FEBRUARY 2017

HEDGENORDIC

Returns a Trade-Off for Responsible Investing
Myth or Major Obstacle?

Exclusions are only a First Step
Allocators with a taste for going further

How Hedge Funds are catching up
Challenges and opportuni-ties for Hedge Funds

Share Their Journey
Managers and Allocators on their ESG implemenation

Sustainable Investing in Alternatives

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

Contents

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THE MULTI-STRATEGIST'S CONUNDRUM

11

WHEN RETURNS ARE A QUESTION OF LIFE OR DEATH

33

LACK OF SRI INVESTMENT FUNDS WORSENS TRADE-OFF FOR RESPONSIBLE ALLOCATORS

42

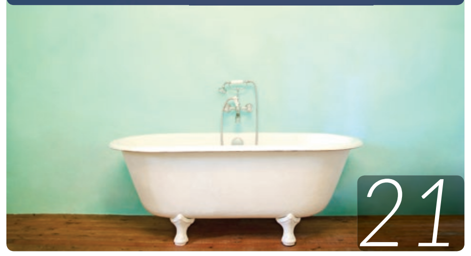
HOW TO IMPLEMENT SUSTAINABLE INVESTING – THE IPM WAY

14

CLEAN YOUR PENSION FUND

08

THE OPTIMIZED SUSTAINABILITY QUEST



21

MAN GROUP'S COMMITMENT TO ESG ACROSS ITS INVESTMENT MANAGEMENT BUSINESSES

36

SUSTAINABILITY INTEGRATION: THE CHALLENGE THAT REMAINS

46

THE SUSTAINABLE ASSET OWNER

39

4	The Editor – From the dark side of the force... to fairy tale
8	Clean your pension fund – How decarbonisation can help solve a pension fund's risk equation
11	The multi-strategist's conundrum
14	How to implement sustainable investing – the IPM way
18	Sustainability as a factor in the management of high-yield corporate bond portfolios
21	The optimized sustainability quest
24	Going the extra green mile
27	In search for sustainability improves
30	Playing sustainability from the long and the short side
33	When returns are a question of life or death
36	Man Group's commitment to ESG across its Investment Management Businesses
39	The sustainable asset owner – How to focus internal resources where it matters most
42	Lack of SRI investment funds worsens trade-off for responsible allocators
46	Sustainability Integration: The Challenge that Remains
50	Corporate Governance – in Finland and the Nordic Region
54	Benefiting from change – Investing into the paradigm shift in energies
56	How investors can adapt portfolios in the transition to a low-carbon economy
60	The Nordics – An elysium of socially responsible investment

IN SEARCH FOR SUSTAINABILITY IMPROVERS

56

IN SEARCH FOR SUSTAINABILITY IMPROVERS

27

HEDGENORDIC

INTRODUCTION

HedgeNordic is the leading media covering the Nordic alternative investment and hedge fund universe. The website brings daily news, research, analysis and background that is relevant to Nordic hedge fund professionals from the sell and buy side from all tiers.

HedgeNordic publishes monthly, quarterly and annual reports on recent developments in her core market as well as special, indepth reports on "hot topics".

HedgeNordic also calculates and publishes the Nordic Hedge Index (NHX) and is host to the Nordic Hedge Award and organizes round tables and seminars.

NordSIP is a leading news website focused on Sustainable Investment viewed from the Nordics.

The site brings together institutional investors, fund managers and third party service providers concerned with ESG. News, opinions, interviews and analysis are provided are showcased on a daily basis.

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The Editors...

From The Dark Side of The Force...

Kamran G. Ghalitschi
Publisher
HedgeNordic

Trading financial instruments is a daily battle against highly motivated, well educated and trained counterparties at the top of their game. Being a trader means fighting against highly competitive individuals and corporations, with a plethora of information, technical and financial means, on a global playing field and in real time.

Hedge funds are often accused to be at the apex of this ruthless game. Managers are thought to let nothing get in the way of carving out an extra pip or two from the markets, treading over dead bodies en route to "delivering." Often they are portrayed as being on the dark side of The Force, and less likeable than the lightsaber swinging Darth Vader on a grumpy day.

Over the years, I have had the opportunity to interview many hedge fund managers, maybe in their hundreds. In my experience those firms that succeed are generally led by hard-working and ethical people. Do I meet the occasional (I was told not to write "prick") from time to time? Sure. But usually the crooks and liars don't last too long (though they often make for a good story!)

The hedge fund industry typically stands out as being entrepreneurial, opportunistic and fast moving towards new trends and opportunities. At the same time, we all know unfortunately, and none the least since 2008, that hedge funds do not enjoy the best of images and reputation. Being "good, caring investors" therefor seems such a reasonable and obvious route to redemption. There is plenty of academic evidence that showing being a responsible investor has a positive effect on performance. Notably pressure from investors to comply with ESG standards should be a strong incentive to do so as well. So why is the space seemingly slow and resistant to take on, and create for itself, a better ESG profile? Or are we falling into the misconception trap?

One observation I can take away from my numerous encounters with hedge fund managers, is that many of them are philanthropists. They understand the big picture. They are empathetic of the basic needs of the underprivileged. Most have acknowledged that we live on a fragile planet with limited resources. Some even care about gender equality. And yes, all these topics have an impact on financial markets, too. But more crucially, not even the smartest of them have come up with a good hedge yet for planet Earth, should it "go to zero".

Our aim was to investigate in this special report how far the hedge fund space, and individual managers have progressed in their adaption and implementation of ESG standards. In other words, we were looking for our Luke Skywalkers, Han Solos and Master Yodas. Or rather, we already knew they existed, but we didn't know how well they mastered their skills yet. Could any one of them really stand up to the challenge of the dark force?

We are pleased to having been able to span a wide range in the maturity in managers´ efforts, from early adapters active in the field for years, or decades to those taking their first steps. The hedge funds cover good breadth and depth of strategies within the universe with their unique challenges and opportunities to overcome, and be it in small steps as not all strategies are born equal overcoming their ESG-ability. Rounding it off, sophisticated institutional investors in the Nordic region who are well experienced and diligent in their ESG approach shared their views.

I am proud and pleased to introduce to you through this report our newest venture, NordSIP, the Nordic Sustainable Investment Platform and its editor in chief, Aline Reichenberg Gustafsson. I do hope you enjoy paging through this report.

... and may the force be with you!
Kamran George Ghalitschi

to a Fairy Tale

Aline Reichenberg Gustafsson
Edior-in-Chief
NordSIP

My ambition as a child was to become a fairy, with magical powers and all. The forces of evil would have no chance against me and I would be able to save the world. But by the time I got to high school, my dreams became more pragmatic. I wanted to become a journalist. Driven by my taste for writing, an unfortunate lack of imagination precluded me from aiming for a career as a fiction writer.

I would like to think that it was also my early desire to change the world for the better, which fuelled this passion for sharing my opinions.

It was most likely my father's advice that soon diverted my path. "There is always time to learn how to write", he said as I was choosing which degree pursue, "but first you must get to know the mechanisms of the world you will be writing about. For that, you should study economics." And so I did. I optimised preference functions under constraints, analysed comparative advantages and discovered the efficient frontier in portfolio theory. This led me to apply for a position as a financial analyst after graduation. Wasn't it the best way to combine my taste for reporting and my newly acquired quantitative skills?

I had the opportunity to revisit my long-term goals while doing my MBA at Harvard Business School a few years later. There we were told that we were to make a difference in the world, and be the leaders of tomorrow. How was

I to achieve such grand plans when my resume showed that all I knew was how to analyse P&Ls and publish stock recommendations? I sought a job in a hedge fund in London – I did graduate in 2007, at a time when a six-figure paying post-MBA job, in pounds (when it was still worth twice the US dollar) was making it a lot easier to repay one's business school student loan. I do remember arguing that managing a hedge fund didn't necessarily have to be a greed-is-good type of business, and that eventually, I was hoping to contribute to society with more than just money. I just didn't know how to, but I was confident that I would soon find out.

Now ten years on, a couple of hedge fund gigs, a move to Stockholm and two wonderful daughters later, destiny has provided me with the opportunity to tie back with my early disposition (find a synonym). My path crossed that of Kamran, the founder of Hedge Nordic, who seemed to enjoy the few articles I wrote for him as a dilettante. As luck has it, he offered me to be the project manager of a publication on sustainable investment. I was due to give birth a month or so before the planned publication date, but it was too tempting an opportunity not to accept such an exciting challenge. I was becoming a real journalist, and within a topic that has great world-saving potential. As soon as we started to work on the subject, we realised that interest was very high across the asset management spectrum. Hence along the way, we wondered if there wasn't an important unmet need for information to be covered by more than a one-off special report. That is how we came up with the idea of NordSIP, a Nordic Sustainable Investment Platform. Our goal is to become the information link between institutional investors and managers who offer sustainable investment products, and ultimately to be a reference place for anyone involved in the field. We thereby would like to contribute and further accelerate the phenomenal trend we have observed while writing this report, by sharing ideas and connecting people within this industry. Today, I am proud to be able to take the position of Editor-in-chief at NordSIP, and I know that I am one step closer to my first ambition: to become a fairy, with magical powers and all.

Yours,
Aline Reichenberg Gustafsson

CLEAN YOUR PENSION FUND

HOW DECARBONISATION CAN HELP SOLVE A PENSION FUND'S RISK EQUATION

by Aline Reichenberg Gustafsson– NordSIP

As any finance student is taught in investment management class, a pension manager's main duties are the matching of assets' and liabilities' duration and the risk optimization for a desired level of return (or vice versa). In practice however, these seemingly obvious tasks can prove challenging. Mats Andersson, former CEO of the Swedish state pension fund AP4, describes for Hedge Nordic how carbon neutralization and implementation of sustainable investment principles in general can help a pension to apply the principles of sound textbook asset management.

"It all started with Al Gore's movie", admits Andersson. "As I watched 'An Inconvenient Truth', I wondered if it was indeed possible [that the climate was changing to such an extent] and if so, what I could do about it." Andersson concluded at first that he couldn't help; the problem had to be fixed by politics, not money management. In parallel, he started reviewing the way pension funds look at risk and time. At a large majority of pension funds worldwide, managers are evaluated based on yearly performance. The implicit incentive this practice generates does not align with the duration of a pension's liabilities, which is usually around 20 to 40 years. Assets should be invested with the same time horizon in mind. Three years ago, AP4's board gave the fund a unique strategic mandate where evaluation should be made on a 3 to 15-year time horizon. So far, outperformance against the reference portfolio was 200 bps per annum. While is too early to tell whether this can be attributed to the change in time horizon, according to Andersson it makes sense: "the less competition you have, the easier it is to generate returns", he says.

In turn, this leads to questioning annual volatility as an adequate measure of a pension fund's risk. "If we can stand volatility", Andersson proposes, "we shouldn't shy away; volatility is just a poor measure of risk for a large state pension fund." Hence the quest for a new metric. Andersson suggests to define risk where there is a possibility of permanent capital loss in the long term. And climate change is just the type of permanent capital loss a pension should care about. Encouraged by his mentor, Laszlo Szombatfalvy, author of "The Greatest Challenges of Our Time" and founder of the Global Challenges Foundation, Andersson decided to take action in 2010. His first step was to survey 10 other large pension funds worldwide to analyse how they approached these questions of risk, time horizon and climate change, but he was disappointed – volatility and one-year horizons prevailed everywhere, and no one considered climate change a relevant issue.

As a result, Andersson went to the drawing board together with his team at AP4. The easiest way was of course to take away all the oil and energy companies from the portfolios, but that represented in effect an undesirable sector bet. Instead, the team worked on a system to minimise the carbon footprint in the S&P500 in a sector-neutral manner. With the help of a consultant, Trucost, the team sorted all the companies and eliminated the worst CO2 polluters in each sector. By doing so, the carbon footprint of the S&P500 was halved without taking any directional bet, and the return was practically the same. In fact, the "decarbonised" index of 350 companies outperformed the S&P500 index by 100 bps. Consequently, the pension fund's board mandated a 50% decarbonisation of the portfolio, thereby decreasing the carbon footprint by 30%. Over 4 years, this strategy has generated an outperformance of 200 bps over the MSCI World Index. "It may be too short a period to draw any conclusions", says Andersson, "but it is certainly encouraging and we still haven't seen the carbon tax, which is expected to generate a certain outperformance".

> *"In 2006 I thought it was impossible to maintain returns while being sustainable, but it seemed acceptable to lose some money in order to be a good citizen."*

Nowadays, climate change is no longer a second thought. Policy makers have carbon footprint at the top of their agendas as everyone recognizes the systemic risk that needs to be monitored and addressed. This is especially true after the Climate conference almost exactly a year ago in Paris, where more than 190 countries have pledged to take action. At the same time as change is happening at the governmental level, institutional investors are pushed into gear. The French government for example, has made it mandatory for anyone managing money to report carbon exposure by the end of this year. "This includes anyone managing French pension money from abroad, so it becomes a global issue", underlines Andersson.

In 2014, together with the United Nations Environment Program and its Finance Initiative (UNEP FI), the Carbon Disclosure Project (CDP) as well as the French asset manager Amundi, AP4 became part of the founding team of the Portfolio Decarbonization Coalition, which committed to decarbonising USD 100bn of institutional investment worldwide. "USD 100 billion is a significant amount but it is absolutely feasible. And we hope that by reaching this target, investors can show that a different course of action is possible, where institutional investors' goals are aligned with, and support the common good," Andersson stated at the time. After 2 years, the coalition counts 26 members and USD 3.2tr AUM, of which USD 600bn will be put in decarbonized strategies.

In parallel with its environmental push, AP4 has of course invested in sustainability more broadly and taken care of

the "S" and "G" in ESG also. In fact, sustainability represents a legal pre-requisite for the Swedish state pensions. "In 2006", admits Andersson, "I thought it was impossible to maintain returns while being sustainable, but it seemed acceptable to lose some in order to be a good citizen." Now he knows better – without compromise, it is actually the fiduciary duty of the pension manager to take sustainability into account.

> *"We are definitely beyond the tipping point. Everyone, be it in private equity, long-only, hedge funds, all will have to report on sustainability going forward."*

In Europe, he believes, sustainability is taken into account more seriously than amongst institutional investors on the other side of the Atlantic, but awareness is raising there also. Sweden is definitely ahead, even if there is still a lot to improve, even at AP4. When it comes to carbon emissions, Sweden has been proactive for a long time. In the 90s already, the country introduced a carbon tax of USD 150/ton, which is substantial compared to other countries. This drove emissions down by 30% while the economy maintained a higher-than-average growth. Many Swedish companies are at the forefront when it comes to sustainability, for example with household names such as H&M and Ikea. Pension funds were late adopters in comparison, but they are catching up fast. National politicians are also ahead compared to other countries. For Andersson, there is no need for further regulation to drive the change. The push will come no matter what, also from savers. The more knowledge people have about climate change, the more they will demand to know where their money is invested. "[For institutional investors] Sustainability will become part of the core business" Andersson expects.

"We are definitely beyond the tipping point", concludes Andersson, "we moved from millions to billions and now to trillions. Everyone, be it in private equity, long-only, hedge funds, all will have to report on sustainability going forward." It may be an issue for those who are more short-term oriented, as sustainability is noise in the short-term. Pension funds will progressively be driven to have a more long-term approach as well. 95% of pensions are still evaluated on a yearly basis and they will have to think this over. For Andersson, all investors managing money with an underlying long-term interest need to find a way to align what they are doing with sustainability. "More than that", he affirms "it is a hygiene factor and an opportunity to create value at the same time."

After starting his career as a journalist at Affärsvärlden in the 80s, and becoming Head of Nordic Equities at Deutsche Bank, Mats Andersson spent his last 15 years in the pension industry, first as a Swedish Equities portfolio manager at AP3, then as CIO at Skandia Liv and finally as CEO of AP4 from 2006 until last July. Since then, he dedicates more time to the Global Challenges Foundation, whose mission is to identify and raise awareness regarding the greatest global risks and problems. One of its goals is to identify a global governance model which fits current challenges better than the existing supra-national organisations that were founded in the middle of the 20th century, when issues were different from today's.

THE MULTI-STRATEGIST'S CONUNDRUM

HOW BRUMMER & PARTNERS IS FORMALIZING RESPONSIBLE INVESTMENT FOR ITS ENTIRE FAMILY OF FUNDS

By *Aline Reichenberg Gustafsson*

In July 2016, the Swedish hedge fund group Brummer & Partners became a signatory to the United Nations Principles for Responsible Investment (UNPRI) and has thereby pledged to integrate responsible investment at the group level as well report on its progress on an annual basis. The group's business model is based on partnerships with independent investment managers.

Each investment manager is co-owned by its portfolio managers and Brummer & Partners (typically around 40% of equity). The Brummer Multi-Strategy (BMS) fund, managed and distributed by Brummer Multi-Strategy AB, also invests in the individual funds in varying proportions, depending on their expected risk-return profile and the overall allocation and composition of the BMS fund. Brummer & Partners provides the managers of the independent funds with risk control, compliance and fund administration. As a result, the formalizing of responsible investment for the group means developing a policy for Brummer & Partners, as well as the multi-strategy fund but also helping each of the independent managers to draft their own principles based on their particular investment strategies, and to apply those principles in practice. Ann-Sofie Odenberg, Head of Responsible Investment and Edward Harrison, Responsible Investment Analyst, describe their journey so far, the challenges they have faced along the way and what they believe are the key factors for successful group-wide responsible investment in practice.

> **"To include all relevant risks and opportunities in the investment analysis and decision making processes is part of the role description for a portfolio manager."**

Even if the signing of the UNPRI and the formal development of policies only date back to 2016, the actual underlying commitment to sustainability has been present at Brummer & Partners since inception. "Our mission is to offer well

“Responsible investment is more straightforward and more easily implemented for equity and credit strategies but for example macro strategies can also integrate ESG-factors into their investment analysis.”

diversified investment management and to generate competitive risk-adjusted returns to our investors”, starts Odenberg. “To include all relevant risks and opportunities in the investment analysis and decision making processes is part of the role description for a portfolio manager. However, the risks have not been labeled E, S or G but rather they have been a risk that should be analyzed such as any other risk. The decision to formalize responsible investment has been made to facilitate for investors who want to learn more about our work in this area and for us and the portfolio managers to educate ourselves and improve.”

Indeed, standards of good governance, transparency and integrity have always been important to Brummer & Partners, as exemplified by the co-founding of the Hedge Fund Standards Board (HSFB) in 2008. Hedge fund managers also become HFSB signatories when they are integrated to the Brummer & Parters group. The HFSB is an initiative aimed at creating and promoting standards of good governance, transparency, integrity and ownership practices for the hedge fund industry. Besides Brummer & Partners, founding members include 13 other major international hedge fund firms such as Man Group, Marshall Wace and Brevan Howard. It is a comply-or-explain regime and the investment managers’ report on their compliance with the standards to the HFSB on an annual basis.

