Innovation conversation

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Topic: Rightsizing - setting the ambition and commitment in sustainability

Participants:
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Agenda
Roger Urwin - Rightsizing: setting the ambition and commitment in sustainability
Chris Redmond - The evolution in WTW's manager research assessment framework

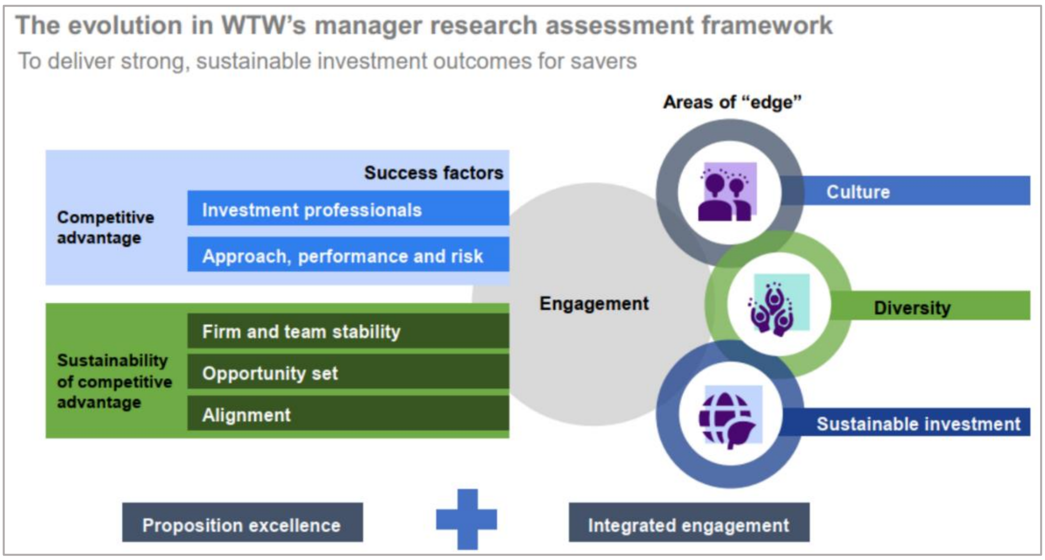
Roger Urwin – Rightsizing: setting the ambition and commitment in sustainability

- Sustainability area has reached peak busy and messy
- Organisations need to have their mission, vision and strategy on sustainability lined up, which is not currently the case due to a lot of uncertainty in this area
- Climate has become a big piece in the risk, return and real-world impact puzzle and we are focusing particularly on sustainability through the direction towards 3D investing
- Politicisation is becoming significant
- Systemic risk needs to be thought about more deeply and integrated into portfolios
- Complexity of all these issues together is becoming too difficult to deal with and requires a strategy
- The concept of rightsizing means trying to set ambition and commitment correctly sized and shaped for the unique circumstance of every fund and to make these unique circumstances count with respect to the mindset, mission, skill set, competitive edge and opportunity
- Below we set out starting principles of the rightsizing

- Often organisations are over enthusiastic with respect to sustainability, but not exploiting the opportunity enough. Positioning yourself somewhere in the middle is extremely important
- This is a difficult area to be joined up on – the number of dimensions and challenges make it challenging to have a coherent proposition running through the theme, especially for asset owners
- Having a *Theory of change* is necessary for allowing certain interventions to take place depending on circumstances and making sure that we consider all these multiple factors which would increase interconnectedness
- The delivery side of it is a lot about resourcing, but also challenges with measurement
- In addition, strategic partnership model represents different ways for asset managers to contribute more to their respective clients, starting from the point of view of the Total Portfolio Approach (TPA)
- TPA is a more complex model, but it looks superior. Asset managers are playing a bigger part in the TPA which is a contributor in a two-way flow of IP - from the asset owner to the asset manager and back to the asset owner. This creates a need for a more selective approach in relationships and creating emphasis on bigger, deeper relationships
- There are widely divergent types of views on impact investing or investing for impact in our industry. We need to develop similar ways of seeing and defining those concepts.

