PRESENTER: So, Alice, starting with you, and there's certainly a lot of confusion out there about all these terms that are banded round: ESG, ethical investing, green, all that sort of thing. Is there a difference between them all, talk me through it? ALICE: Yes, there is a lot of different terminology in this area. It can be a little bit confusing. There are some things that are different but called the same thing, and there are other things where there is clear and specific terminology applied to it. So I'd say first of all responsible investment is kind of an overarching ethos. We as investors have responsibility to understand that our investments have some real world impact. What does that mean for the world and what does that mean for the long value of those investments? So that's more of an overarching concept. And then some of the other terms apply to how you might look at that in practice. So sustainable investing is more of a positive proactive approach. It's not just about avoiding something I don't want to be invested in; it's about how can I proactively identify investments that will have a positive social and environmental impact, and taken to the extreme you would describe that as impact investing. And at the other end you have ethical investing, which is a term that was associated with the origins of responsible investment. It came out of the idea of people not wanting to have exposure to maybe sectors or industries that they were ethically uncomfortable with. You usually think about excluding tobacco, excluding arms and that kind of thing. ESG is a term that you hear overwhelmingly now, and that's really a framework, environmental social and governance issues, which is how you look at sustainability as a concept for investment purposes. Environmental, that would be issues like climate change, resource scarcity, biodiversity, water; social, that would be areas like labour standards, business ethics; and then of course the whole governance sphere applied to active ownership. PRESENTER: And are companies under the ESG umbrella, do they have to incorporate all of these or can they just have the E or the S or the G? CLAUDIA: Yes, it's a whole sliding scale. I think you get some asset managers out there who are focusing very much on the environmental social and governance risks within their investment portfolios, and thinking about how that plays out with their investment decisions. I think you then have specialist companies out there who are providing ethical funds or sustainable funds, and others who are just being active owners. They take their responsibility seriously, and use their vote at the annual general meetings, and they position as an investor to push for improvements on environment social governance issues. PRESENTER: So I mean you mentioned active ownership and engagement, how important is that and where does it fit into it? CLAUDIA: I think active ownership is a really key pillar within responsible investment, and taking the position as an owner of capital really seriously, and that responsibility is a very trusted one and gives you leverage over bringing about really good change within the companies you invest in. ALICE: Yes, as part owners of these businesses, we don't have, we're not neutral actors so to speak. We have both a responsibility to support and encourage positive change, and also the opportunity to do so. I think there are so many enormous social and environmental issues we're facing as a society, and business has a really important role to play both in not contributing to those challenges, but in also working towards solutions. And that's something that we need to support. CLAUDIA: I think there's also recognition that it, I mean the reason why we have done that is obviously because we care about the environment and society. But it's also because we fundamentally believe that by taking that active ownership position you're contributing to making those companies more stable and better in the longer-term- ALICE: More resilient businesses. CLAUDIA: -and just better investments ultimately. And so our team for example focuses on really material environmental social governance issues for that reason, to improve the performance of companies we invest in. PRESENTER: So in practice if a client goes to their advisers and said they want to invest responsibly, I mean what are the key considerations there? ALICE: Well I think as discussed up to this point, there are a lot of different things you could mean by investing responsibly. So I think it would be important for the adviser to understand their focus and their purpose in wanting to invest responsibly, and then he would be able to advise more. Oh so really you're looking at an exclusion-based approach, or let's talk about positive impact investing, or maybe really you'd be comfortable with a mainstream product where you're sure that the fund manager is taking into account environmental and social and governance issues in the course of their investment analysis. Maybe that's really what you're after. CLAUDIA: It's key for the advisers to work out where their client is on that spectrum. PRESENTER: And what should they be looking for in the funds that they're talking about? CLAUDIA: I think that ultimately depends on what's their driver for wanting to invest responsibly. For some people it's very clear it's on climate change. I think that automatically then frames the kind of funds that you'd be looking for, so