecdotes, we drive the positioning of the impact investment industry towards philanthropy. Why is this not only good? Because if you want to mainstream an impact theme you do need scale on a commercial basis. ***Talking too much "impact" and too little "business" may therefore hinder the development of our industry.*** *Example: you want to enter into a business partnership with a large organization. Given the perception of what impact investment is, the* *organization directs you to the small corporate foundation, not to the business side where you want to be, even if your offering is commercially attractive!*

Some impact investment themes and products are clearly institutional investor ready. Even more so if products are blending private and public capital to allow for risk mitigation. Remaining too much on the impact side, in terms of communication and positioning, does not necessary support growth, which is important to maximize impact.

Impact investment is trying to get involved in the nascent stage of an impact relevant industry – where economics are just sufficient and volumes still small – in order to boost its development towards business attractiveness, size, and even more impact.

Such development can't always go linearly steep uphill and some limited market failures are expected to happen. Microfinance, i.e. retail banking and the inclusion of the unbanked population into a formal financial system, has a development history of over 150 years in Europe. What microfinance tries to do is to achieve the same in 20 years in developing countries and in a sustainable and responsible way.

Now, a functioning financial market does not only need financial institutions but also a robust regulatory environment and further infrastructure that needs to develop in the same high pace and in parallel. Balancing all of the needed developments in parallel towards a functioning and responsible retail banking sector in developing countries is a challenge of course. And in isolated cases, market failure has happened, often also triggered by bad political decisions.

Andrea Marmolejo: I agree with you, we are talking about long-term projects and they need time to come to fruition. On the other hand, as Christian said, the idea is not to keep these businesses in an incubator phase forever, but it's entirely the opposite. We would like to see all of these projects and companies fly on their own terms, get as big as they can and become contributors and help others in their own communities and the broader economy.

We talked about microfinance and Piet mentioned securitization, but let's also keep in mind that blockchain and technology in general are going to add transparency and improve the management of these products going forward. While in the later stages of microfinance there have been market failures, I still agree with those who say it was worth the effort because microfinance today is an 11-billion-dollar business that has helped countless people that nobody else was addressing.

What they didn't have was a way of checking, how many loans were given to a particular person because the borrowers were not registered anywhere. Now, with a ledger where all loans could be registered, lenders are going to have a better understanding of how much an individual or family has borrowed.

The idea is to do exactly the same with SME loans. I am working on a project on blended finance and we're looking at how to catalyze mainstream investments from the UK and Europe into Africa to support SDGs. Africa has very thin and illiquid markets. However, the funding need is enormous and in order to attract mainstream capital, we will have to aggregate a high volume of low-value loans, and if you could do this in a way that is transparent, you could even think of going back to CLOs. **Collateralized loan obligations** in its day brought a lot of problems because nobody knew what was in them, there was no ledger keeping track. Now, we will have that. So, technology will help retrofit financial products and increase financial innovation.

Christian Speckhardt: I completely agree with you. Credit bureaus are a very important ingredient for a functioning banking and credit market. In the earlier development phase of the microfinance industry such credit bureaus were not everywhere in place or not gathering all necessary data. In our own investment processes, we therefore always tried to understand the local context and the existing processes to identify multiple lending at a microfinance institution. We avoided lending to institutions that knowingly lent to clients that had multiple loans outstanding above a certain responsible level. Today, credit bureau infrastructure is widely existing and new technologies such as blockchain will certainly further improve the credit business and lending processes.

Matthias Knab

Andrea, you mentioned before that you are helping asset managers implement ESG. Could you share with us some recommendations here? What are some of the best practices, is there a sort of roadmap you are giving your clients?

Andrea Marmolejo:

Well, it all starts with the basics, so we really start with understanding what the manager invests in and what is their market reach. Then we want to understand why they want to make a change which is also quite interesting. A lot of the time the driver is not only personal commitment from senior leadership but also getting additional market share and new clients.

Matthias Knab

It's what you said earlier, the managers focus on ESG because they see it as an opportunity, right?

Andrea Marmolejo: *Correct, it is an opportunity for growth, but also an opportunity for rebranding and an opportunity to reach out to the younger generation. Sometimes it can also be about transitions in terms of assets going to other members of the family if managers are targeting family offices. Many managers work with foundations, and foundations particularly in the USA are increasingly evaluating the impact of the 95% of their portfolio and not just the impact of the 5% that according to regulation has to be invested in line with their program and their mission.*

We next focus on building the necessary infrastructure, like selecting one or more ESG ranking services and dedicated research service providers, we identify other sources of data from relevant NGOs and government agencies, and we structure what would become the internal ESG research effort. This includes internal research and analysis and a methodology for engaging with companies in their portfolio. Once we have ESG research tools in place, we decide how are we going to blend or integrate the ESG elements with the stand alone research and investment process that the manager has in place.