One of the challenges the team faced was to overcome two major misconceptions. People unfamiliar with the concept believe that responsible investment is about exclusions and that it represents a tradeoff in terms of returns. However, as Odenberg explains, any investor whose sole purpose is financial return should take ESG factors into account. Ignoring them may cause the portfolio manager to omit risks and/or opportunities which might ultimately have a material effect on the return. As the PRI prescribe, Brummer & Partners aims to include ESG information in its investment analysis and decision-making processes, but it does not by default exclude investments in so called red-flagged companies (apart from direct investments in companies focusing on the production of controversial weapons). “There may be very good investment rationale behind going long in a red-flagged company”,


Ann-Sofie Odenberg

adds Odenberg. “An example would be a company where management is genuinely intent on dealing with the issues causing the red-flag and where the portfolio managers therefore see upside potential in the price of the shares of that company. A company with ESG issues are also typical short cases for funds with a long-short equity strategy.”

Another entrenched belief is that responsible investing can only really be applied to equity and perhaps credit strategies. One of the challenges Odenberg’s team faces is showing how all strategies can integrate responsible investment in their own way. Typically, there are fewer peers to turn to for inspiration, for example in the case of systematic strategies where investment analysis and investment decisions are made by computers and algorithms. “Some would say that responsible investment is not at all applicable to such strategies but we disagree”, says Odenberg.

“It is true”, she admits, “that responsible investment is more straightforward and more easily implemented for equity and credit strategies but for example macro strategies can also integrate ESG-factors into their investment analysis. It may be especially challenging for some strategies to take specific factors into account, but governance and building a sustainable business are relevant to all.” The traditional screening and exclusion system is indeed applicable mostly to equity and credit funds, but since the idea at Brummer & Partners is to promote a holistic decision making and risk management process, any strategy can participate. “We have tried to avoid a one-size fits all approach, which would not work for a firm like ours”, adds Harrison.

Certainly because it is so much easier to quantify, analyze and monitor ESG-


Edward Harrison

factors for equity- and credit-related strategies, investors and financial services firm that evaluate responsible investment activities tend to focus exclusively on a fund’s investments and on whether ESG considerations are well integrated into the investment decisions. For Odenberg and her team, responsible investment is more than that. “Governance”, she says “is very important to us also at the company and fund level, not only in relation to the funds’ investments, and it surprises me that governance is not fully taken into account by some investors and stakeholders when evaluating how hedge funds approach responsible investment and sustainability.”

As an example, Odenberg mentions the questionnaire her team has filled out for a financial services firm who performs an annual ranking of different pension-asset managers’ sustainability efforts. This questionnaire, she explains, only focuses on ESG integration into the funds’ analysis and decision making processes. How the different companies work to make the pension market more sustainable and client friendly, for example in relation to transparency and fee structures, is not included in their evaluation and grading of the different pension actors’ sustainability work. “That lack of holistic approach surprises me”, Odenberg comments “if you are genuinely interested in making the pension market more sustainable.”

One of the most important factors of success for the implementation of responsible investment is the buy-in from the whole organization, especially the portfolio managers and of course support from partners and top management. Resources need to be deployed internally to allow for the implementation to be carried out effectively, and to give credibility to the initiative. “Due to our joint-ownership model and the fact that many of our funds already have

“We have started to implement responsible investment and we are learning along the way as it is a continuous learning process.”

included ESG risks in their investment approach, although without explicitly labeling it as such, this was not a significant challenge”, Harrison comments. In fact, for Odenberg, the reactions in general have been more positive than expected.

Another key aspect was to get the risk management function on board. Given the independent management of the different firms, the support of the risk team, which provides risk measurement to the investment managers within the group, has been important as it performs screenings of all funds against ISS-Ethix database and includes any identified flagged investments in the risk reports submitted to portfolio managers. “The genuine interest and engagement from the risk team has been a very important success factor”, affirms Odenberg.

Two examples of funds where the responsible investment policies are already quite well developed are the long/short equity fund Bodenholm One and the fixed income relative value hedge fund Nektar. At Bodenholm for example, poor governance is an important criterion the fund uses to select its short candidates. At Nektar, ESG criteria have been used for a long time since the managers believe that ESG factors are important to assess for its macro and fixed income strategies. For them, it has been mostly a matter of formalizing the process and explaining it, so that investors see Nektar’s integration of responsible investment in a framework they are familiar with.

The development and implementation of the responsible investment work is still ongoing and is expected to be carried out intensively over the next few months. The work for Odenberg’s team is unlikely to stop any time soon thereafter. “We have started to implement responsible investment and we are learning along the way as it is a continuous learning process”, she observes. When the responsible policies for all the group fund companies will be fully developed and applied on a day to day basis, the firm will certainly become a model for others, especially when it comes to multi-strategy and for those strategies that are furthest from direct equity and credit investing. For Brummer & Partners and the team, the responsibility journey continues and the sails are fully deployed, with a well-equipped and passionate crew at the helm.

HOW TO IMPLEMENT SUSTAINABLE INVESTING – THE IPM WAY

"There are so many dimensions to take into consideration," Nydahl says. "Should PRI demand less or more from different categories of fund managers? Are our existing instruments applicable? Is a new normative idea feasible? ESG integration, yes, but into which of our investment processes, and how?

By Glenn Leaper, PhD – HedgeNordic

Offering sustainable investment is first and foremost about ensuring investors that moral values and negative externalities, as well as financial aspect, will be taken into consideration when investment decisions are made. However, these considerations should not necessarily come at the detriment of return and risk. Early on, Informed Portfolio Management (IPM), the Swedish systematic investment manager, understood the importance of minimizing the effect of ESG integration on performance.

While the firm is mostly known for its macro systematic strategy, it has also been offering long-only equity products with a sustainable profile since 2007. The firm has integrated ESG factors into the investment process thanks to a number of specifically tailored investment models. For example, IPM's investment process penalize companies that are not ESG compliant, while systematically recovering the lost exposure with the help of an optimizer, leading to a "best in class" approach rather than solely exclusions. When it comes to the risk side of the equation, the longer-term effects of sustainable investing are easier to understand. Avoiding investments with poor governance or that are environmentally damaging is likely to reduce risk in the long term. HedgeNordic sat down with IPM CEO Stefan Nydahl and Anna Frimodig, the Chair of IPM's ESG Committee, for a discussion of their unique approach to sustainable investing.

CUTTING EDGE, BUT CONTINUOUSLY IMPROVING

When it comes to its ESG policy, IPM focuses not only on performance. The firm also strives to have a positive bearing on the companies its funds invest in in terms of ESG, while complementing existing efforts in terms of Corporate Social Responsibility (CSR) through donations and other activities. Finally, it works to concurrently integrate CSR standards among the firm's own staff.

IPM's stated philosophy is to support the principle that companies have a duty to comply with international norms - even if they are not legally obliged to do so - and as a result, IPM funds categorically do not invest in companies that violate ESG norms. Since 2010, the firm is a signatory to the Principles for Responsible Investment (PRI), which provides the broad ESG assessment benchmarks by which it operates. The company is proud of its rating from PRI, but, as Nydahl emphasizes, its norms and requirements change on a yearly basis, as PRI sharpens tools of evaluation and adds new clauses, driven by reported incidents and improved information gathering in the investment space. This means IPM, too, must adapt its own tools on a continuous basis, where it can prove difficult to adopt everything at once, underscoring the importance of early and continuous engagement with both evolving norms

"The ESG effort involves constant work on integration and following the evolution of standards, which is part of its appeal."

and investors' preferences and needs. "This is a long-term commitment" says Nydahl. "It's not enough that the CEO or clients are saying [ESG is] a good idea. The ESG effort involves constant work on integration and following the evolution of standards, which is part of its appeal."

ACTIVE OWNERSHIP & INNOVATIVE TOOLS

As an Active Owner, IPM engages in direct dialogue with the companies in its investment universe that violate UN Global Compact or other well-established international guidelines and conventions. It does this through collaborative efforts, engaging through its own initiative, and with the use of an engagement service provider. Its process is based on results from the GES's Global Ethical Standard analysis model, which measures compliance with such norms as the UN Global Compact, OECD guidelines for multinationals, and ILO, environmental, human rights and weapons-related conventions. Companies failing to

Stefan Nydahl, CEO, IPM

respond to red flags are excluded from the equity funds' investment universe.

The firm's ESG policy is implemented in four main steps. First, its ESG Committee is responsible for overseeing all responsible investment efforts and for providing guidance on responsible investment. Second, the Fund maintains a Focus List of screening companies breaching UN Global Compact or other convention principles, and to verify signs of progress with compliance via its engagements. Third, it maintains an Exclude & Engage List for companies that do not respond to its engagement, where excluded companies remain so until they qualify for re-inclusion. As a forth step IPM Risk Office independently performs daily checks to ensure that the portfolios comply with ESG exclusion lists. Most importantly, "to mitigate potential lost exposure due to exclusions," Nydahl explains, "IPM has developed an optimizer that identifies and overweighs companies with similar characteristics as the excluded ones but that comply with the norms, thus applying a 'best-in-class' approach."

IPM also exercises its right to vote according to best corporate governance practices in the companies in which it holds shares. To this end, it recently announced the creation of a new website to support its ESG implementation effort, in collaboration with Institutional Shareholder Services Inc. (ISS) to communicate how it intends to vote ahead of general meetings and provide real time updates. "This brings our ESG initiative to another level as it increases the transparency towards our investors and invested companies, but also hopefully encourages others to follow our path leading to collectively promote better standards," says Frimodig.

PROS AND CONS - THE EARLIER, THE BETTER

Currently, IPM only applies its ESG methodology to long-only equity products. Naturally, IPM continuously searches for methods to integrate sustainable investing principles into its current alternative strategies. However, ESG screening makes little sense when it comes to strategies such as Global Macro that rely on assets that do not directly relate to companies, such as currencies and interest rate products. The IPM Systematic Global Macro Fund does not

> "IPM is in talks with AIMA to become an early active participant in the working group supporting this effort."

invest in commodities, which could be seen as a way to exclude all carbon-related products, but such an exclusion cannot be compared to the active approach used for its equity strategy. "It's certainly a challenge to integrate ESG when it comes to hedge funds, with a wide spectrum of specialized fund categories," says Nydahl. He believes however that IPM is well positioned to use the experience accumulated since 2007 on the equity product to also be an advocate for an increasing ESG focus within alternatives as well. There are indeed signs that hedge funds interest in ESG is picking up. In a recent initiative The Alternative Investment Management Association (AIMA), where IPM is a member of, is working with UNPRI to help develop ESG guidance for hedge funds. IPM is in talks with AIMA to become an early active participant in the working group supporting this effort.

Nydahl also thinks there is a possibility to create new alternative products that will benefit from IPM's learning curve. Evidence shows that IPM's ESG implementation has provided an upside in risk reduction: "We have shown that we can provide a portfolio that is just as competitive while simultaneously being ESG compliant – and perhaps, in the future, in the alternative space as well," adds Nydahl.

> "It's certainly a challenge to integrate ESG when it comes to hedge funds, with a wide spectrum of specialized fund categories..."

When it comes to offering new sustainable alternative investment products, IPM might have an advantage over those who have not formally implemented sustainable investing principles for as long. As previously mentioned, the PRI has become more demanding over the years, making the slope steeper for a first-time ESG implementation. Another advantage is that "we get a better feeling over time about where the focus is shifting", Frimodig says. "We know what is new and what has always been there." This allows the team to be more efficient at implementing the requirements.

IPM has also had to adapt its governance with respect to who in the organization oversees and is accountable for responsible investment and who does the actual implementation "It is hard to come in and adapt to everything ESG related at once", adds Frimodig. Initially, the firm only engaged an ESG specialist to carry the efforts, but it soon became obvious that it was not effective enough. It became a matter of thinking through the entire organization, and where and how ESG implementation affects decision-making across all its levels, including budgeting. ESG needs to be done continuously as a firm-wide project. This, they say, translates into an argument for adopting ESG as early as possible: the later companies comply with normative standards that are increasingly enforced at the broader social level, the more difficult it becomes. "There are so many dimensions to take into consideration," Nydahl says. "Should PRI demand less or more from different categories of fund managers? Are our existing instruments applicable? Is a new normative idea feasible? ESG integration, yes, but into which of our investment processes, and how? The key is to approach it not from the simplest perspective of how it can apply immediately, but from the intelligent perspective of how and why it makes sense taking all internal and extraneous factors into consideration simultaneously."

At IPM, as is clear, ESG is far from a normative burden or an infringement on potential returns. On the contrary, it represents the opportunity to rethink its strategies continuously, thereby maximizing potential and enhancing client satisfaction.

Anna Frimodig, Chair of ESG Committee, IPM

Sustainability as a factor in the management of high-yield corporate bond portfolios

by Carl Berthold and Kerrin Tansley - JAR Capital

Many investors continue to believe that inclusion of sustainability criteria costs performance and should not play a role in the decision making process. However, a cursory look at the largest defaults in history demonstrates that purely economic factors were seldom the decisive cause. In many cases weaknesses in corporate governance, poor leadership and poor risk management led to the collapse. Nevertheless, these factors rarely attract the attention of investors and analysts. Carl Berthold, portfolio manager with responsibility for sustainability and partner at the UK Investment Boutique JAR Capital, explains how important is it to consider these aspects in the selection of corporate bonds in the high yield space.

CARL BERTHOLD,
PARTNER JAR CAPITAL
PORTFOLIO MANAGER

KERRIN TANSLEY,
PARTNER JAR CAPITAL
SENIOR PORTFOLIO MANAGER

The analysis of companies using sustainability criteria not only focuses on the implementation of socially responsible and environmentally related aspects, but also has the important tasks of increasing transparency within the company and analysing the corporate culture. In particular, companies in the high yield market are mainly controlled by private owners and not listed publicly with the consequence that information availability might be of variable quality. Investors must therefore seek to increase communication with these companies and achieve effective monitoring techniques. This applies even more as these companies depend on capital markets disproportionately for their funding, a growing trend since more and more banks are forced to restrict their lending by the regulators.

The issue of sustainability is becoming increasingly important to a changing investor world. Today, worldwide, around ten trillion euros are invested taking sustainability considerations into account, a trend reinforced by an increasing global socio-political awareness. An example was the 2015 ethically motivated retreat from the South Korean conglomerate Daewoo by the heavy weight Norwegian state fund which manages 788 billion euros. Companies not willing to deal with the requirements of sustainability lock out a substantial and rapidly growing part of the capital market. It is in the economic interest of companies to take aspects of sustainability into account in their decision making process.

However, this is not the only reason why companies should take the issue seriously. According to a study by consulting firm McKinsey & Company most companies consider the greatest benefits from sustainability analysis to lie in the avoidance of reputational and legal risks and in identifying operational inefficiencies. Sustainability offers a win-win process for all concerned.

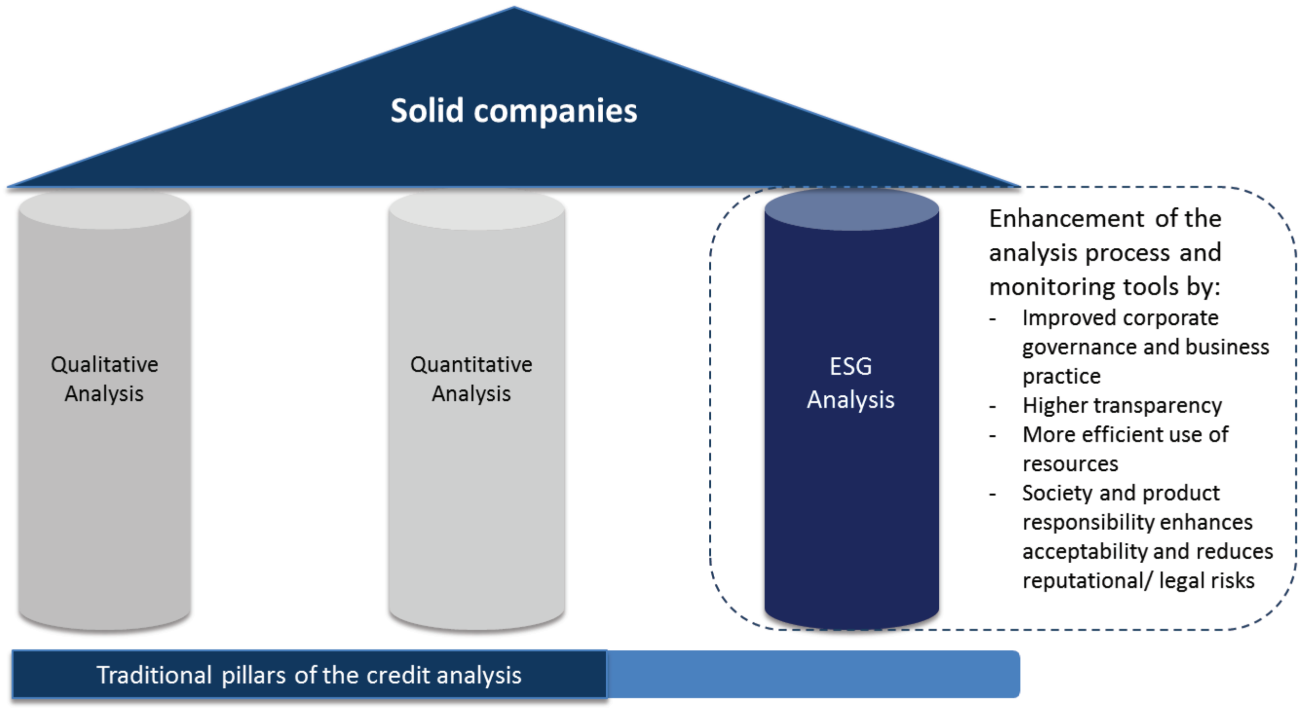
CRITERIA BEYOND THE STANDARD

To date, sustainability analysis by specialised rating agencies has been limited to countries, companies with listed equity, and companies in the investment grade space. Portfolio managers in the high-yield space therefore usually simply exclude certain industries or countries to give their products a sustainability label. We believe this kind of lip service does not go far enough. In addition to excluding certain industries and applying a norm-based screening process we co-operate with a specialised sustainability rating agency which investigates our target companies for us.

Identified issues or weaknesses, be it with environmental, safety or working condition standards, the inefficient use of resources or in the transparency and corporate governance space, are addressed on our behalf by an activist engagement company which represents asset owners of over one trillion Euros. We believe it is important not only to address weaknesses but also to contribute to possible solutions as part of the engagement investment style. JAR Capital works closely with our partner agencies to ensure that the necessary corporate information is available and that a constructive dialogue with the company's management is established. Increased transparency, stronger communication and full analysis using sustainability criteria form an additional risk management resource that can help us recognise early warning signals and avoiding negative surprises.

INVESTMENT PHILOSOPHY AT JAR CAPITAL

Enhancement of the analysis process and monitoring tools



Source: JAR Capital

EXCLUSION IN THE ABSENCE OF COOPERATION

A significant consequence is that companies refusing to increase transparency, enter into dialogue or improve addressed shortcomings have to be excluded from our investment universe. That this was rarely necessary to date clearly demonstrates that the majority of companies are aware of their social responsibility, the changes taking place in the broader investment community and customer base as well as the operational advantages. Company managers understand that ultimately their investors share their own objectives: a stable performance where negative "surprises" - from whatever direction - are avoided.