typically investment portfolios that have a sustainable positive outlook, positive investment around themes, finding companies that are providing solutions to climate change, that kind of thing. Whereas somebody else would feel perhaps very strongly about tobacco, and so that then drives you down more the ethical exclusion-based route, or on the leading edge side on the impact, they really want to have an impact with their money, and what does that look like? And this is a really exciting emerging area where more and more funds are popping up. ALICE: And as an adviser then having identified which aspect of responsible investment you want to prioritise, looking at funds offering that. I would like to look under the bonnet at what's going on, and look at the narrative they have around what they're trying to do: is that consistent with the kind of investments that you're seeing in the portfolio and how are they reporting on that. PRESENTER: Because that would be a big point for clients to assess how credible these funds are, so are there things they should be looking at when they're doing that? CLAUDIA: I think it's really important to look at the investment criteria around it, everything, from the philosophy of the fund, the objectives and the level to which the criteria are thought through. I mean there's such a spectrum on this. There's very simple basic exclusions, right all the way through down to very detailed analysis that, you know, it's not easy actually finding the funds I think that meet the client needs; there's so many opportunities out there. It's about honing in the set to suit the client. PRESENTER: And active ownership we spoke about earlier on, I mean is this something they, I mean how can they even assess how involved they are in that? CLAUDIA: So I think one thing you can look at is how many of the companies within a portfolio have been engaged on environmental social and governance issues. I think if it was me I'd look to see a balance between ES and G, rather than maybe just one. But if you're just driven by climate change maybe that's not of interest. So it's kind of again catering towards the client and what they're after. ALICE: Yes, I was going to say look at the quality of reporting. Look at the purpose, look at the strategic focus around engagement, what are they engaging for, what's the purpose and how is that working in practice? What kind of tracking and milestones can they report on? Some tangible evidence of what's going on. CLAUDIA: Case studies are often a really good way actually of drawing that out. So a case study of the company engaged: what did you ask them, what's been the response, what's next? You know, I think that really teases out quite a lot of the detail that goes behind active ownership and engagement. PRESENTER: Is there anything that they should be wary of? There's this term greenwashing, I mean how does that fit in? That's a concern I think that people hear about. CLAUDIA: Yes, I mean I think greenwash is a very real concern, and I think there are a lot of companies out there saying a lot about what they're doing. I think one key indicator for me would be asset managers often have dedicated environment social governance teams looking at these issues, and one indicator could be the size of resource dedicated to thinking about this. But yes, our team struggle with it every day. If we're engaging with a company, they say something, often it needs a bit more prodding and a bit more analysis behind it, rather than taking facts at face value. ALICE: Also if a fund manager is saying they have an ESG approach, and then you probe them on that, and there's limited depth, there's nothing tangible there that they can talk to. You've identified a stock in their holdings list that doesn't quite feel right to you. It doesn't quite feel consistent with what they say they're doing. You challenge them on it, and they're unable to respond to that, they obviously haven't thought through how that relates to their investment, to their so-called investment philosophy. PRESENTER: Because it does almost feel like

ESG has been really adopted by the mainstream fund managers, and whether they really do have an ESG approach, or whether it's just a marketing tool. It can be quite confusing I think for people who are looking at those funds. CLAUDIA: Definitely, and I mean the whole industry's thinking about this a lot, about how do you make the different labels clearer so that people can navigate and understand what it is that they're buying. I think it's quite an ambitious project because there's so many asset managers just doing things. But to have rough guidelines in place I think would be no bad thing, so we're all on the same page about what we mean when we say impact or sustainable. PRESENTER: So I suppose the main concern of people looking at responsible investing, or ESG, is the trade-off with returns. Because a lot of these companies that perhaps wouldn't fall into this category, I mean you mentioned tobacco. These are the big dividend payers, so is there a trade-off with returns? ALICE: Well I think this was very much the concern maybe 10 years ago. To be honest there's just an increasing and overwhelming body of evidence to say there is no performance penalty to this type of investing. I think that comes through a whole body of academic research observing the industry, and it's been our own experience. And I think when you think about what does ESG mean, it