We also look to identify the investor or manager's personality or style by helping them articulate their values. What exactly is driving the manager, and what drivers are coming through their clients / beneficiaries? Is the primary focus going to be environmental or social? Will they be aligning their portfolios with SDGs? Any cluster of them? This will give an indication on the type of products that we should develop and in what order. For example, if some of the key clients are university endowments, then probably the first product you may need to develop is a fossil fuel free fund or portfolio. The suite of products is discussed with key clients, once there is a clearly articulated vision.

Once you have a clear focus and your ESG tools are in place, we need to screen every single stock or mutual fund in the universe and in existing portfolios and be able to determine the actual changes that would come about as a result of the ESG integration, and what kind of financial impact would these changes generate, if any.

The merits and consequences of this strategy need to be conveyed to existing clients who may not have asked for an ESG overlay. Most clients are excited about the increased level of due diligence and risk management that ESG brings to their portfolios. Sometimes an investor will say, "No, we are not interested." however, in the current environment, clients who have not shown an interest in ESG actually welcome the opportunity to evaluate this additional level of screening.

*I found that through this work, a lot of asset managers or their financial advisors discover a **new pathway to engage with their clients** focusing on ESG and impact investments. Both parties seem to be enjoying a different energy, a different sparkle and IFAs report that clients actually want to talk and focus on their investments in a deeper way.*

But now, all of a sudden you can tell them, "Guess what you're doing with your money!", or, "What would you like to do with your money? We can do this, this and that," and everyone is feeling so energized! We have also seen a lot of members of families that previously were not involved with finance at all now want to come to the table and become involved.

So, the experience has been very rewarding, relationships typically improve, the advisor can attract more clients and increase AUM, the new portfolios perform well financially and support a purpose that is important to the client, and they generate a positive impact for others. As I mentioned, fossil fuel free has been a very typical product, and now more people are paying attention to gender, particularly as a way to support all of the SDGs.

The way women spend their money particularly in emerging markets is usually towards areas sucha s healthcare, nutrition, and education. If you are able to lever technology and women, you can actually target and support a lot of the SDGs. This is one of the reasons why there is more and **more emphasis on gender.** First, it came more from a human rights perspective but now it is also about value. Data is showing us that women on boards improve governance, and that these companies have less stock price volatility and a reduced risk of blow-ups. There are a lot of indicators that come up through metadata today and this is driving demand for such products. It's just about tailoring and executing them well.

Piet Klop: Andrea, thank you for sharing this. I also would like to talk about some products that are interesting for a number of reasons. One is called Open Invest as an ESG-focused online investment advisor. Their platform allows investors to dynamically customize an investment portfolio based on their values, at low cost, and share their views with others. The platform was built by some Bridgewater alumni and makes responsible investing fun, easy, and social.

Matthias Knab An ESG robo-advisor.

Piet Klop: Yes, it's a bit like that, but really, the way they sell it is like voting with your money in between elections. You vote your social preferences, and you do it a very low cost. Maybe the novelty of customizing ('tindering') your investments will wear off but at least the option to continuously vote your social preferences at low cost is there now.

Marisol Hernandez: In my work I am often able to see what investment managers are actually doing, and *I found that in many cases they are already following a form of ESG or responsible investment, but they don't call it that way. I think that hedge funds in particular have a huge opportunity here because they have the people, they have the technology, they can convert unstructured data into a structured data and they can create new products through engagement with clients.*

So, instead of viewing ESG as an obstacle or something to avoid and "not to get involved in", my recommendation to asset managers is to recognize the major opportunity behind it and maybe decide to focus on doing something that includes a positive impact to the industry.

And from the asset owners' perspective, knowing that we are moving from DB to DC, with blockchain technology, beneficiaries will be able to track and see where the money is going to be invested. So, there is opportunity for both sides.

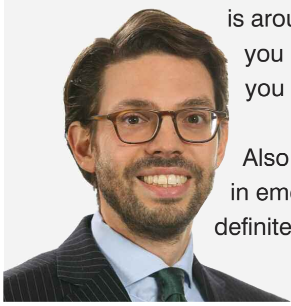
Matthias Knab How much opportunity for alpha generation does ESG offer, and through which processes? Probably for alpha generation, investment managers need to create their own views and datasets, and not just consume some standard ESG scores like the manager next door. What are your thoughts here?

Andrea Marmolejo: You are absolutely right. Each manager will derive their own ESG framework that would typically be based on both external and internal ESG research, their interpretation of materiality when it comes to key issues across sectors, and their engagement policy with companies, proxy voting and external advocacy, and their success in pooling forces with other asset managers or asset owners to work on specific issues. Another differentiating factor is the depth of ESG reporting and transparency of the manager. Any and all of these factors can be translated into alpha generation for their clients.