ABOUT JAR CAPITAL

JAR Capital is an Asset Management boutique headquartered in London with offices in Geneva and Gibraltar. JAR Capital specialises in the European high yield market and the senior portfolio manager, Kerrin Tansley, has a track record dating back to 1996. The management focuses on the preservation of capital and portfolios are constructed conservatively. Stressed and distressed issuers are excluded as are bank, insurance and real estate related issuers. To date, the management team has suffered no defaults. JAR Capital is believed to be the only manager in the high yield space that actively incorporates Socially Responsible Investment criteria in its investment process via an engagement process. JAR Capital is a signatory of the UN Principles of Responsible Investing (UN PRI).

THE OPTIMIZED SUSTAINABILITY QUEST

*By **Aline Reichenberg Gustafsson** - NordSIP*

WHY IT MATTERS AND WHY HEDGE FUNDS SHOULD TAKE THE LEAD

So far, hedge funds have not been particularly well known to rank high on the sustainable investing scale. For Simon Reinius, Managing Director and CIO of the Swedish-based fund-of-hedge-funds manager Optimized Portfolio Management (OPM), hedge funds can however and also should drive positive changes in ESG factors, while improving their risk-return trade-off.

The preservation of the environment has always ranked high amongst Reinius's own priorities. He obtained his first job at The Natural Step (Sw. Det Naturliga Steget), a non-profit organisation founded by Karl-Henrik Robèrt. As early as 1987, Robèrt, set the foundations of sustainability of human activities on Earth in The Natural Step Framework. Following the sustainability framework, Reinius launched svensk miljöfond (Swedish environmental fund). "I have been interested in this field for a long time," says Reinius. "You could say that I am a true believer." For him, sustainability is an important area and not only because of the responsibility we have towards the next generations. Behaving and therefore investing in an unsustainable way also represents a cost that can have imminent consequences. By way of example, Reinius gives us the emissions scandal at Volkswagen. The company had intentionally programmed certain diesel engines to show a lower NOx output during tests than they actually emitted on the road. The aftermath of this deception was an immediate 30% drop in the company's share price and the cost for the company is today estimated at more than EUR 16 billion. It is more than likely that if employees have been able to misbehave so outrageously, the company's culture allowed it, or even encouraged it. A thorough due diligence on Volkswagen

ESG factors could have highlighted such a culture and rung alarm bells thereby dissuading a potential investor to take a long position in the stock.

For Reinius, looking at the long-term consequences of human activity is crucial and not only slowing down, but start reversing the negative effects. "When you pee in the bath, slowing down is not enough. At some point you need to stop and clean the bathtub!" says Reinius, quoting Robèrt. Surprisingly, this realisation has taken a very long time for the world to come to. Some of the history of sustainability can actually be retraced to Stockholm, and the United Nations Conference on the Human Environment as far as 1972. It then took 15 years until the publication of The Brundtland Report, a.k.a. Our Common Future which inspired the founding of The Natural Step, and which outlines the necessity to consider what we today call ESG factors. Another ten years would pass until the Kyoto Protocol was adopted in 1997. Today, twenty years later, the machine is slowly starting to move. Soon everyone will have integrated in the investment process that misbehaving is bad for business. "If you don't have a good culture," extrapolates Reinius, "smart people will not come to work for you and you will have a hard time competing."

"I was surprised to see that some hedge fund managers treated sustainability like some kind of socialism. We met some hedge fund managers with absolutely no moral sense."

With Reinius at the reins, OPM has always had a focus on sustainability. The firm started implementing ethical investing principles in its hedge fund manager selection process in 2010. The team tried to find out if sustainability and ESG factors were important for the hedge fund managers at all. "At the beginning," he says, "I was surprised to see that some hedge fund managers treated sustainability like some kind of socialism. We met some hedge fund managers with absolutely no moral sense." In the past two years however, a significant change is observable. One important driver of the evolution of the Nordic hedge fund industry is Anders Ahl with the KK stiftelsen (Knowledge Foundation).

"The hedge fund managers have started caring about responsible investing beyond the need for a green stamp," Reinius comments. "We think that if hedge fund managers are not concerned about ESG factors, they probably have risks in their portfolio that they can't see." Once OPM redeemed a fund for that very reason; the fund had a different view about the risk around some of their trades. Nowadays, most of the managers Reinius meets are very interested in sustainable investing, but often more from a personal standpoint; the actual investment process does not always take ESG factors into account formally yet. OPM has also been engaging with the funds and fund managers they have invested in or are targeting to take a more proactive approach to responsible investing. Hedge fund managers should not stop at merely excluding individual stocks based on lists and rankings, but they should instead actively drive change in the companies they invest in. "If good people stay away from harmful companies", Reinius emphasises, "people with less moral sense will take control and do even more harm". In other terms, the responsibility of the investment community should not be, as it is most often the case today, to turn its back on damaging businesses, whether they are polluting, using child labour, or engaging in corruption for example, but do the opposite and become the engine of change. As a fund-of-fund manager, OPM acts mostly as a second layer and raises awareness at the hedge fund level.

In practice, OPM checks how the managers of the funds included in its portfolio fare by examining holdings disclosed in the funds' semi-annual reports, and screening them with the help of the external SRI service provider ISS-Ethix. If flagged companies show up, OPM has a conversation with the manager to determine what can be done. For hedge funds, which Reinius sees as having nimble investment processes, the decision path is often shorter than in more institutional and traditional fund management structures. As a result, the manager of the underlying fund can act immediately and communicate directly with a portfolio holding when an issue appears that rises concern in one of the ESG dimensions. Hedge funds have a great opportunity to change a company's culture and make its processes more sustainable. In larger institutional settings with more red tape, this decision could demand the approval of a committee and be more complicated. The fact that larger institutions may also have a more significant holding in the stock than a smaller hedge fund is not as important as could be intuited. A shareholder's complaint will be escalated to the CEO very swiftly nowadays, regardless of how many shares are held. Of course, this is only really valid for equity funds, and mostly for those with a longer-term approach, or strategies such as Event-Driven, where the investment thesis can depend on ESG factors.

Simon Reinius,
Managing Director and CIO, Optimized Portfolio Management

Managers of short books and trading books will likely get less involved with sustainable activism. Reinius believes that most of the time, exclusion factors are too long-term to make for effective shorts. For non-equity strategies, such as Global Macro and CTA, it is very difficult to analyse ESG factors, let alone promote any kind of involvement. That being said, OPM does not let the sustainability criteria influence its asset allocation at the detriment of expected performance. Given the current market conditions, low-beta strategies such as Global Macro and CTA are overweight compared to Event-Driven, which has no allocation in OPMs portfolios at the moment.

"It was clear that demand from both institutions and individuals is higher in Sweden. But the growth is stronger in North America, where the interest for sustainability is coming from a much lower base."

"We are a small company," says Reinius, "so we do the best we can with the resources we have". One example is the asset managers most recent fund launch, OPM Quality Companies Fund in May 2015 (global equity). This fund's goal is to identify the long-term winners, rather than merely staying away from the unethical companies. OPM Quality Companies Fund is expected to benefit from a long-term positive enhancement to returns from best-in-class companies, rather than the usual risk-reduction sought by sustainable investors in the medium term. In general, the SRI process at OPM is driven internally but external investor's interest has been growing strongly in the past few years, which gives the firm an advantage as early adopter. Interest in the Nordics is still stronger than in the rest of Europe and in the US, as illustrated at a recent conference Reinius attended in New York. "It was clear that demand from both institutions and individuals is higher in Sweden. But the growth is stronger in North America, where the interest for sustainability is coming from a much lower base." After recent debacles, such as the aforementioned Volkswagen scandal or the BP Deepwater Horizon oil spill, and investments in fossil fuels not performing as well as expected, investors have more willingly started to get onto the SRI boat. It definitely looks like the wind has finally turned. Let us hope that there will be a reason soon for more to see hedge funds investing as an effective way to make the world a better place.

> *"We were early adopters, as a hedge fund, addressing ESG-issues already in 2014. At that point, I believe we were the only Nordic hedge fund to incorporate a negative screening tool into our investment process."*
>
> ***Andreas Julin, Head of Business Development - QQM***

GOING THE EXTRA GREEN MILE

by Jonathan Furelid – HedgeNordic

Being one of the pioneers among Nordic hedge funds to adapt its investment strategy to ESG guidelines, QQM fund management announced its negative screening efforts already in 2014. Now, the market neutral fund manager aims to take the next step in becoming a truly green option in the alternative investment space by altering its cash management principles.

”We were early adopters, as a hedge fund, addressing ESG-issues already in 2014. At that point, I believe we were the only Nordic hedge fund to incorporate a negative screening tool into our investment process”, Andreas Julin, QQM's Head of Investor Relations explains when HedgeNordic meets up with the manager at their Stockholm office overlooking Hötorget.

The negative screening that Julin refers to is based on the United Nations so called ”compact list” which is a list that stems from the world´s largest corporate sustainability initiative, calling for companies to align strategies and operations with principles on human rights, labour, environment and anti-corruption.

”It was a natural step for us to incorporate these principles into our investment process. While many were talking about aligning their strategies to this initiative, we took action early on. Partly, this was a request from investors, but more importantly we wanted to show a firm commitment to these questions that we deem to be of vital future importance.”

In practice, the decision from QQM to adhere to the UN Global Compact initiative meant reviewing its current investment universe as well as making sure that future additions to the universe complied with rules set forth by the UN.

”Up until now, our process has only been focused on excluding companies that do not live up to the UN compact list requirements. For that purpose we have a cooperation in place with an outside consultant company called ISS Ethix, who are continuously updating us on the companies that we are allowed to invest in and who needs excluding. So far, the impact has been relatively limited, excluding only 1-2 percent of our total investment universe of 600 companies”, Julin explains continuing:

”The negative screening has had no negative effect on our performance and we do not foresee it to have any negative impact on our ability of generating alpha over time, rather the opposite. When we now take the next step in our ongoing work to become a truly green hedge fund alternative, the positive effects will become even more evident.”

A GREEN BOND INITIATIVE TO CASH MANAGEMENT

The next step that Julin refers to is a firm wide decision to also incorporate a positive screening with regards to ESG principles. This will be applied to the cash management part of the portfolio. ”We are bringing in green bonds to our cash management, in other words we will invest the part of the portfolio that is held in cash or cash equivalents into bonds that support sustainable projects. In doing this, we will further strengthen our ESG-profile”, Julin says.

The green bond investments will be carried through by direct investment as well as indirectly through investment grade green bond funds or through funds with a clear ESG-profile, according to Julin. He however highlights that it will not alter the risk profile of the QQM Equity Hedge program.

”As the market for green bonds has grown and investment options becoming more accessible and liquid, we have decided to shift the portfolio’s cash portion from bonds with highly rated issuers into green alternatives with a similar risk profile. We will have the same credit risk but with a profile leaned towards green projects. The investment will also hold the same duration as previously to make sure that we do not alter the fund´s risk characteristics.” Julin believes that QQM have an advantage with respect to how flexible they can be on the cash management side compared to the average hedge fund, which ultimately has given them the opportunity to bring in green bonds.

”Unlike many other long/short equity hedge funds, that in varying degrees are dependent on returns generated from cash replacement products, QQMs results are solely driven from alpha in stock selection. Without altering the return targets for the fund we can therefore easily incorporate ESG compliant investment options. Investing into highly rated green bonds would for many other funds involve taking on less credit risk and translate into lowered return targets.” For QQM there is now conflict between sustainable investing and financial ambitions.

According to Julin, the work the company has done on ESG questions during the past 2.5 years, caters for a smooth transitioning with regards to the green bond initiative and also gives credibility to QQM as a true practitioner of sustainable investment solutions.

”Employing a positive screening approach with regards to ESG investments is very rare in the hedge fund space today, even on a global scale. We were early in adopting a negative screening and see no reason for us not to continue on the same path for positive screening measures. Of course this is partly a decision that stems from increased investor demand, but we firmly believe that it will also have a positive impact on our investment work as well as having us contributing to a better future.

> *“The negative screening has had no negative effect on our performance – rather the opposite.”*

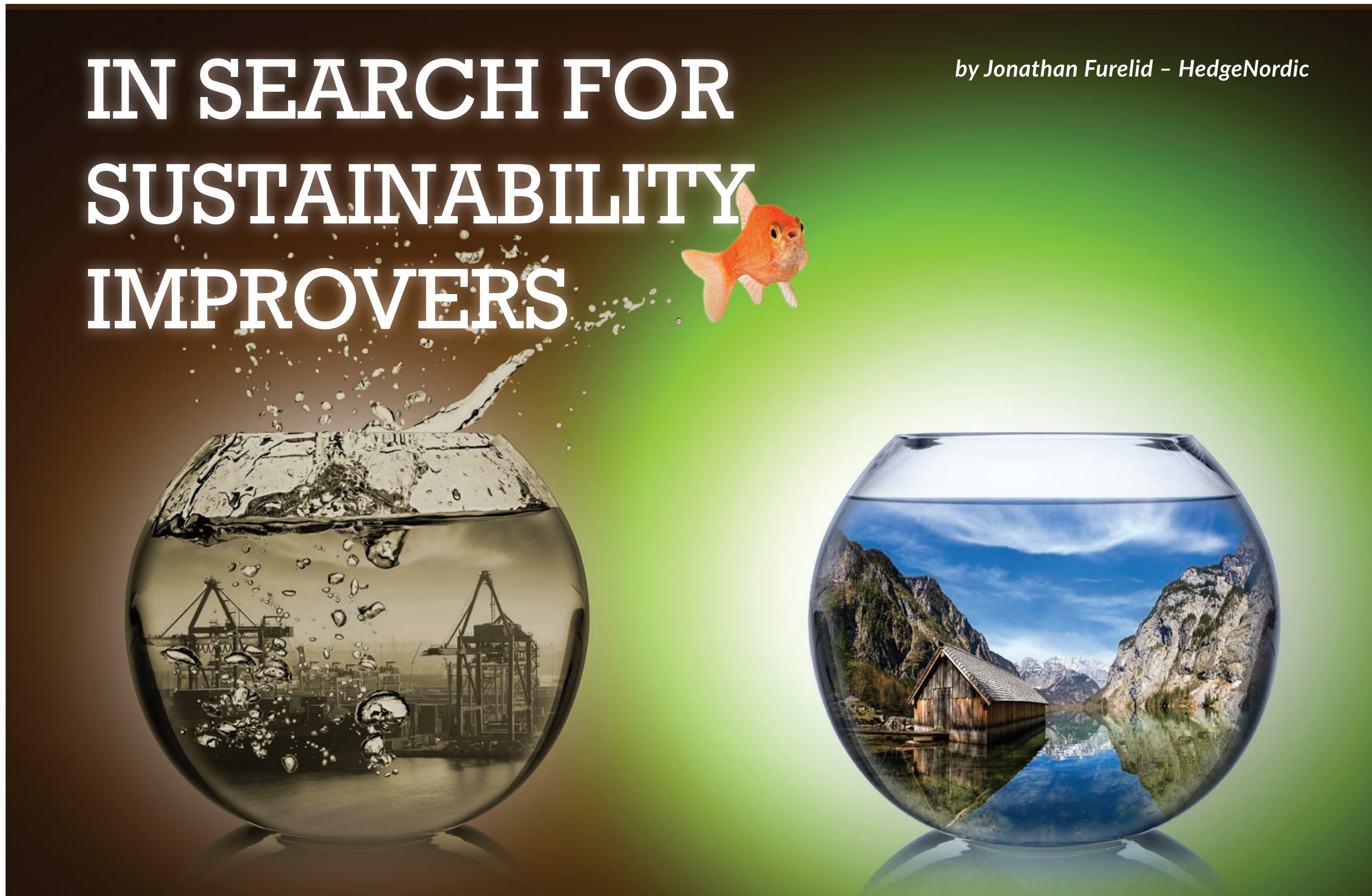
QQM’s green bond initiative is well underway and Julin foresees it will be fully implemented already this year. ”We have already made our first green bond investment and I foresee that we will have our cash positions fully transitioned in the beginning of next year.” QQM has filed a revised policy document to ISS Ethix who, as with the negative screening oversight, will be responsible for overseeing the green bond positions in the cash book. In order for the process to be discussed and reviewed on a continuous basis, QQM will also form what is referred to as an ”ESG Committee”, again with ISS Ethix as an active independent partner, ensuring an objective revision.

”The ESG Committee will be consisting of three members including an external representative as an independent consultant. This is a way for us to ensure credibility. We will have two meetings per year discussing ESG-related issues and how to work proactively to meet increased demands for sustainable investment solutions among our clients and prospective clients.” Julin also stresses that there is likely to be additional initiatives undertaken to get further recognition as an ESG compliant investment manager and that these questions will remain a top priority for the foreseeable future.

”We have yet to be PRI-certified but aim to go that route. In order to meet the increasing demand for fossil free alternative investments solutions we can already provide clients with tailor made fossil free versions of the QQM Equity Hedge in managed accounts. This said, we take environmental and social governance questions very seriously. The fact that there are climate change issues that have a direct effect on the environment surrounding us is a constant reminder that things need to be addressed, sooner rather than later.”

IN SEARCH FOR SUSTAINABILITY IMPROVERS

by Jonathan Furelid – HedgeNordic



In April 2016, Kames launched their Global Sustainable Equity Fund focusing on companies worldwide with strong sustainability characteristics. In an interview with HedgeNordic, portfolio manager Craig Bonthron and Ryan Smith, Kames’ Head of ESG Research, explain what they believe makes their investment process work differently from other funds making the sustainability claim and how that transfers into a concentrated portfolio of 35-45 truly sustainable companies with an active share of above 90 percent.

“What distinguishes our investment approach is that our approach to sustainability allows us to consider companies that may fall outside the regular ESG universe. Should we only consider companies that show the highest rankings in readily available ESG scoring systems, that would leave us with a portfolio of only the largest companies in the developed world, making it very difficult to extract alpha”, Smith says when describing how Kames approach sustainable investing in their newly launched fund.

LOOKING FOR ESG LEADERS AND IMPROVERS

When the Kames team of analysts filters out companies that they believe offer the most interesting opportunities, they make use of their 25 years of experience in managing portfolios of ethical investments and detailed governance analysis. The approach is built on fundamental bottom-up stock selection combined with a proprietary quantitative ESG screening tool that includes external ranking data from the likes of MSCI and Sustainalytics besides Kames´ own scoring system. This aims to flag companies that seem to be showing improvement when it comes to ESG, thus meriting further fundamental investigation and analysis.

> **“We aim to track the ESG improvement of these companies through time as they (hopefully) transition to ESG leaders.”**

”The process we have is built on classifying companies in one of three categories, being Sustainability leaders, Sustainability improvers or Sustainability laggards. Laggards

Craig Bonthron, Portfolio Manager

we don´t invest in, leaders and improvers we can invest in. However, to only invest in Sustainability leaders does not provide for a lot of alpha opportunities, hence our focus is on improvers. These are companies that we feel are on a journey, improving their sustainability performance. Academic studies suggest that this is the best place to invest if you want to capture sustainability alpha", Smith believes.

The fund´s portfolio manager Craig Bonthron emphasises that most sustainable investment funds focus on the leaders, leaving them with a developed market, large cap, value and often European bias. Larger companies naturally have better reporting standards when it comes to ESG, but many smaller companies have equally compelling sustainability characteristics and many sustainability solution providers are based in emerging markets.