means that companies are thinking ahead about sustainability challenges that their business faces. If they're doing that effectively, they're likely to make their business model more resilient than if they hadn't given those any consideration. And so it makes intuitive sense that at the very least those businesses doing that more successfully are less likely to underperform. And I think what the research has shown is there's at the minimum no penalty overall. CLAUDIA: I think another thing to look at is with these funds what are they benchmarked against? If they're benchmarked against mainstream MSCI indices, and they're performing well, I mean that just ticks off any questions about performance, and so we've definitely experienced that, because we benchmark our funds against mainstream. And so the results speak for themselves. ALICE: And I think sustainability issues matter more over the long term than they do over the short term. And you might have periods of time where there will be structural biases of an ESG screened portfolio that might cause it periods of short-term underperformance, depending on market conditions. But as you move over the longer term, which we now have increasing data over the longer term, because this is a relatively nascent industry. It's showing the longer you move out, the more supportive of long-term performance this approach is. PRESENTER: But another concern of people is that it really limits stock picking, and that in turn can have an impact on diversification. Is this something you're finding or concerned about? CLAUDIA: I think that's probably only relevant for exclusion ethical-based funds, where you're potentially excluding large sectors, but only if you were doing that. I think generally the universe out there is large enough for fund managers to stock pick and find great opportunities. I think it's the mindset of the fund manager, and their appetite for seeking out these opportunities that's the exciting bit. ALICE: Also in an actively managed portfolio you're only ever owning 30, 50, 100 stocks at most out of 1,700 stocks or so in the MSCI World or maybe even broader. CLAUDIA: Yes that's true. ALICE: And you're going to be limiting your universe in one way or another. There are lots of different ways of making money. PRESENTER: But what's the environment like for this at the moment? You mentioned that maybe it was true 10 years ago that tobacco, and not including these as an issue, but how does it stand now? Because I've heard that a lot of times the stocks that you're talking about now, it's because we've been very much in a value environment so they've done well now. Do you think in the future they'll do well, and is now the time for them? ALICE: Well I'd say we'd been in a growth environment over the last 10 years. Definitely the type of stocks you would hold in an ESG fund, more quality, slightly growth oriented, have done well. That's certainly true. I think looking forward there will be periods of time when the traditional value industries outperform, and that will be a performance headwind no doubt to companies that exclude those or are underweight them. But as you look out even further I think part of why this whole ESG approach has gained such traction and such interest is because the thesis is clear. The world is changing, populations have already doubled more or less in our lifetime, the world of the future doesn't look like the world of the past, and we need to think differently about investments that will be successful in the future. And that's the mindset, that's the thesis, and I think that's where you'd expect long term performance to continue. Especially when you come back to the idea that companies that are looking at these issues and really embedding them in their business models are likely to be more resilient. And you can't really get away from that. And the other thing I would add is we ask companies to report on this and that, report on climate change strategy, report on energy efficiency and so on. And those businesses that are able to provide that data, they must be doing, they tend to have better management information systems. They tend to have better control and understanding of their businesses in general. And so that continues to lead you to look at more quality companies. And we think these are also likely to keep performing over the longer term. PRESENTER: Well let's move on to risk then, and what does this look like in this space? CLAUDIA: So risk, I think this is, for us you're looking at what the environment social governance risks are across the investment space, across asset classes, across geography. And it's an art. It's about using third party research providers who have global coverage of stocks, and then really translating that and working out what the true risks are for different portfolios. And I think this is where engagement comes in as well. So when we identify a risk say within a portfolio, it's then working out whether engaging with that company is a useful thing to do in order to bring about change, and maybe reduce that risk, or exploit at an opportunity. So we do think of it as risk as well as opportunity. PRESENTER: Well in a fund management industry cost has been coming up a lot of late. So this is seen the rise of passives. So can ESG and responsible investing, can this work in the passive space? ALICE: Yes, I think this is an approach that is more easily applied to an active portfolio, or more