*Going forward, I believe that we will see increasing upside from alternative ways of generating alpha. One way is l**everaging the use of artificial intelligence** and going for the best companies with the idea that they will perform better, that they will be less volatile and that there's less risk of a single event that can potentially affect your entire portfolio. I am aware of more firms in the USA and in Europe starting to* *adopt AI and they are changing the whole process which today is based on self-reported data, to say simply looking at a company's water bill. These type of managers are not even asking companies any questions, I find that very interesting.*

Another way is through **successful ways of engaging.** Certain investors have achieved good returns by investing in companies that have poor ESG ratings, as they have been able to persuade company managers on the merits of managing these risks more effectively, This can include a few investors getting together and pushing the envelope, and a board or a management team on the other side that understands that this is what they need to do anyway and that they might as well do it with the help of shareholders that support them, then this can be a clear win-win.

I think that shorting stocks on this basis is a little more difficult because of the potential lack of a clear catalytic event, the timeline here is the trouble. Usually a short seller needs a very clear understanding of what is it that will tip the stock down and then needs to wait for that moment. The types of events that are taken into account in ESG investments may come any moment, might come right now, or in three years, so this is often unclear. Pair trades could work better though.



Vincent Triesschijn: We also did some analysis on this. One factor where you can see a clear impact on a stock is around the controversy levels that the ESG data providers use. When a company has a certain incident, you can rate it in terms of a controversy level, and when it's so bad that it breaches the UN global compact you can see an effect in many cases.

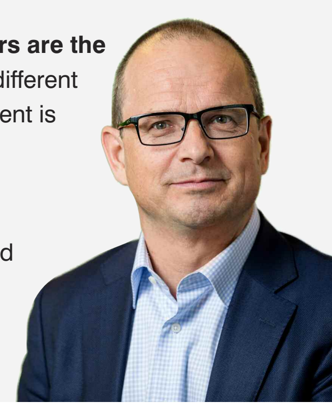
Also, I think everyone is pretty much aware that the G within ESG can really add a lot of value, for instance in emerging markets, but also here there's no one size fits-all rule here. But certainly, all these aspects are definitely something to look into when more data becomes available.

Piet Klop: Most of the data we are looking at in ESG is all backward looking, so the predictive value is limited.

What we are trying to do, thanks partly to the TCFD (Task Force on Climate-related Financial Disclosures) is to get better in building scenarios that we can actually believe in, rather than just go with past performance as the ultimate guide to future risk. I think that's just odd, and all our disclaimers say it's odd, and yet we do it all the time. So building scenarios that are forward looking is probably going to be the next big thing and I agree with Andrea that artificial intelligence is a real big help here.

Also, a lot of these self-reported data are going to be viewed with a more critical eye now that we are able to combine all sorts of data sources on things like resource efficiency, employee satisfaction, and so on.

From my perspective, **artificial intelligence and forward-looking scenarios with proxy indicators are the next big thing in ESG integration.** I do find it troublesome that ESG integration can mean many different things to different people. It is a very big umbrella. Exclusion is apparently a part of that, engagement is part of that. We run a CO2 index which is moving money within certain sectors from the inefficient laggards to the carbon efficient leaders. That's ESG integration too.



A lot of these concepts and buzzwords really depend on what instrument you are talking about and what asset class you are applying it to. But the one thing that I believe is important to all of that is that investors are trying to see the future through the windscreen rather than the rear-view mirror.

Andrea Marmolejo: I think that we agree that the market is moving more towards ESG adoption, so it is very important that we improve and widen our research on ESG, both in-house and through service providers.

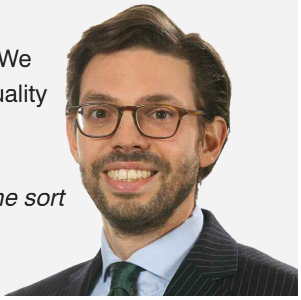
One thing that would be disastrous is if we all start narrowing the universe of investible companies – due to lack of ESG ratings and research or because only a handful of companies get top ESG ratings – and everyone ends up with the same concentrated portfolios. This would bring about other problems that the financial sector does not need.

That's another reason to further push the dissemination and the importance of ESG by extending this analysis further to a wider number of small caps and to emerging markets really swiftly, as well as engaging with the companies that do not have good scores, which I think are increasingly willing to engage. This is because companies can be quite confused if they get different scores from different ratings companies. So they don't really know what investors do in fact care about. This is another avenue of work, that investors as a whole liaise with corporates and tell them sector by sector, "Guys, this is what really matters. This is what you need to get right."

That needs to happen. Ideally, we need to convert all companies very quickly to ESG-ready, and then we can all invest across the actual universe of investable assets.

But investing within a fraction of the companies available, particularly for pension funds that need to own pretty much the index in every single country, that's going to be very difficult.