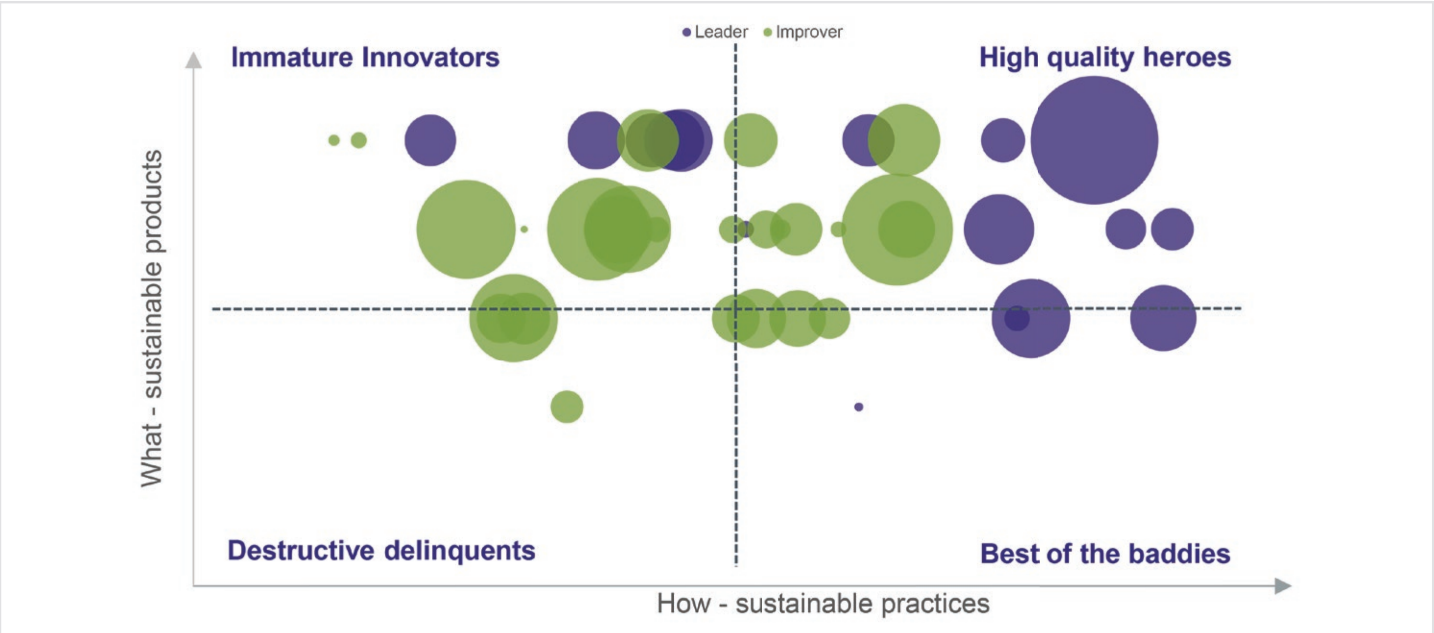
INCORPORATING SUSTAINABILITY INTO THE INVESTMENT PROCESS

When analysing companies from a sustainability perspective, Kames combine the fundamental analysis from their global equity team with proprietary quantitative ESG flagging system and detailed qualitative sustainability analysis.

> **"In order to extract alpha, we think you need to dig deeper than just looking at the ESG ratings."**

Most of Kames´ positions are focused on companies ranking highly from both the product and process perspective, so-called, "high quality heroes". Sizeable exposure is also held in companies which Kames consider to be" immature innovators" where the products rank highly from a sustainable perspective but where operational practices are sound but not best in class. "We aim to track the ESG improvement of these companies through time as they (hopefully) transition to ESG leaders" said Smith.

SUSTAINABILITY PORTFOLIO POSITIONING



INVESTMENT PROCESS IN ACTION

In describing how Kames develop investment ideas and how these ideas are turned into actual positions in sustainable companies, Bonthron mentions Mohawk, a US-based company that turns recycled plastic bottles into carpets.

"Our fundamental analysis favoured the company on the back of a strong housing market in the US combined with positive impressions from company meetings. Fundamentals also pointed to strong cost leadership and a well-managed business in a fragmented industry. From a sustainability standpoint, we ranked the company as a sustainable leader primarily because of the half a billion dollar investment Mohawk has made in its recycling plant. The company is the largest recycler of plastic bottles in the US. It's a strategy that has allowed them to reduce their exposure to oil prices and become a cost-leader in a fairly commoditized industry. Sustainability has provided them with a competitive advantage.

> **"We believe that many of the sustainability leaders of tomorrow, the immature innovators, will be companies outside of the developed world."**

Another sizeable position in the fund is the Japanese sensor manufacturer for robotic production lines, Keyence. According to Smith, this is not an obvious stock to include in a sustainable investment fund merely looking at ESG disclosures. However, Kames has identified Keyence as having very strong sustainability and governance characteristics.

"The company's products improve efficiency and the working environment for the people involved in assembly line production. At the same time the company demonstrates strong governance standards, including an independent board (relatively uncommon in Japan). Keyence also have a zero-tolerance policy for nepotism within their company, and which is another common problem in Japan", Smith says.

HOW TO CAPTURE SUSTAINABILITY ALPHA

Smith and Bonthron return to one of the things that they judge to be of upmost importance when talking sustainable investments but that is often overlooked - the ability to create sustainability alpha.

Ryan Smith, Head of ESG Research

"We invest with the purpose of finding companies that build their competitive advantage in-part through sustainable business models and practices as well as sustainable products. This is done on a cross sector and cross regional basis. In order to extract alpha, we think you need to dig deeper than just looking at the ESG ratings", Bonthron says.

One way Kames look to extract alpha is to focus on companies in emerging markets where ESG ratings are generally lower compared to the developed world. Sometimes one can identify significant improvements being made, where regulators are putting new ESG guidelines and corporate governance codes into action, which in turn make companies improve on their sustainability work. Given Kames´ focus on sustainability improvers, this fits well into their investment process.

"Emerging markets show a much lower number of companies having a high ESG-rank but since Hong Kong implemented their ESG guide in 2012 and Japan introduced their stewardship code in 2014, a lot has happened in terms of increased corporate regulation and standards. We believe that many of the sustainability leaders of tomorrow, the immature innovators, will be companies outside of the developed world. In order to profit from this development, now is the time to identify those improving companies and to invest accordingly", Smith concludes.

Anders Blomqvist, Atlant Fonder

PLAYING SUSTAINABILITY FROM THE LONG AND THE SHORT SIDE

by Jonathan Furelid – HedgeNordic

In May of 2016, Swedish hedge fund shop Atlant Fonder launched a new hedge fund investing only in equities and corporate bonds with a sustainable profile. Through shorting the Eurostoxx50 and using short delta option strategies against these holdings, the fund aims to be market neutral. In essence, this translates into a fund that goes long of sustainable companies and goes short the market, including companies being less highly ranked in terms of their sustainability work. Can this be an innovative way to extract alpha? HedgeNordic sat down with portfolio manager Anders Blomqvist to have him sharing some thoughts about the new fund named Atlant Responsible.

Jonathan Furelid: What is the reason behind launching a sustainable hedge fund?

Anders Blomqvist: The reason for launching a hedge fund that has a sustainability focus is twofold. On the one hand it is a result of our view that sustainable companies in the long run holds an advantage to those that ignore these issues, which also should translate in them being more profitable and in the end higher valued than non-sustainable companies. Being a hedge fund, we can play both the short and the long side of this trade, which allow us to potentially extract this valuation difference over time. On the other hand, we see a great and increased demand for fund products that embrace sustainability. By having a truly sustainable product we look to tap into this demand. Sustainable products has so far been a rare species in the hedge fund space but we cannot ignore the fact that this has become an increasingly important consideration for investors in the space.

Jonathan Furelid: How is the portfolio structured?

Anders Blomqvist: The idea behind Atlant Responsible is to be able to offer a market neutral hedge fund that invests in companies with a high sustainability rank. The long book includes companies that are selected from a European sustainability index that excludes everything that can be considered non-sustainable. This is not limited to how the companies approach environmental issues, it can also be applied to how they treat their employees and how ethical standards are structured and applied. The index includes roundabout 190 companies, so there is a large enough universe to chose from.

In order to hedge out the market risk, we use futures and options on the Eurostoxx50 index that includes some of the largest companies in Europe, not taking into account the sustainability aspect. There is an overlap in terms of companies included these indices, so essentially what the net exposure results in is a long position in sustainable companies which is hedged with an index that comprises non-sustainable or less sustainable companies. It is then the net market exposure that we can play given our view on the market.

You are using derivatives to express your overall market view, explain briefly how this is done.

Anders Blomqvist: Atlant is known for being able to efficiently express its market views through the use of futures and options. In the Responsible fund we are using options mainly to extract time value and to have a protection should the market go against us in the resulting net exposure from the long Eurostoxx Sustainability and the short Eurostoxx50 trade, which is typically marginally long.

The way we use options is that we sell volatility and collect premiums as long as volatility stays low and there are no extreme expected moves to the upside. We continuously invest part of the proceeds into put options with the purpose to be "over-hedged" on the downside if the market unexpectedly would turn extremely bearish.

> *"The idea behind Atlant Responsible is to be able to offer a market neutral hedge fund that invests in companies with a high sustainability rank."*

This strategy fares particularly well in times of low volatility and moderately rising equity markets, which has been the trend for quite some time.

The worst case scenario for this strategy is that volatility rises quickly and that this is combined with significantly rising equity markets. To some extent this move would be hedged by our long equity positions but losses from sold options would affect performance negatively. This type of market action is highly unusual as the typical pattern is that a significant rise in volatility is coupled with falling equity markets.

Jonathan Furelid: What has been your experience so far with regards to performance and exposures?

Anders Blomqvist: In order to stay true to the market neutral claim, we can only have a limited net exposure in the fund. Since inception of Atlant Responsible our net exposure has been below the 25 percent threshold of the fund´s NAV, which is in line with stated targets. Contrary to some of our other products, we cannot use a significant amount of leverage in Atlant Responsible. Our return target is 5 percent on top of the risk free rate, defined as the

> *"Sustainable products has so far been a rare species in the hedge fund space but we cannot ignore the fact that this has become an increasingly important consideration for investors in the space."*

3-month Euribor fixing, and to achieve that return to a risk that is significant lower than that of the stock market as a whole. So far we are in line with our stated return target.

In terms of market development and how our sustainable approach has played out, one reflection is that the fund tends to have relatively weaker performance in a market environment where commodity companies outperform. Since equities within the energy and mining sectors by definition holds a lower sustainability score, we tend to be short of this sector as opposed to the larger universe of European companies.

The market development post the US election worked in favour of cyclical and commodity related stocks, which played negatively into the performance of Responsible, however our positive market view as of late has had the fund recovering and as of February 2017 we are close to all-time-high levels.

Jonathan Furelid: What opportunities or threats do you see ahead?

Anders Blomqvist: Going forward we are still optimistic about the stock markets and our base case view is that Swedish stocks are poised for at least another 15 percent run this year. At the same time, statistics tell you that an imminent correction is underway in the US equity market. This could be as significant as a 20 percent drawdown, which would of course have a negative impact on European stocks as well. If this was to happen, I believe that the Responsible fund would be particularly well-suited for offering protection given its market neutral profile while being able to quickly adapt to a new market scenario through the use of options.

Atlant Responsible sector exposure and contribution to returns since inception

WHEN RETURNS ARE A QUESTION OF LIFE AND DEATH

THE ETHICS OF LIFE INSURANCE

Investing in life insurance policies can yield attractive risk-adjusted returns while procuring welcome diversification to any portfolio. Many potential investors however ask themselves if this is really ethical. In fact, it may be one of the reasons returns are still attractive in this asset class.

*by **Glenn Leaper,** PhD – HedgeNordic*

Ress Capital is a company on a mission. The Swedish fund management firm focusing on insurance-linked securities with an emphasis on the secondary market for U.S. life insurance policies is often confronted with investors' concerns about so-called "death speculation". The market itself is also accused of being unregulated, and thereby predatory towards unsuspecting individuals. Jonas Mårtenson, Ress´s CEO, is used to dispelling such myths. His arguments are clear: the market is good for the policy seller since it offers an attractive alternative. It is also regulated in 45 U.S. states.

These are clear examples of socially responsible investing. The firm's Ress Life Investments Fund, which recently surpassed the $80 million mark in investments, represents an attractive risk diversification tool for any investor looking at investments with single-digit annual volatility. Mårtenson explains that the main risk in a life insurance portfolio is longevity, which is highly uncorrelated to the general economy.

Big Questions, Rational Answers

The big question facing Ress and other life settlements fund managers was: Is life insurance investments ethically acceptable? To investigate the question in light of its own processes, Ress commissioned a study in 2013 from TrustBrand, a Swedish brand valuation firm. The study made recommendations on the basis of determining ethical questions on a philosophical basis (which can ultimately only be subjective). The findings showed that the U.S. secondary market indeed operates ethically. Ress however was encouraged to adopt a more activist stance to communicate its own ethical responsibilities. As Mårtenson explains, Ress has since stepped up to the challenge to ensure policy sellers and investors understand that there is no contradiction between ethical prerogatives and smart investing, and to be in a position to explain why.

"Buying life insurance policies is, indeed, ethically acceptable. Very much so," Mårtenson says, offering 'Mrs Smith' by way of example: "Mrs Smith is 78 years old. The beneficiaries of her life insurance will often be her children. They are now grown up and thus the original need for a life insurance policy is no longer there. The most common thing that happens is that she stops paying her premiums, after ten or twenty years, for lack of knowledge that the policy can instead be sold. As a result of no longer paying the premiums, the policy lapses, and Mrs Smith and her children lose out on years of premium payments. Sometimes Mrs Smith's insurance company will offer a 'surrender value' and allow her to cash out, but the secondary market and funds like ours pay a lot more!" Mårtenson is supported by statistics: Between 2006-2009, policy owners who sold their policies received $6.2 billion, more than ten times the total surrender value of $0.6 billion from insurance companies, according to the U.S. Governmental Accounting Office.

"The key risk is longevity, which is also indifferent to all the other risks the fund assumes, such as credit, operational, valuation and premium risk factors."

That fact alone indicates how beneficial the U.S. secondary market actually is to the consumer, Mårtenson says. If this market was to disappear, consumers would be at the mercy of insurance companies who clearly take advantage of the consumers' misinformation. Often, the policy simply lapses, where, according to the Life Insurance Settlement Association (LISA), 50% of policies lapse within 10 years. "The key is to understand that there are clearly strong economic interests against the secondary market, when ethically speaking it's actually meant to be the other way around. Allowing the consumer to sell the policy at the highest value, empowering the consumer, not the insurance companies," Mårtenson affirms. Many people may be negative around the hyperbole of 'profiting from people dying', but in effect it's actually about giving the consumer better choices while still alive. "So on whose side are those criticising this market? The consumer or the insurance company?" Mårtenson exclaims. The bottom line remains that most policies never pay out, and very few of them are sold in the secondary market, mainly for lack of awareness about the alternatives available.

The Secondary Market: Not the Wild West

"European investors don't realise that the secondary market for US life insurance policies is a regulated market. They think it's some sort of cowboy market. The fact is that this segment is highly regulated in 45 U.S. states, and the processes are highly transparent," Mårtenson emphasises. To that end, the TrustBrand report Ress commissioned was in part intended to provide answers to investors in Sweden that initially regarded the market with scepticism, which meant explaining how the secondary market actually functions:

"For example, the seller's agent shows Mrs. Smith's insurance documents, policy and premiums to a number of wholesalers, called providers – our brokers, so to speak," Mårtenson explains. "The objective now is for the insurance agent to get as high a price as possible for the seller. The agent therefore shows this to a number of buyers who bid for the policy in an auction, after which the highest bidder can buy the policy. Buyers cannot transact directly with the individual, they have to transact via regulated agents and providers. It is important to remember what this process actually looks like," Mårtenson adds. The closing process takes 2-4 months and the fund continues to pay the premiums after it has bought the policies, relieving the seller from that obligation. The fund is now the new beneficiary and receives the policy payout when 'Mrs Smith' dies.

An important aspect of Ress's investment policy is that the fund does not buy life settlements from people suffering from a terminal illness and it focuses on wealthier and relatively healthy individuals with long life expectancies. The average policy size is approximately $2 million, underlining that sellers are not powerless people incapable of making a reasonable decision, but rather the opposite: people who are in an optimal position to do so. Apart from the ethical advantage of this criteria, the fund benefits from a higher predictability; the healthier the individual, the less volatile the life expectancy. This means that the likelihood of a healthy person living 10 years for example may be higher than that of a relatively sick person living 3 years. For a sick person, the outcome is more binary and the average outcome may be less representative.

Ways And Means

The biggest risk to this investment process is the longevity of the initial policy holder, forcing Ress or any buyer of the policy to pay premiums for a longer period and delaying the payout. Determining longevity risk is therefore a crucial component. A buyer typically receives a life expectancy report from one or several medical underwriters. For example, the seller, on average age 78, has a life expectancy of 12 years until age 90. Returns are then calculated based

"Policy owners who sold their policies received $6.2 billion, more than ten times the total surrender value of $0.6 billion from insurance companies..."

on the expected benefit payment within this timeframe. If the seller lives well beyond age 90, the investor will continue paying the premiums, and the payout of the policy is of course delayed; returns will be reduced. So on average, for a number of policies he life expectancy is too short, and for others it is too long, but what actually matters is the portfolio as such.

The selection of the medical underwriter is fundamental. Based on a simple discounted cashflow calculation, one can easily understand why it is in the interest of Mrs. Smith to appear sicker than she is in reality. Therefore, Ress insists on obtaining its own life expectancy estimates from independent and trusted medical underwriters, who base their assessments more on health records and objective criteria than on patients' interviews. This gives Ress a more realistic view of the policy's expected return, which means it is also more conservative (but mostly fairer) in the valuation of its own portfolio.

"In short, the key risk is longevity, which is also indifferent to all the other risks the fund assumes, such as credit, operational, valuation and premium risk factors. To an investor looking for risk diversification alongside property, equity, fixed income bonds and so forth, this is also a good alternative opportunity to add to the portfolio, that also happens to be based on ethical premises," Mårtenson explains.

Consumer protection organizations have been very welcoming to life settlement buyers such as Ress, Mårtenson offers. Additionally, investors have become far more knowledgeable than they were in the past on the transparency of the U.S. secondary life insurance market. Ress has thus been able to communicate that it is indeed well regulated with more ease than previously. Mårtenson does acknowledge Ress needs to be even more proactive on a one-to-one basis, following a previous approach in which the issue wasn't broached with investors inclined to think of the secondary market as controversial. "We've made the decision that this is a sustainable form of investment, we think it's good for the consumer, so we therefore think we should be even more assertive about this," Mårtenson says.

Jonas Mårtenson, Ress Capital CEO & Founder

Ress is now in the process of in the process of signing the United Nations Principles of Responsible Investments (UNPRI), which it expects to have completed by early 2017. Hardened old attitudes may be hard to change, but it turns out filling the gap between subjective ethical expectations and smart investments, and exposing them as two sides of the same rational coin, is one way to do it.

Man Group's Head of Sales for EMEA, Steven Desmyter talks about Man Group's commitment to ESG across its Investment Management Businesses.

by Kamran Ghalitschi – HedgeNordic

Kamran Ghalitschi: How does Man Group currently think about ESG when it comes to its own product range within its hedge fund business?