thoroughly applied to an active portfolio. But I think you can, there are a number of things you can do in the passive space. If it's completely passive that is what it is, but you can still engage with companies held within the portfolio, and also at the public policy level to advance regulatory standards, improve the overall value of the market in some senses. But there are other semi-passive approaches you can take. You can eliminate a small number of sectors or securities, maybe the most carbon-intensive industries, maybe tobacco, maybe controversial weapons is something that's typically eliminated with very limited impact on diversification. CLAUDIA: Or rather than exclude you can underweight, you can underweight the poor ESG players- ALICE: That's true. CLAUDIA: -and overweight on the positive. So yes there's lots of options there. I think passive funds that purely rely on an external ESG research provider might not be adequate enough for someone who I think possibly cares a lot about sustainability or responsible investment. So I think it's again where that investor is on the spectrum and what's important to them. PRESENTER: I suppose most people when they think about ESG, they're just thinking about equities. But does this also apply to fixed income, and how do the two differ? CLAUDIA: Yes, absolutely, it covers both. I think many fund managers out there are providing responsible or sustainable funds that will cover both equity and fixed income. And other asset classes, you know, property, private equity, it's kind of cutting across everything now. In terms of engagement, we engage with companies both from the fixed income side and on equity. There's obviously slightly different issues sometimes as a focus, but generally we see a huge amount of overlap. ALICE: I think I would characterise some of the difference as in the equity space you have a stake in the growth of the future; whereas on the fixed income side it's more about what ESG issues could impact cashflows to the extent that it changes the ability of this company to repay the debt. And so there's definitely more of a focus on the risk side when you apply this to fixed income and more of a focus maybe on the opportunity side when you apply it to the equity world. CLAUDIA: But obviously in fixed income you don't have the right to vote from your bond holdings. But we've found that our fixed income team for example has benefited from our engagement on the equity side, because a lot of those issues are about governance and how well run the company is, which is of value and of note for fixed income portfolio managers. PRESENTER: So, how do ESG teams at asset managers interact with the managers then running portfolios, talk me through the process? CLAUDIA: I think this completely varies between asset manager to asset manager. For us, it's very important for us to interact with all of the portfolio managers depending on the risks and opportunities within their portfolio. Sometimes it can be led by which sectors they're particularly exposed to. So our team for example is arranged by sector to cover environmental and social issues. And so that then naturally fits with engaging with analysts across the floor depending on which sector they're covering. And that's where you get the most overlap in terms of knowledge and sharing. I mean, many teams in this space, the ESG teams provide reporting to portfolio managers at portfolio level in terms of where the risks are. That's something we do. We also do deeper dives for fund managers and analysts on a company where there is an issue, and we want to get a bit more depth or analysis on what that really means, and how that should feed into investment analysis. But it really does depend from asset manager to asset manager; I think everyone's got a slightly different approach. ALICE: Yes, I think whatever you call it, the ESG team, the responsible investment team, again the terminology varies, and some don't have dedicated teams at all. The capability is embedded in investment teams. But they'll typically take responsibility for the active ownership activities of the organisation as a whole. And yes, the ESG teams can really provide more in-depth knowledge on particular issues, like water stress or labour standards, and that will match up with a deeper sector and company knowledge the financial analysts typically have. And so each firm is working out the best way of integrating one type of knowledge with another type of knowledge- CLAUDIA: It's so much safer out there. ALICE: -to enrich the analytical process. CLAUDIA: Yes, what's just so hard is there's just so much information isn't there? It's about trying to drill down on what's the nugget of information from this vast amount of information out there. ALICE: Working out materiality. CLAUDIA: Yes. PRESENTER: So I mean looking at this overall, currently what would you say are the most important engagement issues then? CLAUDIA: There's a number that we're working on at the moment. So for example climate change is obviously a big issue for us, and has been for a lot of asset managers for a while. Other issues include nutrition and obesity, water. Plastics has obviously come to the forefront especially recently, especially in the public eye. Labour standards, business ethics. ALICE: Well I think you've got these kind of background top level issues that are ongoing: climate change, huge major ongoing multi-year, multi-decade, multi-sector