Vincent Triesschijn: I definitely see the data challenge, we should carefully look at the available data. We understand that there's a need for a broad set of data, and that doesn't necessarily result in a better quality of data.



Large datasets that become available for tens of thousands of companies are very likely based on some sort of statistical analysis which makes them probably different to classic ESG research.

Matthias Knab Right, and their ratings and rankings and scores are all over the map and don't correlate.

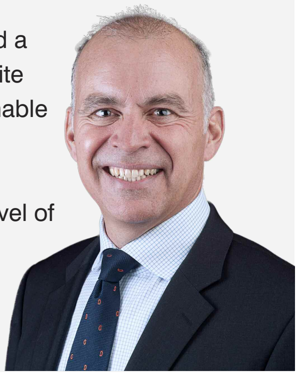
Marisol Hernandez: *Now that you said ESG ratings, I wanted to mention the importance of **differentiating between ESG scores/ratings and credit ratings.** The former, which I prefer to call ESG scores, evaluates a security issuer (either of bonds or equities) according to their exposure and performance relative to ESG factors and compared to their peers. They are quantitative indicators, unregulated and provided by a third-party service providers.*

The later are opinions about the relative creditworthiness of a bond issuer or its issues, based on the likelihood of default. They are regulated and based on qualitative and quantitative assessments. Both can be used on combination but being aware of their differences.

We are currently working with 144 investors managing nearly US$29 trillion collectively globally who have signed to the PRI *ESG in Credit Ratings Initiative* which aims to advance understanding of the materiality of ESG factors to credit risk.

Christian Speckhardt: I attended a breakfast session recently where the University of Zurich presented a study looking at the ESG landscape in the context of the Swiss private banking sector. What I found quite interesting was that most of the private banks were very active and do have ESG strategies and sustainable investment offerings in place.

But the weakest point in the system, according to the study, was the relationship managers, i.e. their level of ESG knowledge and comfort to advice clients and recommend those products actively. The client interface was a major weakness that was identified in Switzerland.



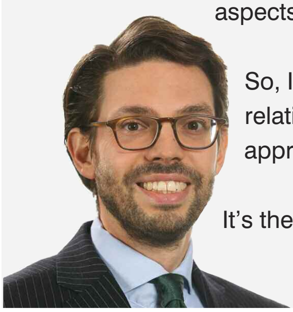
Matthias Knab So you are really point the finger at private banks as one of the weakest links?

Christian Speckhardt: Well, it is not so much about pointing fingers, we are all in a development process, but certainly, sustainable investment knowledge and ESG training at relationship manager level needs to be increased in the Swiss private banking sector. Given the size of the sector, this would have a major positive impact, since client decision taking and distribution of the ESG products happens there. The good news is that ESG strategies and products seem to be implemented which in turn means that strategic management support and leadership towards sustainable investing is existing at these banks.

Vincent Triesschijn: I know that University of Zurich report, it was only focusing on Swiss private banks. Forbes also published an article that referred to this paper and actually suggested that banks and business schools should focus on ESG. It was very difficult for us to find an academic sustainable investing related course. We ended up at the business school of the University of Oxford tailoring a course together with them. Oxford Saïd has a strong background in ESG and impact investing.

Piet Klop: The CFA Institute has become quite active there as well.

Vincent Triesschijn: Right, but they focus very much on the CFA charter holders, and as Christian mentioned we also have to educate relationship managers as well. They don't have a CFA usually. It's not so much about the technical or the investment aspects, but on 'how to discuss this with clients' too.



So, I would agree with the Swiss that probably there is an industry wide need for training because relationship managers feel insecure discussing ESG with clients. If anyone would like to know how we approach this, let me know.

It's the nail on the head, starting with training, awareness, education is key.

Matthias Knab The Sustainability Accounting Standards Board (SASB) has created the Fundamentals of Sustainability Accounting (FSA) Credential. They say it's the "only credential that teaches you how sustainability information can be financially material, and what you can do with that information".

The majority of test takers are professionals in investment analysis, consulting, and sustainability. Their first exam – Level I – focuses on principles and emerging practices, and Level II on application and analysis.

Vincent Triesschijn: The PRI also has an e-learning course with three modules, it's pretty comprehensive, focusing on the technicalities of ESG. Not so much on how to introduce and explain ESG though.

Piet Klop: Opportunity again!

Matthias Knab Right, we should develop our own then...

Marisol Hernandez Education is at the core of what we do. Apart from the PRI Academy, we run free educational events in conjunction with CAIA. We've started at the end of last year with two events in Madrid at the IE Business School and Barcelona at Banco Sabadell, and we aim to continue this year once we publish the hedge fund industry guide. I'd like to invite anyone who is interested about responsible investment in hedge funds, independent of your job positon and level of financial literacy, to come to join us.

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Opalesque.TV video which got 104 views over 2016 Christmas:
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