Steven Desmyter: Man Group manages a diversified collection of alternative and long-only products across its various investment engines. While a firm-wide responsible investment committee exists to drive responsible investment policies across Man Group's investment engines, Man Group does not impose a single house view in terms of ESG application. Rather, we provide the ESG resources and tools to support and facilitate the investment decision making process from both financial and non-financial perspectives. The latter involves using our sophisticated, firm-wide technology platform to approach ESG from a systematic, fundamental or negative screening perspective. The system allows for a broad array of ESG indicators to be deployed using various data providers, including Sustainalytics and Ethix for governance and social factors, and Trucost to support our environmental analytical capabilities. External information is then supplemented with ESG work conducted by our in-house analysts. The consequence of all this is that our managers are well positioned to consider and capitalise on this information in their investment decisions.

Kamran Ghalitschi: What is the story behind ESG and Man Group? How has it evolved over time?

Steven Desmyter: Man Group has a history of participation in normative organisations and the promotion of ESG issues, as evidenced by our interactions with portfolio investments and our activities across the wider hedge fund industry. Man Group is a founding member of the Hedge Funds Standards Board, and remains a Board Member under Luke Ellis. Two of Man Group's investment managers, Man GLG and Man Numeric, are signatories to the United Nations' Principles for Responsible Investment (UNPRI). Jason Mitchell, who overseas responsible investing at Man GLG, has chaired the UNPRI's Hedge Fund Advisory Committee since 2014.

Man Group's efforts in ESG began through a focus on governance. Our commitment to active ownership can be measured by our high proxy voting activity using ISS, and by the frequency of our managers engaging on issue-specific governance matters with management teams and boards. Man Group has supplemented governance with a strong emphasis on environmental analysis, developing proprietary carbon-cost accounting systems across the firm and developing long-only strategies that identify carbon leaders and laggards.

More recently, we have adopted a firm-wide Cluster Munitions and Anti-Personnel Mines Policy developed alongside ISS-Ethix. This has involved designing the requisite procedures to ensure compliance with the Cluster Munitions Convention, including the regular monitoring and identification of companies involved in the manufacture, supply or distribution of these weapons.

Kamran Ghalitschi: Hedge funds taking note of ESG considerations is arguably a new phenomenon, what are some of the main challenges that Man Group notes?

Steven Desmyter: The integration of ESG challenges occurs at several levels, particularly for a large, multi-strategy alternative asset manager like Man Group. First, from a client perspective, one challenge stems from the fact that many investment mandates are coupled with norms- or values-based requirements. Man Group needs to understand and reconcile investor preferences - which span the pluralism of world views and normative codes - in such a way that doesn't undermine the investment manager's ability to drive returns. Since investor preferences differ widely in these areas, particularly around criteria applied in determining exclusions, we have focused on helping to tailor solutions

> **"Jason Mitchell, who overseas responsible investing at Man GLG, has chaired the UNPRI's Hedge Fund Advisory Committee since 2014."**

to best fulfil the ESG requirements of our clients. Our systems allow for reports aligned to specific regional or religious ethical codes, executive compensation schemes, governance practices, human rights violations and pollution considerations to name a few. This ensures that the great majority of our portfolios have the tools available to them to dynamically adapt to most ESG requirements.

Second, Man Group's size and breadth across asset classes means that the integration of ESG must be tailored individually to its investment strategies. As the active management component of Man Group, Man GLG will have an inherent focus on active ownership and clearer framework around which to fulfil the UNPRI's Six Principles. Other strategies like Man Group's quantitative trading programmes, represented by Man AHL, are more constrained by the very nature of their strategy in how aspirational codes like UNPRI are and the role of active ownership can be applied.

> **"Man Group's size and breadth across asset classes means that the integration of ESG must be tailored individually to its investment strategies."**

Last, the firm's size presents a challenge in that Man Group must continually ensure that its investment staff is provided with the latest ESG technology resources and guidance in responsible investing. This means a vigilant Man Group Responsible Investing ('RI') Committee, regular RI teach-ins to investment professionals and the publication of relevant leadership thought pieces.

Kamran Ghalitschi: How does ESG impact costs, recruitment and new suppliers of data?

Steven Desmyter: Man Group recognizes that the development of ESG capabilities and systems to accommodate investor preferences around norms-based screening requires significant upfront investment. Man Group's approach has been to partner with key third party data providers like Trucost and Ethix to provide data across the firm. In other instances, individual investment teams within Man Group subscribe for specifically-tailored ESG data. It's the long-term strategy for Man Group to develop a central ESG resource that aggregates data streams from several providers to produce a comprehensive ESG risk profile that can be balanced against screens that measure a portfolio's performance and risk attribution, factor sensitivity, and behavioural analytics.

Man Group always welcomes new suppliers of data, although with the caveat that new services considered must drive a higher level of ESG risk assessment rather than simply replace current providers with little value-add. The firm has generally maintained a policy where investment teams themselves are responsible for the approach and application of ESG, including team-specific headcount. The firm has generally found that investment managers and financial analysts who embed ESG factor criteria produce greater accountability and decision-making over standalone ESG analysts.

Kamran Ghalitschi: We note significant change in attitude from hedge fund managers regarding ESG. Why is this happening now? What are the main drivers of this change?

Steven Desmyter: The main reason why this movement has gathered pace in the last few years is that clients have started demanding it more. As mentioned, it is not for us to dictate a moral compass to our clients. Instead we need to ensure that we have the capabilities to effectively respond to their varied ESG views. We owe our ultimate duty to the investors who charge us with stewardship of their capital – the more they see ESG criteria as part of that stewardship, the more we will do to further those interests. Specific to

> **"As our clientele has evolved, our treatment of ESG has changed to reflect it."**

hedge funds, we note that the space has become far more institutional over the past decade. We find that pension funds, university foundations and other big institutional investors have advanced requirements related to ESG issues. As our clientele has evolved, our treatment of ESG has changed to reflect it. Last, asset owners and consultants are becoming more sophisticated in this area, particularly in the RFP process. As chair of the UNPRI Hedge Fund Advisory Committee, we are leading the work stream to develop a sophisticated Due Diligence Questionnaire template that enables investors to ask more tailored ESG questions.

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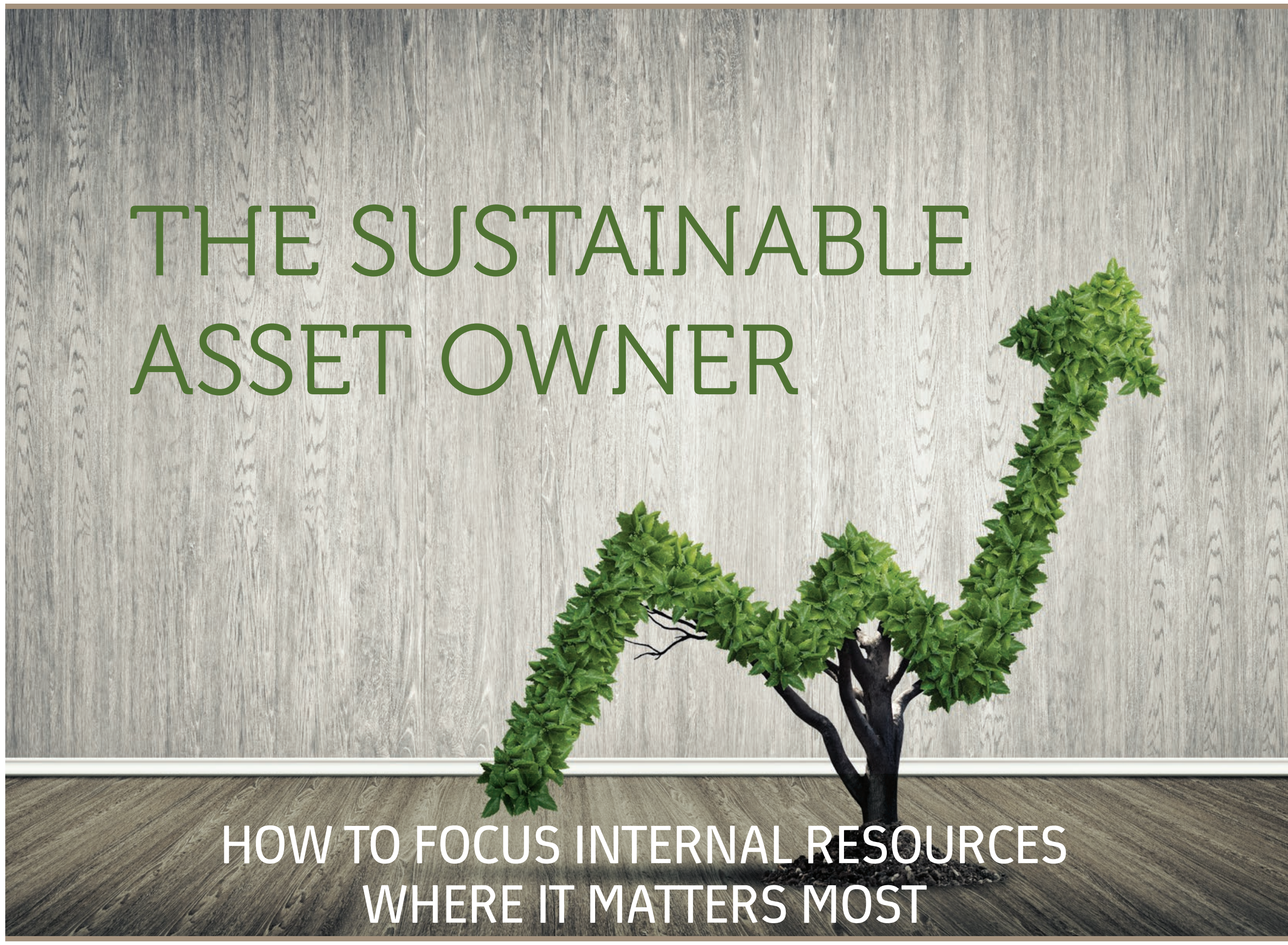

THE SUSTAINABLE ASSET OWNER

HOW TO FOCUS INTERNAL RESOURCES WHERE IT MATTERS MOST

By ***Aline Reichengerg Gustafsson***

While some investors consider sustainability a "nice to have", Folksam, one of Sweden's largest insurance companies, has chosen a more radical route. Instead of considering it an afterthought that merely complements their investment strategy, Folksam has prioritized sustainability internally while outsourcing passive investment management. Emilie Westholm, deputy head of Corporate Governance at Folksam, explains how her department operates and how stockowners can make their vote count.

Sustainably and responsible investing (SRI) has been on the agenda of Folksam since 2001. Already early on, the process was very much driven by the company's owners. The insurance company's customers are also its owners and sustainability ranks high amongst their priorities. As a result, the board, which is composed of customer representatives, including union members, has been very focused on this topic. The first steps were easy as the company excluded ethically questionable industries such as controversial weapons and tobacco from its investment universe. "To implement exclusions is easy", comments Westholm, "but the hard work is to get companies to

> **"To implement exclusions is easy, the hard work is to get companies to improve."**

improve." In other words, there is an important step between sustainable investing and responsible ownership.

Interestingly, Folksam made a decision to focus its internal resources on active ownership, a skill where the company could develop an edge. When it comes to the portfolio management of its SEK 400 billion equity portfolio, not only is the mandate passive but it is also outsourced to Swedbank Robur, one of the largest asset managers in the Nordics. Of course, the investment guidelines allow for the exclusions dictated by the SRI screening and the work of the team. The responsible investment analysis and monitoring are performed by Folksam's team and the exclusions are reviewed every quarter and sent to the portfolio managers at Swedbank Robur.

Nowadays, exclusions are not only prescribed by a simple screening such as in the case of tobacco companies or weapons manufacturers but Folksam also takes active measures. The team considers ESG incidents as they are reported, either in the news, by NGOs or by a consultant, and then communicates with the offending companies. Interactions with companies imply letters and phone calls but also AGM participation, and even AGM resolution filing. In the case of Shell and BP, the team co-filed resolutions on climate-change strategies together with other large institutions. All the questions and company responses on ESG topics are published in the AGM report that Westholm's team writes. The AGM attendant even tweets directly from the AGM since access is not always granted to market participants that do not own at least one share. Issues are also discussed more in detail on the team's blog.

Exclusions are followed through mainly when companies do not make enough of an effort to improve as suggested. For instance, if a case of child labor is reported the team will initiate contact through a phone call, and follow up with a meeting in which they will ask for a commitment beyond the resolving of a specific incident. The violating company will be required to show how they will prevent the same issue from recurring in the future, by updating their policies and their internal structures and explaining the concrete changes they envisage. "If the companies say that it is none of their concern", Westholm adds, "we will have to take the decision to no longer own shares in the company, but it is actually unusual. Nowadays, most companies realize they have a responsibility."

As an example of exclusion, Westholm mentions Lundin Petroleum, for which human rights violations were reported in relation to their operations in Sudan and the company has not addressed them sufficiently, Folksam felt. Other examples include Ryanair and Wal-Mart for non-respect of trade-union rights. "Mining is also a sector with many exclusions, especially when too many injuries or fatalities are reported and the company doesn't take it seriously", says Westholm. More often than not companies actually respond favorably to investors' concerns on ESG factors. "When I started in 2007", she explains, "companies answered: We don't do charity! Now most people are aware of climate change and want to do something about it." In fact, a few times the persons responsible for sustainability within Swedish companies have thanked Folksam's team for their intervention at the AGMs, as it highlighted the importance of their work within the organization and helped escalate the urgency of ESG issues at the board level.

"Before, you thought you had to give something up to be responsible, but that is no longer the case. If a company handles risks within sustainability, then they also handle their other risks."

At Folksam, corporate governance means being proactive as opposed to only responsive. "In Sweden", she says, "our work is not only incident based. We sit down with the companies we own shares in on a regular basis and talk about how they can improve. It depends on where they are on their own sustainability journey. It can be about environmental issues for some, or gender issues for others. We meet with the sustainability representatives, but also with the CEO, the legal counsel or human resources when it comes to equality or human rights questions.

"Westholm's team makes a point to send a representative to every one of the 45-50 Swedish holdings, whenever scheduling allows. Increasingly, companies also spontaneously invite their investors to sustainability round tables. This openness has seen a positive trend that has accelerated in the past couple of years. At the beginning of her career at Folksam, Westholm remembers, if companies were not ready to listen and embrace the necessary changes demanded by investors, they risked to see their names in the papers. They realized that defending themselves once a scandal had broken out was difficult, so they started opening their ears more willingly, and sooner.

For its foreign holdings, Folksam mainly uses the proxy voting system when ESG-related resolutions are passed.

Emilie Westholm,
Deputy Head of Corporate Governance at Folksam

Whereas Swedish AGMs are large open meetings, it is not the case everywhere. In the US for example, all the owners regularly vote electronically by proxy. The AGM may be attended only by the CEO and the legal counsel, so it would be pointless to waste time on the trip. This being said, it is always possible to make a difference, even from afar, even electronically, and even without a large stake in the company. "It only takes one share to file a resolution", Westholm reminds us.

Despite the strong progress that has been made in the past few years in all ESG dimensions, Westholm believes that there still is room for improvement. The low-hanging fruit of environmental improvements has been or is being addressed, as it is most visible and perhaps most measurable. In addition, energy efficiency also represents immediate cost savings for companies, so resistance to change can be more easily overcome. However, Swedish companies are still often naïve when it comes to governance issues such as corruption. At the employee level, most agree that corruption is an evil notion, but when they get confronted with the situation on the ground, they may not actively oppose it, especially if the instructions from above are to get the deal done no matter what. The remedy for these behaviors is mostly information. In some instances, where corruption was discussed in forums, Westholm was positively surprised to see how engaged employees were. Clearly in specific situations or regions, business cannot profitably be conducted without corruption; but in that case, the answer may be that business should not be conducted in that part of the world at all. Skanska for example, decided to leave Russia altogether. In the end, it all comes down to money – unethical behavior has increasingly proven to be costly for companies, and therefore also for their investors. "From an investment perspective, sustainability has become synonymous with profitability", Westholm says. "Before, you thought you had to give something up to be responsible, but that is no longer the case. If a company handles risks within sustainability, then they also handle their other risks."

"It only takes one share to file a resolution."

As a result of the resource focus on corporate governance, responsible investing has always been a key aspect at Folksam but it is constantly evolving, improving and gaining in importance. As of January 2016, the Corporate Governance team was integrated to the Asset Management team and as of January 2017 the questions of sustainability was incorporated into other aspects of the investment process, such as in the case of external manager selection for alternative investments. Responsible investing is already part of the selection process, but ESG criteria and the Sustainability Development Goals in Agenda 2030 are on the way to be reinforced even further.

Lack of SRI investment funds worsens trade-off for responsible allocators

For allocators who adhere to a sustainable investment philosophy, trade-offs can be very different from those fund managers face. If everyone involved in SRI now understands that investing responsibly does not require giving up any risk-adjusted return, allocators also have to take into account other questions.

by Aline Reichenberg Gustafsson – NordSIP

Is the offering of responsibility-labelled products broad enough? Does the label adequately reflect the content? Are the measures used by portfolio managers appropriate? We sought answers from Gunnela Hahn, Head of Responsible Investments at the Church of Sweden and Christina Hillesöy, Head of Responsible Investments at Länsförsäkringar, one of Sweden's largest insurance companies.

Both institutions invest mainly through external managers and have responsible investment at heart. For the Church of Sweden, ethics have always been of great importance. Hahn, who joined in 2008, is responsible for the sustainability aspects of the organisation's investment policy, within a team of four at the financial department. Hahn's role is to ensure that her organisation is at the forefront of responsible investing. For example, she drove the divestment from oil and coal in 2008, thereby following the Church's philosophy. "We were ahead of our time", she comments, "and we were confident that it would work out well. It is important that sustainability goes hand in hand with financial return."

For Länsförsäkringar, the history of responsible investing is linked to its origins. The company is formed of 23 local insurance companies which have always been engaged with local societies on environmental and social issues. Profitability was enhanced by encouraging society to behave responsibly, thereby avoiding accidents, while preserving the environment and improving society's wellbeing simultaneously. The organisation's commitment to responsible investments has increased over time and solidified with the hiring of Hillesöy in 2014, at which point her full-time position was created and Länsförsäkringar AB became a signatory of the UN Principles for Responsible Investment (UN PRI). Her responsibility is to ensure that ESG principles are part of the manager selection process, to work with the fund managers on their own ESG process, to continuously develop Länsförsäkringar's approach to responsible investments and to engage with the companies that the organisation invests in (even when done indirectly through external managers).