Chris Redmond - The evolution in WTW's manager research assessment framework

- The modifications we have incorporated into our research process reflects the evolution of what clients are asking us for, which is triggered by the challenging system-level issues and increasingly strong politicisation of those issues



- The left-hand side of the image above is our old model of looking at managers through a set of traditional financial metrics, while the right-hand side of the image shows the evolution required to deal with the organisation of tomorrow and the challenging issues of sustainability
- The engagement model in the centre represents the strategic partnerships which mean a significantly more engaged model between asset manager and asset owner
- These three critical areas are important in assessing asset managers' competitive advantages and their ability to engage directly on these topics to solve some of the key issues
- The asset owner of the future will require greater consideration of issues like sustainability, while also on traditional risk, return and asset class focus - which creates a place for greater customisation. The issue for asset managers will be to deliver all that profitably.

Discussion

- Would some sort of an organisational innovation score - which includes an assessment of whether an asset manager pushing forwards into new boundaries and, also, if they have the operational capability to support that - help your assessment frameworks? At the moment, the entire consulting industry looks at products mainly, but products today might not look like the mandates that we're running in the next several years. And so there needs to be a way to account for what an asset manager does well and score them highly for innovation and operational flexibility.
    - We feel it is not so much the mandates, but the number of relationships that matter, given there are multiple dimensions and levers that you can pull to manage the overall plan. There is a growing realisation it would be easier to have fewer local relationships and spend more time with those partners, acknowledging the complexity of the issues that people are dealing with. So we do think it is true, we should we give greater credence to those who have a track record in doing innovation well.
- Do you need to have a TPA approach to be able to do 3D investing? Can 3D be done in SAA world?
    - We are not completely disregarding SAA model, but we suggest that 3D works better with TPA approach. It enables the total portfolio thinking that is necessary with respect to the sustainability impact piece.
- What is your biggest challenge in assessing the softness of diversity?
    - Diversity can never be fully captured by quantitative metrics and regulators make that impossible also. So, with diversity we need to leverage many kinds of factors and pieces of information, it's a combination of quantitative and qualitative, a balanced scorecard type of model. It's not easy, but it's doable.
- Most mandates currently still make reference to SAA tracking error, have Alpha target, etc so how do you incentivise collaboration between different individuals to reach a certain outcome? Fostering collaboration culture is very important to us, but it's also a question of incentives. What would be the evolution of this concept value for money in TPA approach?
    - Incentives are hugely important, so the starting point is the investment principle. With SAA things are more mathematical and linear, but that isn't the real world. TPA responds to all the different portfolios, circumstances and conditions and comes up with a better, more dynamic outcome linked to the goals. TPA is more complex, so new measures have to be introduced, such as RAG analysis. This introduces a degree of subjectivity, but it doesn't mean it doesn't matter, because it is still descriptive of qualitative things that are actually really important alongside the ultimate outcome.
- With sustainable investing being one of the main points in your manager research approach, how do you define what sustainable investing is and how that is changing over time? What is required for an investment to be sustainable?
    - For us this is probably slightly more a client-specific, belief-led interpretation. There are some regulatory points which we can agree to such as article eight, but primarily it is whether we believe that the manager is capturing the risks effectively in the decision-making process?
    - Some of it is a minimum standard, that has existed forever and now it's just a formalisation of that across broader dimensions. The newer part is looking at organisation's behaviour in terms of being an active steward of their assets, the universal-ownership-type thinking.
    - It is true that our language on this hasn't settled. It's important to think about sustainability through a financial lens to start with. The first materiality, which includes long-term

investment efficiency, intergenerational investment efficiency, return per unit of risk – all these are the risks of ESG on the portfolio. More recently, with sustainability taking on a new dimension with sustainability impact, Freshfields and PRI definitions on instrumental IFSI are important and instrumental to a better financial outcome.

- What do you think about the direction the industry is taking on sustainability? There is some concern, that for many this is a "check box" exercise with some rolling back on their net-zero commitments.
    - Firstly, checking boxes might be simply responding to peak busy and peak complex. But in time the industry will find answers to this complexity, some of it is in delegation. A lot of it does come with checking boxes, such as reporting.
    - In our experience from a European / global perspective, the top-end asset owners are on a one-way trip towards more sustainable portfolios.

About the Thinking Ahead Institute
The Thinking Ahead Institute is a global not-for-profit member organisation whose aim is to mobilise capital for a sustainable future. The Institute's members comprise asset owners, investment managers and other groups that are motivated to influence the industry for the good of savers worldwide. It has around 60 members with combined responsibility for over US$16 trillion and is an outgrowth of WTW's Investments' Thinking Ahead Group.