issue; labour standards, same story really; and then we break them down into more specific nearer-term projects that we can work on very specific goals. And that's where things like gender equality comes up; that's a more recent issue to be working on in governance structures, but also more broadly. CLAUDIA: Yes, that's true actually. One longer-term engagement is obviously governance. I mean we do so much on remuneration board structure, that's the same engagement that's been going on for 18 years: it's different companies but it's the same issues. Some are very continuous and long term, and others pop up as nearer-term, short-term projects. PRESENTER: And does that create a lot of confusion for you when it comes to things like that when you've got a company that might have excellent governance but then falls short in the E part of ESG? I'm thinking of perhaps BP, excellent governance, and then you have something like Tesla that's good for environment but its governance because it's a new company is perhaps lacking. So how do you deal with that sort of issue? CLAUDIA: So it depends on your starting point. So if it's for an exclusion-based fund, a company would have to meet minimum criteria in order to be rated as acceptable for those funds. And so that's much easier. I think where it's much harder is on the active ownership, the ESG integration space where you have to work out what's good enough, and where does it tick over into being a very material risk that should impact your valuation of the company? ALICE: It's quite hard. CLAUDIA: It is. It's almost case-by-case, I'd say, and then how a company compares to its peers. ALICE: And then looking at valuation of course. If you have identified, you know, let's take your example of BP: good governance, terrible social and environmental issues historically. Then what's the valuation of that company, does it adequately reflect those concerns? And that also, it's a bit of an art and a science. Looking at Tesla I'd say the valuation certainly reflects the positive upside; maybe to the point that it doesn't quite sufficiently reflect the weak governance. PRESENTER: So, in terms of demand then for these sort of funds, are you seeing much of an uptake from DFMs and advisers for these kind of products? CLAUDIA: Slightly crazy is probably, demand has gone through the roof for existing product, but also new funds that are out there to meet the evolving needs of different investors. So yes we've been overwhelmed. ALICE: There's been an explosive, literally explosive interest and demand. We've both been in this space for a long time, and when I started looking at these sort of portfolios 12-13 years ago really you were very much the vegetarians in the corner. CLAUDIA: The tree huggers. ALICE: Exactly, and now suddenly it seems to have reached some sort of a tipping point. It's no longer really acceptable for any fund to ignore these issues altogether. It's only a question of how much, how far, how deep, what sort of quality are you applying, what quality of analysis are you applying to the situation? How pure, how specific can you be in your positive impact? There's an explosion of interest. CLAUDIA: But one thing that I think is a bit of a challenge is I think I've heard that definitely advisers sometimes feel nervous in this space. Because of the issues around the terminology and what different funds mean, I think we as asset managers have a role to play in helping them understand the full spectrum and what that means, so they can then feel comfortable having those conversations with their clients. PRESENTER: What do you think is driving demand for these funds? Do you think it's very investor-led or do you think it's advisers seeing it as a good opportunity to market a new fund? ALICE: I would say yes, a mix of both. I would say advisers, apart from a very small number who've been focused on this since the beginning, I'd say advisers are more picking up and reflecting the interest that's coming to them from underlying investors. And I think there are several things at play. I think there's been a bit of a sea change since the financial crisis really. There's been a sense that wait a minute, what is this industry? Something's not working, how do we think about that? And that's percolated its way through people's investment thinking. And suddenly one way or another people are making more of a connection between what's in their savings fund, what's in their pension portfolio and what that actually means in real life. And they're wanting to understand more about how their money is invested, and that seeking of understanding is leading them to say hey, wait just a minute, I wouldn't buy this at the supermarket, why am I supporting it with my pension fund? And so yes there are a lot of questions that are being asked. I think it's also a generational thing. CLAUDIA: I was just about to say yes. So you're seeing increasingly young people, if you look at surveys of their decisions on investments, obviously they haven't got lots of money at the moment but that's the generation going forward in terms of what they expect and where they want to put their money. I think all the data is showing that there's a significant increase in them wanting to focus on ESG compared to the older generation. PRESENTER: So then for advisers in this are who are new to ESG, where should they be going to do their research? CLAUDIA: I think primarily it's about identifying asset managers, a