> **"The real challenge was to find managers that had both good financial management skills and strong ESG principles and processes. It could be very frustrating, and it still happens sometimes."**

"On an overall basis", remembers Hillesöy, "I was warmly welcomed. No one resisted the increased focus on ESG, as it was already taken into consideration before. The real challenge was to find managers that had both good financial management skills and strong ESG principles and processes. It could be very frustrating, and it still happens sometimes." One of Hillesöy's and the External Management Selection team's goals is therefore to try and promote responsible investing amongst external fund managers, and other asset managers, in order to increase their level of ESG-proficiency and

> **“After the reputation of the hedge fund industry suffered so much from questionable ethics during the last financial crisis, ESG would offer a way to redemption.”**

the breadth of product offering. At Länsförsäkringar, the ESG side of the manager selection process is performed based on a 35-questions assessment which covers three main topics: the organisation’s committment to ESG including policies and ESG-teams, the engagement with companies, and the integration of ESG in the investment process. A score is established and reviewed annually. The team will select the managers with the best score within the relevant product category, provided that the financial performance is satisfactory. Hillesöy and the External management selection team team meet annually with the external fund managers to provide feedback and


Christina Hillesöy,
Head of Responsible Investments
at Länsförsäkringar

advice. “Many external managers are very keen on getting advice”, she says, “especially those who have not come very far yet.” “When we invest in external funds, we cannot decide which investments they should exclude”, Hillesöy explains, “but we try to persuade the managers to follow our exclusion list. We do see some fund managers implement changes, especially when it comes to controversial weapons, since it is such a big issue for many Scandinavian investors”. “We also encourage fund managers to engage directly with the companies they invest in as well as integrate ESG into their investment analysis”, she adds.

In general, Hillesöy wants to drive ESG integration within existing funds, as well as support the creation of more responsible products. Some markets in particular are not very mature, she believes, such as in the case of Emerging Market credits. Private equity has been an early mover in the alternative investment space, but there is a still room for improvement. Equity and credit products, especially in the traditional long-only developed market, have integrated ESG criteria but they can also develop further. In particular, relative managers should shift to the new indices that take ESG into account, instead of the conventional indices that include many harmful companies. In fact, it is surprising if not slightly disappointing that there are not more ETFs available that invest in these indices. Hillesöy adds that responsible investment managers across asset classes should shift towards selecting the best-ranking investments according to ESG criteria instead of merely focusing on eliminating the worst ones.

Another area where Hillesöy is surprised responsible investment has not been more integrated is the hedge fund industry. After the reputation of the hedge fund industry suffered so much from questionable ethics during the last financial crisis, she believes ESG would offer a way to redemption (no pun intended). She admits that it is currently difficult for certain strategies to find the right approach to integrate ESG investment criteria, but the hedge funds should organise themselves better, drive change and define their own standards. They should follow the example of the private equity industry has done already a few years ago. Concretely, it means forming or reinforcing committees within hedge fund trade organisations, providing guidelines and templates and promoting responsible investment across strategies.

One burning topic among investors today according to Hahn, is to measure the impact investments have on society. She welcomes this focus, since ESG is not equal to sustainability – a tobacco company can have the highest ESG scores for example. Nowadays, an increasing amount of information is available about the purported degree of sustainability of a product, but does the measurement correspond to the actual goal behind the responsible investment policy? “A fund may publish its carbon foot print”, Hahn explains, “but it could be misleading. A solar panel manufacturer will have a higher carbon footprint than a bank, which lends a lot of money to carbon-intense projects.” Those familiar with carbon-measurement terminology talk about “scopes”, which determine which emissions are being measured. Scope 1 measures the energy generated and used by the company itself. Scope 2 looks at the energy consumption the company would source from outside. These are relatively easy to measure in terms of carbon footprint. Scope 3, which is the hardest to measure but also the broadest, includes the emissions of carbon dioxide and other greenhouse gases in the whole value chain, from suppliers to the use and deposit of the end-product itself, and so on. In most sectors, Scope 3 stands for over 80% of the total emissions. As an example, Hahn explains that in the car industry, the biggest part of the carbon footprint comes from driving the cars, not from the actual production or distribution of the cars. Some talk about Scope 4, which could include the negative footprint, as in energy savings

> **“For asset managers and the financial industry in general, carbon footprint measured as it is today is a good start, as the use of numbers is a way to approach the issue that is familiar to most in this industry...”**

and increased efficiency generated by the use of end-products, such as in the case of solar panels. “Scope 3 is already difficult to measure”, Hahn says, “and scope 4 is not captured at all in carbon footprint measurements currently.”

“For asset managers and the financial industry in general, carbon footprint measured as it is today is a good start, as the use of numbers is a way to approach the issue that is familiar to most in this industry,” Hahn comments. “But it should only be the first step of a more thought through climate strategy. An in-depth analysis of the opportunities and risks in the whole value chain needs to be performed.” According to Hahn, the carbon footprint or other such simplified numerical measurements should not


Gunnela Hahn, Head of Responsible Investments at the Church of Sweden

be used to communicate with the end-investors, and it should not drive the investment selection process alone. There is a risk that an asset manager will have to abstain from investing in good companies, such as those with attractive Scope 4 scores. “People want simplified measurements, but carbon footprinting can be very misleading,” Hahn concludes.

That being said, for Hahn, the financial industry’s progress has accelerated in the SRI dimension at a somewhat surprising speed. She explains: “When we exited fossil fuel investments in 2009, not many other asset managers were moving. Today, everyone is looking at carbon as a strategy to reduce risk and find opportunities. What surprised me was that it became so big and so suddenly. Scientists have warned us about global warming for decades. Perhaps the Paris agreement was a trigger and what followed was a large snowball effect. Also, the divestment movement probably played a huge role.” As a consequence, the advantage for early movers like the Church of Sweden is that the relative performance of their de-carbonized portfolio is positive. This should serve as an example to other funds and incentivise them to accelerate the adoption of sustainable investment practices, and as Hillesöy prescribes, to be amongst the first to seek best-in-class companies in this dimension. If the trend continues the companies that are best at ESG will certainly be tomorrow’s outperformers, not only because they will be better positioned fundamentally and carry less risk, but thanks to the inexorable shift of the financial industry into more sustainable investments.

SUSTAINABILITY INTEGRATION: THE CHALLENGE THAT REMAINS

by Nushin Kormi & Daniel Karlén

The Nordics are well-known for being leaders in sustainable business and responsible business practices. Images of an engaged society with socially and environmentally conscious consumers and employees, and thoughts of consumer-facing brands like H&M and industrials leaders like Atlas Copco come to mind. Outspoken corporate leaders who embrace the message that sustainable business means well performing business are not hard to find. But does this recognition flow over into investment behavior as well?

As of November 2016, 89 investment managers and 41 asset owners in the Nordics were signatories to the UN Principles for Responsible Investment (UN PRI).[1]

It is clear that the Nordic investor community has made a commitment to responsible investment. But the process of integrating environmental, social, and governance (ESG) data into investment decision making processes and having it improve performance has proven to be difficult. Most are still grappling with how to thoughtfully incorporate ESG considerations into their investment decisions. To move from commitment to integration, managers must have access to relevant information, know how to use that information, determine the best way to include the information into the investment process, gain internal buy-in such that the information is additive to an investment decision, and communicate the effectiveness of their integration to stakeholders.

THE PERFORMANCE – SUSTAINABILITY TRADE OFF IS A DATED MYTH

A commonly and long-held belief has been that if a company makes a decision that is beneficial for the customer, community, society, employees, or the environment, then it must pay a price and therefore hurt its bottom line. In other words, one must trade profitability or investment performance for sustainability. The research demonstrates that this, in fact, is not accurate.

Morgan Stanley's Institute for Sustainable Investing published a report in which they analyzed several studies on sustainable investment performance and performance data on 10,228 open-end mutual funds and 2,874 Separately Managed Accounts in the United States. They concluded that investing in sustainability typically met, and often surpassed, the performance of comparable traditional investments, both on an absolute and a risk-adjusted basis, across asset classes and over time.[2]

Similarly, the University of Oxford and Arabesque Partners published a meta-study using over 200 sources that found a correlation between diligent sustainability business practices and economic performance. They learned that 88% of the sources they reviewed found that companies with robust sustainability practices demonstrate better operational performance, and 80% of the sources they reviewed found that companies with strong sustainability practices have a positive influence on investment performance. 90% of the studies showed that sensible sustainability practices lower the cost of capital.

GOOD MANAGEMENT BREEDS GOOD BUSINESS

Past performance does not guarantee future results. We have all heard this many times and yet we tend to look retrospectively when trying to predict future performance. We then layer on a plethora of assumptions about the future operations of a company in an attempt to hone in on its value and possibly its future performance. But to truly understand a company and its likelihood of success, it is essential to evaluate its management. A company's management will dictate how the company reacts to risks and how it seizes opportunities. Strong investors know that good management breeds good companies. Case in point, Volkswagen. Ownership challenges, corporate culture, weak governance, lack of independent and diverse opinions and expertise, and conflicts of interest have been blamed for the diesel-emissions scandal.[3] Some argue that the scandal could have been predicted if consideration had been given to Volkswagen's structural governance issues.

Research that links a focus on sustainability, which includes attention to governance, to strong economic performance is abundant. But even if the research were not conclusive, it simply makes sense that a company that manages its ESG aspects well is likely also managing its business well. Having suitable measures in place to appropriately handle topics such as health and safety, resource consumption, employee training, and consumer safety, allows a company to operate in a manner that improves operations and reduces risk. A well-governed company is a company that can be resilient in challenging times and one that has the ability to seek and create opportunities for growth. Long-term value creation is dependent upon good management. And sustainable business is business that is long-term viable.

RISK MANAGEMENT VERSUS VALUE CREATION

Historically, sustainability has been viewed as predominantly a risk management tool. Risk management, reputation preservation, and meeting stakeholder demands ranked at the top of the list for why companies, and investors, devoted resources to sustainability.[4] The goal had been to avoid negative headlines and stakeholder scrutiny.

The tide has turned since the early days of sustainability and now companies and investors alike are beginning to look at ways to differentiate themselves. They are also recognizing that a focus on ESG can protect and create value. The opportunity set includes, amongst others, process efficiency and product innovation; trust, loyalty, and consumer perception; innovation of service offerings; logistics management; and resource management in operations.

Companies like Michelin, are reinventing their business models to meet current demands. In Michelin's case, the company is progressing from using resource-intensive and environmentally-unfriendly sources as material inputs, to tapping the world's supply of hundreds of millions of discarded tires. This decision to support the circular economy can ultimately create a recyclable tire that is leased, not sold, to consumers, and result in an innovative evolution for a traditional manufacturing company.

Nushin Kormi

The move from a focus on the risk side to a more expansive perspective on the opportunity side has brought sustainability into the executive dialogue and has made it a part of many companies' core businesses and investors' core considerations. Though risk management and reputational issues remain important drivers, the opportunity to differentiate analyses and investment decisions by methodically incorporating sustainability is gaining momentum.

SEEKING THE ELUSIVE ALPHA

In their book, "The Incredible Shrinking Alpha," Larry Swedroe and Andrew Berkin show that in the recent past only 2% of all active managers generated statistically significant alpha versus 20% of active managers who generated alpha about 20 years ago.[5] Their rationale for this trend includes alpha being converted to beta, the shift of stock ownership from less informed individuals to highly informed institutions, and an increasing amount of institutional money searching for a limited pool of unique investment opportunities.[6] So managers are faced with the reality that competition has stiffened, alpha

> "The tide has turned since the early days of sustainability and now companies and investors alike are beginning to look at ways to differentiate themselves."

is more difficult to generate, and a unique approach is what may attract the new generation of investors.

In an interview with the Swedish House of Finance's Director, Anders Anderson, Dr. Anderson discussed that one significant challenge is how best to convey relevant ESG information to consumers such that the general population can make informed decisions on investments like their pension contributions. He makes the analogy to the difficulty in conveying the impact of fees on investment performance, which he argues should be of first-order interest to the consumer. Still, it has been proven difficult to communicate this efficiently, even if many countries have tried different standards to display and simplify the effect of fees on long-term performance.

Managers who find a way to truly integrate and communicate ESG such that it is a proactive, thoughtful, business-relevant aspect of their investment strategy will stand out from the pack.

MOVING FROM COMMITMENT TO EXECUTION

Theoretically, investing responsibly in sustainable companies makes perfect sense. The research shows that investment performance can benefit from doing so. The prospect of generating alpha by identifying outperformers is real. The ability to attract more capital by demonstrating a unique investment strategy is appealing. And it seems that everyone is clamoring for ESG integration.

The struggle is how to actually integrate ESG into investment decision-making in a practical, comprehensive, and insightful manner. The first step is to define what integration means. For some managers, simply having an exclusion list that dictates which companies should not be investment targets suffices. For others, performing diligence with ESG industry-specific checklists satisfies integration. Some managers turn to ESG research providers, or have in-house staff dedicated to ESG research, as their ESG integration. And others adjust assumptions in their financial models to account for ESG considerations.

For all of the above-mentioned levels of integration, four critical components are needed to move from commitment to execution.

Daniel Karlén

1. Information: Access to relevant and comparable ESG information for a manager's investment universe is necessary. While efforts are being made to have companies report ESG data in a standardized manner, collecting ESG data on companies remains a time-intensive and challenging process. Information can be gathered by managers themselves, ESG research can be purchased from ESG research providers or procured from in-house ESG research teams, or ESG data can be obtained from ESG data providers.

2. Training and Process: Once managers have access to the appropriate information, they must know how it may relate to a company's performance, and they must incorporate it into their investment processes. There may be limitations of available historical data and associated benchmarks or the investment process may require additional analysis including qualitative due diligence. For most managers, ESG is outside of their areas of expertise. Therefore, translating data into investment analyses and opportunities is a significant hurdle that must be overcome. For this reason, some managers turn to existing ESG research rather than working through the data themselves. But this precludes managers from generating value by performing unique analyses. Managers who take the time to gain experience on what aspects of ESG are relevant to their analyses and incorporate that thinking into their investment process will reap the greatest benefits.

3. Buy-In: Generating alpha, not creating a burden. Managers have a never-ending list of priorities in managing their portfolios to generate alpha. Integration must be seen as additive and straightforward to get manager buy-in. If ESG integration is viewed as a way to improve a manager's ability to generate alpha, then its integration has a much higher likelihood of success.

4. Effective Communication: Communicating the benefits of the integrated model allows stakeholders to gain an understanding of the manager's perspective on long-term value creation. It also gives managers the opportunity to attract additional capital by informing investors who may make decisions based on how sustainable a fund's holdings are.

The Nordics have been first-movers in sustainability policies and measures, and have led the way on corporate transparency and disclosure. This has created a corporate culture that emphasizes sustainable business. The investment community has followed this path and has set forth commitments to integrate ESG considerations. And while varying degrees of integration are appropriate for different managers, incorporating information on ESG in analyses leads to a more accurate determination of long-

> "Managers who find a way to truly integrate and communicate ESG such that it is a proactive, thoughtful, business-relevant aspect of their investment strategy will stand out from the pack."

term value creation potential, allows managers to refine their analyses and to gain further knowledge on companies, and honors the commitments made to stakeholders.

About the Authors: Nushin Kormi and Daniel Karlén are founding partners at Stockholm-based consulting firm Resility. Nushin has significant international industry experience including as a Vice President at Goldman Sachs in New York where she worked across investment research, principal investing, asset management, and investment banking. Daniel has expertise in business development and change leadership. He has extensive experience working directly with operating companies on strategic direction and operational efficiency.

Resility focuses on corporate ESG research and integration of sustainability in the finance industry. Resility has established the Nordic Compass, a database of ESG data on publicly traded Nordic companies. It is the most complete Nordic-focused database for ESG data and currently holds harmonized annual ESG data on approximately 400 publicly traded Nordic companies. Resility and the Swedish House of Finance collaborate on the use of Nordic Compass ESG data for the purposes of academic research. This collaboration means there will be an increased significant impact on thought leadership in sustainability and finance.

1) UN PRI website. November 7, 2016.
2) Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies, Morgan Stanley Institute for Sustainable Investing, March 2015.
3) Boardroom politics at heart of VW scandal, Observers highlight lack of diversity, expertise and independence, Financial Times, Chris Bryant and Richard Milne, October 4, 2015.
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5) The Incredible Shrinking Alpha: And What You Can Do to Escape Its Clutches, Larry E Swedroe and Andrew L Berkin.
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CORPORATE GOVERNANCE – IN FINLAND AND THE NORDIC REGION

by Pirkko Juntunen – HedgeNordic

The Nordic region often punches above its weight when it comes to various global lifestyle and economic rankings. For its size, it also has a wide range of global companies from cars, design, furniture, technology and machinery sectors. So what makes Nordic companies successful?

Some argue that the culture of consensus-based decision making, transparency and political stability are part of the success and that this has translated into the way companies are managed. Perhaps the time has come for the world to take note of the Nordic way of corporate governance, rather than just for its design, music and flat-pack furniture.

Friederike Helfer, partner at Cevian Capital, the activist investor, is of the opinion that Finland and the other Nordics could teach the world a few things about good governance and is urging institutional investors such as pension funds to step up to the task. Talking of her experience on Nordic boards, including recently on the board of Valmet, the Finnish developer and supplier of technology and automation systems and services for the pulp, paper and energy industries, Helfer explains some of the advantages of the Nordic way.

> "The style of governance is unsurprisingly directly a reflection of the culture and in Finland this tends to be fairly monosyllabic and true to the saying of 'say what you mean and mean what you say'."

The style of governance is unsurprisingly directly a reflection of the culture and in Finland this tends to be fairly monosyllabic and true to the saying of 'say what you mean and mean what you say'. Helfer said subtlety is not understood and directness is appreciated and respected. Out of the Nordic countries Finland is the most hierarchical whereas the Swedes have more of a consensus culture with longer discussions. "Being Austrian and having worked in Switzerland most of my career I can clearly see distinct differences. The Swiss do not exaggerate and are careful with words but careful to the extent that criticism might not be heard. Germans are more direct and blunt and employees appreciate a leader that takes charge. They would be at a loss with a Swedish-consensus seeking boss," she explained.

"The first distinctive feature in the Nordics is the pronounced ownership mentality. There is a high private share ownership rate – a large majority of Swedes own shares, for instance. In addition, there is a history of "spheres" which own 15-20% of total Swedish Stock Exchange, and most of the largest companies have a large private family owner, the biggest and most well-known being the Wallenbergs", she explained.

In Finland large institutional investors such as Ilmarinen take large stakes in companies thereby making them influential owners.

Another feature is that shareholders determine the board composition directly through nomination committees. The typical Anglo-Saxon model is that boards nominate themselves. In the Nordics, the committee that nominates the board of directors is composed of the four largest shareholders in the register and the chairman of the board. "The biggest differentiator, compared to the Anglo-Saxon world is the clearer feeling of accountability of the board members. The members understand they need to report to the shareholders, rather than to the chairman and the other members," Helfer said.

She also pointed out that the CEO is an employee and not the king, as is often the case in the US, and the Nordic boards take a consensus oriented, pragmatic, meritocratic approach, creating more checks and balances.

Issues in the US, where ownership has become so dispersed that no one actually feels responsible for the long term. "Institutions tend to vote for management or vote with their feet – i.e. sell their stake. This has led to the CEOs of the companies essentially becoming and behaving like kings, even though they should actually be the first employee, but there is nobody left to control them. You read about the downside of these systems every day in the news – exploding remuneration and value-destroying acquisitions, and too much risk-taking for short term profits, as shown by the banks in the run-up to the financial crisis", she explained, adding that the shareholder activism in the US has partially developed as a counter-movement, to rebalance the system. "In Sweden, the Wallenbergs and other spheres have always acted in this counterbalancing way", she said.

"Employee representatives are from the company not from a nation-wide union aiming at achieving a greater goal rather than solving the issue at hand. "

Helfer also said that the co-determination structure is more constructive than in many other countries. "Employee representatives are from the company not from a nation-wide union aiming at achieving a greater goal rather than solving the issue at hand. A negative example is Germany, where national unions such as the IG Metall have representatives on the boards. Those representatives could actually have a very different agenda, strongly influenced by politics or decisions based on principles or ideologies", she said. She compared this with Finland and the case of lay-offs at Valmet. "It is good to have strong unions as long as it is a two-way dialogue with all the parties working for constructive solutions, which was the case at Valmet", Helfer said.

In addition, the Nordic corporate structure tends to be non-hierarchical so there is less need for 'face saving', she explained. "The boss doesn't need to have all the answers, doesn't need to be always right, so there are less ego driven fights for power in contrast to the US where the CEO is the Chairman, who is the one who rules", she said.

"The established discussion culture makes sure every voice on the table is heard. This is good for board dynamics as everybody is encouraged to speak up and importance is placed on that the board is not composed of yes-men and box tickers." she added, noting discussions do not slow down corporate decision-making.

Another reflection of society on boards is equality, even if there is still a way to go, Helfer said. Legislation has forced boards in Norway to take on more women and other countries are considering similar steps. "It is often a generational issue. I know this from my work on the Valmet board, which is a male-dominated, traditional company. The older men may think you are less qualified because of your age, not just gender. I would say it is equally hard for a man under 40 as it is for a woman in general to get heard. Being on a board can be brutal and if you are seen as less qualified it will be noticeable. You just have to be persistent and make yourself heard," she said, adding that having a strong backer, i.e. Cevian with a 14% stake in Valmet at the time, helped.

Despite the many positives, issues remain, Helfer said. "In Sweden the dual share classes enable dynasties such as the Wallenbergs to control more companies with limited amount of capital," she added.

Votes could historically be as low as 1:1000, now limited by law to 1:10. "The pro argument for ratio shares is fundamentally that it enables the company to tap international capital markets while at the same time keeping Swedish, long-term ownership and therefore continuity and oversight. Often mentioned is the example of the bad short-term hedge funds that are just in there to make a quick buck. Contra arguments are that it violates the key democratic principle of 1 share 1 vote, making all investors equal and that it protects the incumbent, implying that the incumbent is the better owner. History tells of course that this is not always the case", she explained, pointing to the recent corporate scandals showing that even the incumbents might need some oversight.

Recently Finland has had a difficult time economically but Helfer puts this down to the traditional industries, rather than corporate structures or governance. However, there are still improvements to be made on the corporate governance level too. She said one of the problems comes from the mix of political and economic interests. The Finnish government, through Solidium, is holding big stakes in listed companies. In the cases of Valmet and Metso, Solidium is holding above 10% of shares. "The conflict of interest becomes apparent in discussions whether or not Solidium should be able to invest outside Finland? Should it be able to divest stakes in important companies and who they could potentially sell to," Helfer said, adding that the current discussion focuses on what the purpose or goal of Solidium's involvement is. "It seems the pendulum is swinging more towards the political role/involvement, meaning that the government keeps a controlling stake in companies it defines as key to influence, but disposes of the rest", she noted.

"The Nordics remain a very important part and currently Cevian has about 1/3 of its AuM invested in the region. "

Cevian has its origin in the Nordics and brands itself a constructive activist as opposed to an event-driven or hostile activist investor. Its first fund, Cevian Capital I, was purely focused on the Nordics whereas the second Fund, Cevian Capital II, expanded towards other Northern European Countries, notably Germany and the UK. The Nordics remain a very important part and currently Cevian has about 1/3 of its AuM invested in the region. Cevian's disclosed investments in the Nordics include Danske Bank, Volvo Trucks, Tieto, Metso, and Valmet. The two founding partners are Swedish and have learned their nuts and bolts about investing and have developed their strategy in a Nordic corporate governance environment. Cevian aims to be the biggest minority shareholder when it takes a stake in a company, Helfer explained.

"We see ourselves as owners of companies who have rights, but also obligations to contribute to the long-term value of the company, which we do through participation in nomination committees and boards. We see our role especially in companies with fragmented ownership that actually lack a committed shareholder. Our own firms culture and our constructive interaction style has been successful", Helfer said, adding that culturally having public fights, i.e. in the media, is not the done thing in Finland.

ABOUT CEVIAN CAPITAL

Cevian Capital is the largest European activist fund at about $13bn in AUM:

- Founded by Christer Gardell and Lars Förberg in 2001
- Focused on Northern Europe: Nordics, UK and German speaking parts of Europe
- Holding a concentrated portfolio of 10-15 holdings at one point in time
- No hedging, no leverage, therefore full alignment of incentives with other investors and the company
- Taking significant minority stakes in publicly listed companies, frequently taking board seats in investee companies.
- Strategy is supported by a stable capital structure, where over 90% of the fund AuM is locked for 3 or more years on a rolling basis
- Investment team: 31 investment professionals in Stockholm, Zurich and London offices
- Current investments in the Nordics are Tieto, Metso, Volvo, Danske Bank. Previous investments include Valmet (just exited), Telia Sonera, Intrum Justitia.

Friederike Helfer - Partner

Cevian Capital

Alexander Jansson,
CEO CB Fonder

BENEFITING FROM CHANGE

Investing into the paradigm shift in energies

by Jonathan Furelid – HedgeNordic

Through its CB Save Earth Fund, Stockholm-based CB Fonder have invested into sectors poised to benefit from structural environmental changes since 2008. It is not until now that climale issues are playing into the profitability of these sectors, according to CB Fonder´s CEO Alexander Jansson.

"When we launched the fund, we had identified a number of areas that we identified as becoming beneficiaries of structural growth trends within the environmental sector. We pinpointed water, clean-tech and renewable energy as being the most interesting ones. As it turned out, these sectors were in for unexpected challenges. The financial crisis was particularly hurtful to companies within clean-tech and renewable energy", Jansson says.

As these sectors are now maturing, Jansson believes that the time has come for them to shine. At the same time, he expects water, which is a sector that has performed relatively well, to continue to grow at a stable rate.

The energy market is witnessing a regime shift, according to Jansson, where it goes from being commodity-based to technology-based, which in turn means that it goes from a situation where higher demand translates into higher prices (commodity supply being limited) to a situation where higher demand means lower prices (unlimited technological capacity).

"We have seen many technological shifts and this one is no different. As the new technology reaches around 10 percent market share this becomes a game changer for the old technology, which is being replaced. From the major technological shifts that we have experienced over time, it is obvious that these transitions are taking place at an ever increasing pace.", Jansson says.

> **"Already in 2020, wind and solar power will the cheapest sources of energy in many countries."**

He compares the trends within the environmental space to those experienced within computer hardware industry and production costs will continue to fall, despite an already steep decline, translating into lower prices. Already in 2020, wind and solar power will the cheapest sources of energy in many countries, in 2030 this will be the case for the vast majority of countries in the world.

Jansson argues that despite falling prices, the renewable energy sector in particular will benefit from improved margins going forward as the sector matures. "I expect wind and solar power to grow at steady rates with decent and improving margins over time. The Danish supplier of wind power turbines, Vestas, is a good example of a company transitioning from being close to bankruptcy to becoming an industrial growth company. Today the company has a margin of 12 percent which is in line with other companies within industrial engineering, the only difference being that Vestas is exposed to an industry with underlying structural growth. This makes the case for continued growth going forward."

Within solar power, Jansson sees a much more immature industry but with improving margins. "The solar power industry is still immature and grows too quickly to be truly interesting from an investment standpoint. But as the sector consolidates, profitability is steadily improving. In 2012, the gross margin for the sector was at 5%, in 2015 the corresponding figure was 25%. According to Jansson, there is a common misunderstanding that investing in the quickest growing sectors and markets is the best way to get the highest returns – and by that logic renewable energy should be the most interesting sector. That is not the case, he argues.

"As an investor, what you should look for is where growth is taking place structurally at a somewhat higher rate than the average. The short explanation being that companies within those sectors that are growing very quickly will be forced to make large investments into new capacity and hire more people, this eats into margins and profitability. The fastest growing companies are also making new share issues more frequently, diluting the current shareholders."

Jansson argues that the wind power sector has gone through the challenging phase with very high growth rates and has now entered a more mature phase with sustainable long-term structural growth of around 10% per annum. This makes it a much better investment case than solar power which is seeing much higher growth rates of around 30% per annum and with equities developing poorly. "We think it is more attractive to own wind power stocks currently, even though we are much more positive to solar power in the long run."

Looking at the historical development of the different sectors within the environmental space reveals that as sectors mature, they tend to converge to performing in line or better than the MSCI World Index, this has been the case for water, Jansson argues. "Water has over time performed in line with or better than the world equity index, simply due to the fact that it is a more mature sector benefiting from structural growth trends. As the clean-tech and renewable energy sectors are maturing we see them starting to show a performance pattern increasingly similar to that of the water sector".

> **"Water has over time performed in line with or better than the world equity index, simply due to the fact that it is a more mature sector benefiting from structural growth trends."**

"Going forward, we expect these three megatrends to outperform global stocks thanks to higher structural growth rates. In the current environment with interest rates of zero or even negative, the key is to find pockets of growth."

Jansson believes that the perception that the price of oil is a significant risk factor to the renewable energy space is currently being challenged. The changes in the price of oil was previously perceived as a significant risk factor for the renewable energy sector, however as the sector matured and as it went from niche to mainstream, there is today a lower sensitivity to external shocks related to the oil price. In the case of water, the sector has been more or less completely unharmed by historical oil price drops.

"For an investor seeking exposure against energy and structural growth, but who at the same time looks to hedge against poor performance of companies exposed to fossil fuels and structural decline, clean-tech and renewable energy are interesting options.", Jansson concludes.

FROM BROWN TO GREEN ENERGY:

by Aline Reichenberg Gustafsson – NordSIP

How investors can adapt their portfolios in the transition to a low-carbon economy

The world is getting hotter. The potential consequences of a mere two-degree Celsius temperature rise has not only driven diplomats to sign a historic climate change agreement, but also spurred regulators in countries around the globe into action. This rapidly evolving regulatory landscape is creating numerous opportunities for investors who are interested in capitalising on the transition to a green, low-carbon economy—without materially impacting performance. Jamie Forbes, Director Institutional Client Solutions at Russell Investments shares her thoughts about the key trends in the carbon landscape and discusses some of the challenges she faces together with her team. As a member of the Institutional Investors Group on Climate Change, Russell Investments collaborates with investors to encourage public policies, investment practices, and corporate behaviour that address long-term risks and opportunities associated with climate change and has been a signatory of the UN PRI since 2009.

Forbes starts by explaining why the de-carbonisation trend has recently started to accelerate. "With the Paris Agreement entered into force on November 4, 2016 and 129 countries who have ratified their participation to date, the transition to a low-carbon economy is well underway. This landmark agreement aiming to keep the overall increase in global temperatures to below two degrees Celsius will mean a major shift in how we produce and consume energy going forward. We expect to see greater emphasis on energy efficiency, pressure on the coal industry, and increased investment in renewable technologies like solar power, wind power, hydropower, and biofuels."

> **"Some experts believe Chinese capital has become a more important driving force behind the expansion in renewable energy capacity around the world than US policy."**

According to Forbes, the trend is similar across the globe. "Some of the world's largest carbon emitters—including the United States, Australia, and China—have already begun making headway on the de-carbonisation front. In the United States, former President Obama's Climate Action Plan saw a roll-out of specific regulatory initiatives to reduce greenhouse gas emissions and increase energy efficiency. The Australian government has set a Renewable Energy Target of 23% of expected energy generation coming from renewable sources by 2020. In addition to the over $100bn China is already investing in domestic renewable energy (more than double the US figure), China has expanded their overseas investments in green technology to more than $32bn in 2016 – a 60 percent increase on the previous year. Although Trump's presidency could undermine US commitment to enforcing the commitments made under his predecessor, even members of the Republican party are starting to make noise about a carbon tax and some experts believe Chinese capital has become a more important driving force behind the expansion in renewable energy capacity around the world than US policy. For example, five of the world's top six solar panel manufacturers are Chinese, as are five of the top 10 wind turbine manufacturers."

"Within the financial sector," Forbes adds, "the Taskforce on Climate-related Financial Disclosure (TCFD), chaired by Michael Bloomberg, recently published its final report and recommendations to push for greater transparency of climate related disclosures in corporate reporting, allowing investors to better assess the impact of climate risk on their portfolios. All these regulatory responses to climate change mean that the global energy mix will continue to gravitate away from traditional fossil fuels, or "brown" energy, and towards renewable, green energy."

For Forbes, this shift brings some risks that investors should factor into their approach to the energy sector, but also presents significant opportunities. Some of these include the risk that carbon-intensive securities will lag behind the broader market in the long term or that fossil fuel assets become 'stranded', no longer contributing to the economic viability of energy and coal mining companies, and traditional risks like illiquidity and market volatility. On the flip side, investment opportunities in this space are

> **"Investment opportunities in this space are plentiful and will only continue to grow as the world shifts to a greener economy."**

plentiful and will only continue to grow as the world shifts to a greener economy. Investors can already access carbon themed investments via public and private markets, including equity, fixed income, and alternative markets. "Green real estate, green bonds, climate-friendly companies focused on renewable energy sources, and companies with high ESG scores are all opportunities investors can capitalise on to align their portfolios with this long-term trend and reduce exposure to carbon-intensive holdings," Forbes explains.

Practically, making these opportunities available for her clients can be a challenge sometimes, Forbes admits. One of the most common challenges include availability and robustness of data, such as carbon emissions and aggregate ESG scores. "Our team spends a great deal of time", Forbes says, "ensuring we understand how the data is captured, presented, and any assumptions used to ensure we can utilise it in our investment process without unintended consequences."

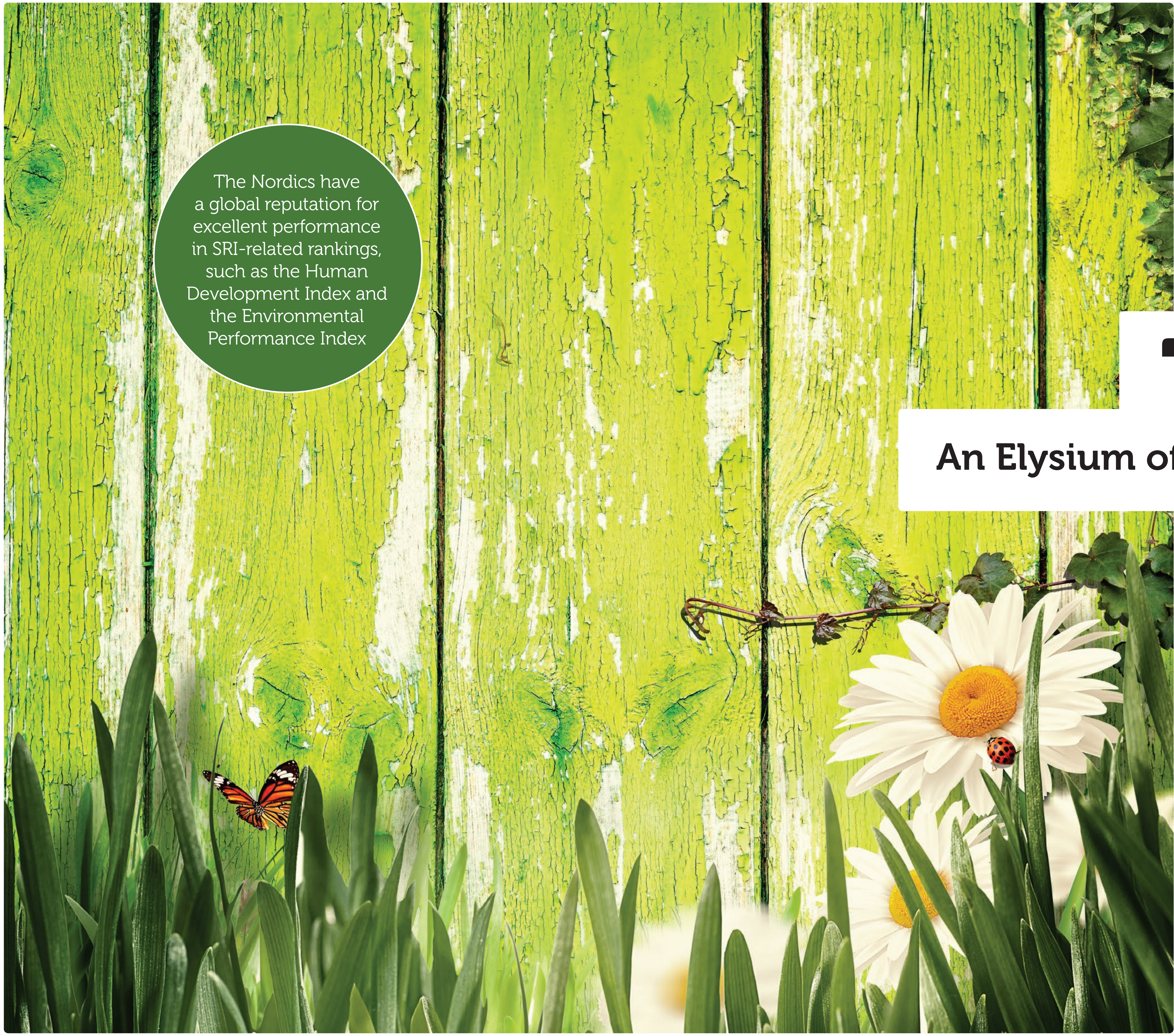
"One of the key challenges we continue to face is how to translate 'values' – some investor's unique moral or ethical beliefs – across to 'value' – sustainable investing as part of the total valuation of an investment that applies universally."

"Another one of the key challenges we continue to face", Forbes comments, "is how to translate 'values' – some investor's unique moral or ethical beliefs – across to 'value' – sustainable investing as part of the total valuation of an investment that applies universally. In terms of 'value', we endeavour for this to permeate our global investment process for all clients, but that may not always line up with some client's very specific 'values' requirements, which present us with an opportunity to customise something for their needs." Thanks to the expertise that Russell acquires from such challenges, new interesting products can be developed that can benefit other clients as well.

As an example, Forbes gives us one Australian client who started off asking Russell to take an 'avoidance' based approach to reduce carbon footprint, as well as reduce exposure to fossil fuel reserves with limited tracking error. Then a European investor challenged Forbes's team to extend this further in order to position their portfolio to also benefit from the transition to a low carbon economy. "We developed something called the 'green energy ratio'. This allowed us to identify energy generating companies who are sourcing more of their power from renewable sources. Additionally, we also consider those companies whose ESG practices (relative to their industry peers) were more advanced. The original client liked those enhancements and wanted to see them incorporated in their portfolio as soon as possible and given the strong demand we're seeing throughout Northern Europe, we are now putting this approach into fund format."

Forbes believes that this flexibility constitutes the strength of her team. "Our experience has shown that there is not a great deal of managers who can provide the same service as we do. Many of the solutions in this space started off with an index that was simply implemented by their passive manager, without a great deal of room for the manager to add much value, nor evolve the process over time without switching to a new benchmark." For her, it is key that sustainable investing is integrated throughout the entire investment process in order to truly align with the investment outcomes they're looking to achieve. "At Russell", Forbes says, "this effort is really one that permeates throughout the organisation globally, beginning with those associates who engage directly with our clients and challenge us to continually evolve our practices of sustainable investing, across to the portfolio managers who embed our understanding of how these factors impact the value we deliver to clients."