short list of asset managers that are known in the ESG space, and doing a fair bit of digging on their websites. Understanding the philosophy behind why they're running these funds, what the objective is, what they're trying to achieve, and the level of ESG-ness within their process. And I think that can get teased out by website materials, but also importantly I think meeting face to face fund managers, because that's when you really get the depth of information on what they're doing and why. ALICE: The Ethical Investment Association have always historically been active in this area and have a lot of information. Also the UK Social Investment Forum should have. CLAUDIA: What we've also noticed is a number of organisations are now doing ESG ratings of all portfolios, not just ESG specific funds. And actually that is a starting point. I mean they use a lot of data in order to generate those ratings, I don't think they should all necessarily be taken at face value, but it's a good starting point if you wanted to filter out some, if you set the threshold on what you're looking for that could definitely screen out funds at the beginning. So Morningstar is one example. PRESENTER: And like you said earlier in the Akademia session I think, it really matters to know what their clients are after. So, if at certain points they're very much interested in climate change then you have something to go to and then you know what to- CLAUDIA: Absolutely. PRESENTER: -research rather than having this huge umbrella of every issues that could be considered, which can be quite a task. ALICE: I think over time I've encountered advisers who have set up their own questionnaires to try and work out what the priority issues for their customers who have expressed an interest in this area. I'd recommend that as something that is worth doing. PRESENTER: So then for our viewers who've been watching this session, what would you say then to summarise the key takeaways from today? CLAUDIA: I think one of the key messages is that, I hope we've got this across, that engagement and active ownership is a really important component of the ESG offering, and something where you can really add value to your investment portfolios. ALICE: And that environmental social and governance issues have some importance regardless of your investment approach. But there's also a huge spectrum of specialist approaches you can take if you want to go to the next level, from ethical exclusions to positive impact investing. CLAUDIA: Another key message possibly is that we have had people saying is this just a fad, is this something you were just thinking about now, and it'll disappear, and next year it'll be something else. And our answer to that is absolutely not. We've been working in this space for a long time, and all we've seen is a steady increase in demand for better quality ESG products. ALICE: And a better understanding of how these issues translate into investment analysis. CLAUDIA: Absolutely. PRESENTER: So then we're hearing a lot about ESG throughout the media really, does this mean that ESG is now really becoming mainstream? ALICE: We think so yes. I think it's really got to the point where the overwhelming majority of RFPs that we're receiving from across the organisation have an ESG component. Not necessarily to any very great depth at the moment, but there is a desire to understand how all mainstream asset managers are considering these issues in their investment analysis. CLAUDIA: I think it's become more expected yes across the board. Every investment portfolio should be thinking about these issues, environment social and governance. And so what's going to be interesting is that that's the minimum. So this space is only going to I think keep raising the bar in terms of what's expected and required. So it's pretty exciting, because I think asset managers will have to be clever about keeping up with that demand, and structuring themselves in order to do that properly, because that's what the investors will expect. ALICE: And I think we're at the stage where investors are asking the questions of their asset managers about what are you doing, how are you looking at this, how are you considering it and incorporating it? And then I think it's going to get to the point where there's more of a general standard and an understanding of where we've got to. And then it will go to the next level, and there'll be better differentiation between approaches. And I think at the other end, the specialist areas of focus, this desire to have a genuinely positive impact, I think that is also increasingly percolating into mainstream thinking. So how do you incorporate these issues in your investment analysis? And then a little bit down the road I think it will be likely looking for OK then how can you justify continuing to invest in some of the more egregious ends of this? CLAUDIA: Yes, and I wouldn't say that the ESG specialist funds with exclusions, I don't think it's fair to say they're going mainstream. ALICE: No absolutely, yes that's true. CLAUDIA: They're getting taken up a lot more by a wider audience, but I think it would be a step too far to say that that's mainstream, because it's absolutely on the investment- ALICE: No you're right. CLAUDIA: -process and analysis across investment portfolios. PRESENTER: Super, well certainly interesting industry to watch, so Alice and Claudia, thank you. CLAUDIA: Thank you. ALICE: Thank you very much.