Jamie Forbes,
Director Institutional Client Solutions at Russell Investments



The Nordics have a global reputation for excellent performance in SRI-related rankings, such as the Human Development Index and the Environmental Performance Index

Sweden and Norway have long been SRI pioneers, with Denmark bringing up the rear in more recent years, and Finland having begun SRI implementation in earnest much more recently.

by Glenn Leaper, PhD – HedgeNordic

The Nordics

An Elysium of Socially Responsible Investment

With their world-renowned commitment to sustainable investment, the Nordic countries have been at the vanguard of the revolution in Socially Responsible Investment (SRI) implementation for many years, still routinely appearing atop global sustainability rankings.

This is not accidental. A strong argument can be made that the relative cultural, historical and socioeconomic homogeneity of the rump Nordic countries of Norway, Sweden, Denmark and Finland, in tandem with the strong, entrenched social welfare models in each country allowing for considerable bargaining power, power-sharing and participatory approaches, have created the favourable conditions for mutually reinforcing approaches to Corporate Social Responsibility (CSR) and, consequently, SRI. The scope of CSR has expanded across the investment universe dramatically over the years, now covering aspects of business operations as diverse as corruption in supply chains, local environmental efforts and the broadly ethical composition of portfolios. This has helped to strengthen the introduction of relatively harmonized regulatory frameworks and standards aimed at promoting and integrating Economic, Social and corporate Governance (ESG) across the Nordic region, of which SRI is an increasingly clear and vocal expression.

In many ways, the socio-historical background of the Nordics speaks for itself. Ane Jensen, Knowledge Network Manager within the Academic Network of the Principles of Responsible Investment (PRI), relates in her introduction of sustainable investment in the Nordic region (2015) how the very first ethical investment fund in the world open to the public was Sweden's AktieAnsvar Aktiefond, which was established in 1965 by the religiously motivated "temperance movement." The religious foundations of that fund provided natural screening targets for investment exclusion, such as alcohol, tobacco and firearms providers, which remain a staple of SRI screening today. The Church of Sweden was an important catalyst in the expansion of the market for SRI up until the 1980s, with the subsequent establishment of several other funds employing strategies based uniquely on humanitarian or ethical values. SRI became an additional area of concern and interest to both public and private investors throughout the 1980s and 1990s with the increasing awareness of environmental issues then sweeping the region. Investors also began to change their ethical outlook and investment prerogatives on the issue. Almost all key players in the Scandinavian market for SRI are now larger institutional investors, with religious organizations playing a smaller, if still historical, role in raising awareness.

NORDIC STATES


FINLAND


NORWAY


SWEDEN


DENMARK

The Nordics have a global reputation for excellent performance in SRI-related rankings, such as the Human Development Index and the Environmental Performance Index, with their business communities and government policies often held up as an example to other countries. In addition, Sweden, Denmark, Norway and Finland all routinely feature in RobecoSAM's annual Country Sustainability Ranking of 59 countries, which is based on 17 environmental, social and governance indicators. Norway topped the most recent 2016 iteration of the survey, providing, as the report suggests, the 'new standard in sustainability,' with Sweden and Finland in 2nd and 3rd place respectively and Denmark in 10th place. Finland, a latecomer to SRI by comparison with its Nordic peers, has also been rapidly making up the difference. The Nordics also often feature heavily in the Dow Jones Sustainability Index, alongside other leading global sustainability indices.

There are clear differences between the Nordic countries however, as exemplified in the number of signatories to UNPRI and the AuM of Responsible Investments. As per PRI and Eurosif sources, Sweden leads with the amount of PRI signatories, followed by Denmark and then Norway. By contrast, Norway leads with RI (Responsible Investing) in AUM by far , followed by Denmark and then Sweden. The differences here can partly be accounted for by the Norwegian Government Pension Fund. The world's largest sovereign wealth fund managing revenue from Norway's considerable oil ventures, which are deeply invested in RI. And as indicated by an earlier study by B. Scholtens and R. Sievänen, researchers at the University of Groningen and Helsinki respectively, differences between the Nordic countries affect the size and composition of Socially Responsible Investing (SRI) in each country respectively. Their study, "Drivers of Socially Responsible Investing: A Case Study of Four Nordic Countries," (2012) finds that particularly the factors of economic openness, the size of the pension industry, cultural values of gender equality and uncertainty avoidance can be associated with differences in SRI across the four countries. The study also found that SRI tends to be directly linked to certain actors and characteristics specific to each society, as opposed to being a general feature of the Nordic economies. By contrast, the more open the economy, the more there exists a broad basis for SRI implementation, if not a direct cause for it.

In addition, Scholtens & Sievänen find factors like the size of the pension industry in each country to be of importance. The larger the pension industry is, as in Norway, the more incentive there being for longer-run value- or norm-based investing across society. Moreover, the more gender equality is experienced in each society, as is the case in Norway and Sweden, the greater the preference for RI appears to be. Employing a general framework relating economic, financial, cultural and institutional characteristics to SRI using data from Eurosif for SRI and various sources for data from each country, on a preliminary basis Scholtens & Sievänen also found the following: Despite striking similarities in economic, social and CSR performance, the four countries differ significantly in the size and composition of SRI.

In terms of size, composition, investment categories and investment strategies, Sweden and Norway have long been SRI pioneers, with Denmark bringing up the rear in more recent years, and Finland having begun SRI implementation in earnest much more recently. Below, we summarize some of the main institutional drivers of SRI in each country and, where applicable, look at some of the bottom-up efforts from funds and hedge funds to integrate SRI.

NORWAY

The SRI market is the largest in Norway, according to Eurosif figures , where much SRI is based on norm- and value-based investment. The Norwegian Government Pension Fund contributes greatly to Norway's reputation for ethical investment strategy, as the world's largest sovereign wealth fund with an average holding of 1% in equities worldwide. Initially created in 1990 as the Petroleum Fund, it invests Norway's excess oil revenues in international stocks and bonds on behalf of the country's future pensioners. It first established ethical guidelines and appointed an advisory council on ethics in 2004. The fund has several ways in which it carries out its ethical investment strategy.

Norges Bank Investment Management (NBIM), the managers of the fund, practices active ownership through voting, filing shareholder proposals, investor expectations documents, and engaging directly with management. NBIM has six strategic focus areas within active ownership: equal treatment of shareholders, shareholder influence and board accountability, well-functioning, legitimate and efficient markets, climate change, water management and children's rights. Norway's finance ministry has the role of screening out companies that produce weapons and excluding those that may pose a risk of human rights violations,

> "Sweden was the first country to demand sustainability reports from its state-owned enterprises, which must comply with guidelines from the Global Reporting Initiative."

such as child labour, violation of individuals' rights in war or conflicts, severe environmental damages, gross corruption, other serious violations of fundamental ethical norms, and tobacco companies.

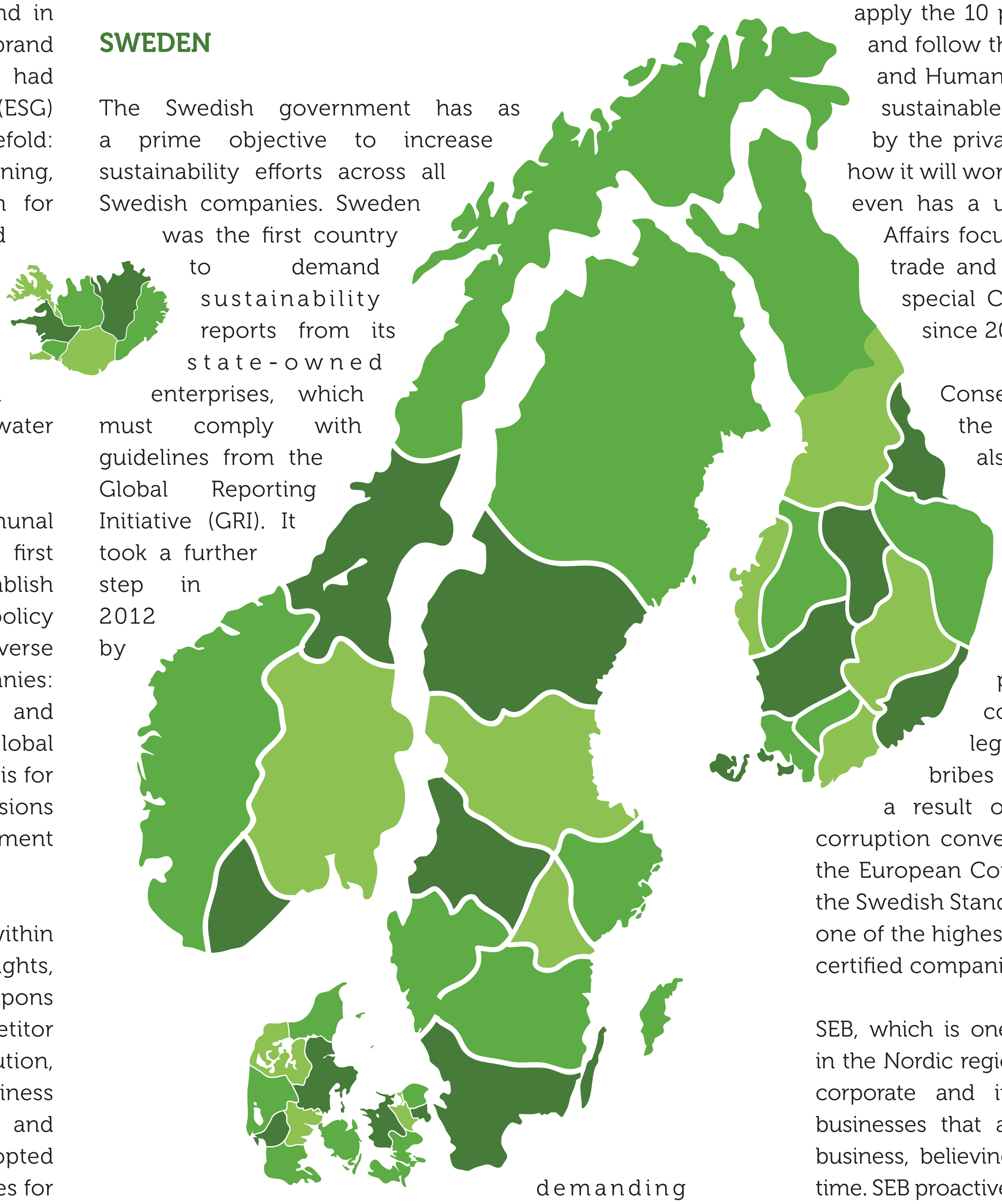
Of greater note is that Norwegian fund management industry SRI efforts since the mid-1990s predated the Government Pension Fund's ethical guidelines by nearly a decade. For example, Norwegian life insurance company Storebrand was the first fund manager in Europe to establish an environmental value fund in 1995, and later developed its own product, Storebrand Principle Funds, in 1997. By 2005, Storebrand had adopted environmental, social and governance (ESG) standards into all its funds. Its strategy is threefold: negative screening, Best in Class/positive screening, and engagement. There is a negative screen for tobacco companies, weapons producers and those that are Worst in Class (i.e. the 10% worst performers within ESG in high-risk industries, such as mining and textile). Its other means of practicing responsible investing is through active ownership in companies with breaches of human rights violations, child labour, environmental and water damage, and corruption.

Equally worthy of mention is Kommunal Landspensjonskasse (KLP), which was the first Norwegian life insurance company to establish a comprehensive ethical investment policy encompassing its entire financial investment universe in 2002. KLP uses three tools to influence companies: active ownership and engagement, exclusion, and sustainable investments. It primarily relies on the Global Ethical Standard Investment Services (GES) analysis for its engagement and exclusions, as well as decisions of the Ethical Council for the Norwegian Government Pension Fund.

It practices engagement and exclusions within the following areas: human rights, labour rights, environmental degradation, corruption, weapons production, and tobacco production. KLP competitor DnB, Norway's leading financial services institution, promotes sustainable development through business operations emphasizing environmental, ethical and social consequences. In 2008, the company adopted the Equator Principles, a voluntary set of guidelines for managing environmental and social issues in project finance. The guidelines are based on the UN Global Compact and the OECD guidelines for multinational companies, focusing on environmental considerations, human and labour rights, and corporate governance.

In addition, companies involved in the production of weapons of mass destruction, cluster bombs or anti-personnel mines are excluded, as well as companies producing tobacco and pornography.

SWEDEN



The Swedish government has as a prime objective to increase sustainability efforts across all Swedish companies. Sweden was the first country to demand sustainability reports from its state-owned enterprises, which must comply with guidelines from the Global Reporting Initiative (GRI). It took a further step in 2012 by demanding companies set sustainability goals and to report on them, but with the targets set by company boards focusing on diversity, environmental issues, human rights, working conditions, anti-corruption measures, business ethics and gender equality, with targets specifically measurable according to a company's operations. The government also expects all Swedish companies to respect human rights in all their operations, encouraging the private sector to follow OECD guidelines for multinational companies to apply the 10 principles of the UN Global Compact and follow the UN Guiding Principles on Business and Human Rights. The end objective is to have sustainable business practice driven and owned by the private sector, with each deciding if and how it will work to implement CSR. The government even has a unit within the Ministry for Foreign Affairs focusing on issues related to sustainable trade and business, and has also appointed a special CSR ambassador (Ms Diana Madunic, since 2015).

Consequently, Sweden remains one of the world's least corrupt countries, also ranking in top placements in Transparency International's Corruption Perceptions Index over consecutive years. Internally, Transparency International Sweden assesses the 20 largest companies, finding that Swedish companies perform better than international counterparts. Sweden introduced legislation in July 2012 categorising bribes of all types as serious crimes as a result of the country's adoption of anti-corruption conventions in collaboration with the EU, the European Council, the UN and OECD. In addition, the Swedish Standards Institute shows that Sweden has one of the highest per-capita levels of environmentally certified companies in the world.

SEB, which is one of the largest institutional investors in the Nordic region with SEK 1,700b in AUM for private, corporate and institutional clients, invests only in businesses that actively manage the ESG aspects of business, believing these will be more successful over time. SEB proactively supports its portfolio managers who integrate ESG factors in their investment decisions. In 2015, SEB strengthened the role of sustainability aspects in management of all major asset classes. SEB launched 2 sustainability funds in 2015 in addition to its external funds and active ownership and microfinance funds.

DENMARK

Denmark's SRI relies largely on Fixed Income-based SRI and focusing on integration and simple screening strategies. Denmark also has a high proportion of UNPRI signatories for the country's size, there being a statutory requirement from the Danish government dating from 2008 that large companies must take a position on CSR in their annual reports. This includes reporting on SRI policies, how companies translate SRI into action, and evaluations of yearly progress on SRI initiatives. The same reporting requirement has been introduced for institutional investors and investment funds, and is particularly relevant for financial companies. In addition, the Danish Council on CSR was established in 2009, comprising members across all sectors of society, and providing guidelines for SRI considerations in investment decisions per the preambles of the UNPRI.

"Denmark also has a high proportion of UNPRI signatories for the country's size, there being a statutory requirement from the Danish government dating from 2008 that large companies must take a position on CSR in their annual reports. "

Denmark's UNPRI signatories are mostly gathered in Dansif, an impartial forum for players with a substantive interest in SRI. The most recent Dansif Responsible Investment Study (December 2015) reports that (among other factors):

- 44 of the 50 largest institutional investors in Denmark have an RI policy, representing 98% of combined AUM;
- 66% of investors, representing 93% of AUM, have a specific engagement policy, up 10% from the previous survey in 2014;
- 52% of respondents confirm the responsible investment policy covers all AUM (up 11% since 2014), with 41% saying it covers the majority of AUM;

- Use of proxy voting continues to grow, with 68% of respondents casting votes on some or all listed equities, and 88% using negative screening;
- 60% confirm that a process for responsible investment in government bonds is in place, up 12% from 2014.

Among Danish hedge funds, such developments are already very much in evidence. To take but three: Nykredit Asset Management's Fixed Income Nykredit KOBRA Hedge Fund is subject to its sustainable investment policy that covers not only associations but also investment in its own funds. Nykredit's sustainable investment policy is built upon two pillars: biannual screenings against UNPRI and Global Compact principles, and the use of sustainability criteria e.g. environmental, social relations and corporate governance issues in the investment process, with increasing consideration of non-financial data such as CSR reporting in the evaluation of a company's future results.

The PFA Investment Fund follows similarly stringent policies for RI, as Denmark's largest pension fund. PFA claims its experience has already been obtaining optimal results by investing in responsible companies that meet UNPRI and Global Compact standards, partly a result of its Responsible Investment Board consisting of investment and CSR executives overseeing implementation of SRI policy and through being an active owner. Finally, Danske Invest recently announced the creation of a special Sustainable Investment fund, the Danske Invest European Corporate Sustainable Bonds fund. Corporate bonds are selected based on two criteria: a financial assessment of the company, and an evaluation of the company's sustainability efforts.

FINLAND

The government of Finland and its Ministry of Employment is committed to promoting CSR through a specially drafted CSR action plan and CSR guides for different sectors of the economy. Finland is committed to the implementation of the OECD Guidelines for Multinational Enterprises, the ILO Declaration on Fundamental Principles and Rights at Work, and the tripartite declaration of principles concerning multinational enterprises and social policy by the ILO. Finland has also joined the Extractive Industries Transparency Initiative (EITI), which supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas, and mining. Labour and environmental laws and regulations are not waived to attract or retain investments.

In Finland, the Securities Market Association established by the Central Chamber of Commerce, the Confederation of Finnish Industries (EK), and NASDAQ OMX Helsinki have developed a Finnish Corporate Governance Code for companies listed on the Helsinki Stock Exchange. In addition, with around 270 members, the Corporate Responsibility Network (FiBS), established in 2000, is the leading corporate responsibility network in Finland.

While Finland is catching up to its Nordic counterparts in terms of overall CSR implementation and scoring higher than previously in sustainability rankings on a national basis, we know relatively little about the approach of its hedge funds to ESG /SRI issues. Nevertheless, as the Helsinki Capital Partners demonstrate, it can also be a matter of a bottom-up approach: HCP considers itself an example of a small but growing company built on the idea of social responsibility, as opposed to one grudgingly adapting to emerging CSR standards. The financial industry in the country has been under much justified criticism since the financial crisis, and companies often consider CSR issues only once they reach a certain size. Typically, they are compelled to do so by legal requirements and external pressures.

It appears certain that the Nordic countries are set to remain trailblazers in the field of SRI and a clear example to other countries, not least through the precedent provided by the patient, historical provision of institutional and structural norms and the ongoing attunement to environmental and technological change and possibility. The lesson to be taken from the Nordics is, then, that the more robust and responsible the social structure is, the more freedom there is to re-conceptualize problems with solutions that benefit society at large, which in the Nordics is demonstrated by the increasingly successful marriage between environmental preservation, maximized returns on responsible investment, resulting in a healthier, happier and more industrious environment for all.

HEDGENORDIC

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