Norway's Summit on Responsible Investing

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Abstract

This is a summary of the issues discussed at the 2013 Investment Strategy Summit for Norwegian Government Pension Fund Global. The emphasis of the summit was responsible investing with a special emphasis on ways to strengthen the Fund's work on responsibile investment. The summit brought together experts (both practitioners and academics) and discussed ethical issues, financial performance, and activist investors in the context of social, environmental, and governance concerns.
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The Ministry of Finance's 2013 Strategy Council, chaired by Professor Elroy Dimson of Cambridge University Judge Business School and the London Business School, held a strategy summit of the Government Pension Fund Global (GPFG) on May 31, 2013, in Cambridge, U.K. The summit was streamed live on the internet (www.government.no). The 2013 Strategy Council also includes Idar Kreutzer, Managing Director, Finance Norway (FNO), Rob Lake, an independent responsible investment advisor, Hege Sjo, a senior advisor to Hermes Investment Management, and Professor Laura Starks of the University of Texas-Austin's McCombs School of Business. The summit's objective was to bring together asset owners and managers with world experts on responsible investing in order to develop more clarity on the purposes and outcomes of such investing strategies. The goal was to help develop an intellectual framework connecting investment decisions of large asset owners and managers with Environmental, Social and Governance (ESG) issues. This intellectual framework will help provide a basis for the 2013 Strategy Council's report on responsible investing.

The Director of the Cambridge Judge Business School, Professor Christoph Loch, opened up the conference with a discussion of two problems inherent to modern day investing, the first being the uncertainty that carbon dioxide brings to regulatory decision making. He pointed out that while many estimates suggest we are nearing carbon dioxide capacity, the roles governments will take to limit use are uncertain. Consequently, companies holding varying levels of reserves may never have the opportunity to use them. Secondly, he discussed the effects of modern environmental and social externalities. He argued that because of the size of sovereign wealth funds and pension funds, it will be partly their responsibility to mitigate these externalities, in particular, because their investment decisions have an impact on society. He concluded that these issues are important for both academics and practitioners as there still exist fundamental questions for which we do not yet have satisfactory answers.

The Ministry of Finance's State Secretary, Hilde Singsaas, next welcomed the group stating that the purpose of the summit was a simple but important one - to learn more. She then explained the basic setup of the GPFG, now the largest sovereign wealth fund in the world. The State Secretary emphasized two major goals of the Fund: first, to ensure that not only this generation, but also future generations will benefit from the petroleum wealth and second, to safeguard stability in the mainland economy. These objectives coupled with the fact they are a universal owner gives the Fund a unique, extremely long-term objective and emphasizes the importance of responsible investing, that is, contributing to sustainable development in economic, social and environmental terms.

The Ministry of Finance provides the general framework for the Fund's investment strategy, which is anchored in the Norwegian Parliament. Norges Bank is the operational manager of the Fund. In addition, the Ministry has an independent Council on Ethics for the Fund that recommends exclusions and observations of companies from the Fund based on guidelines that have been developed. The Fund excludes companies for two reasons: products a company produces or a company's systematic violations of ethical norms. Eliminating companies based on the types of goods they produce is rather simple after guidelines are in place. The tougher exclusions are for companies that are judged to have committed systematic violations of ethical norms. Singaas pointed out that exclusion rarely solves the underlying problem directly and that it eliminates the Fund's shareholder rights.

The exercise of ownership rights is delegated to Norges Bank. The major issues, which are based on internationally recognized principles, are governance issues (including equal treatment of shareholders, board accountability, and well-functioning markets), children's rights, climate change, and water management. State Secretary Singsaas concluded that through international collaboration, the GPFG continues to contribute to the development of best practices, in addition to research and investigation. The Ministry updated its strategy in 2010, but she emphasized the current strategy for responsible investing is not an endpoint and they hope to have another update with the help of this summit.

The conference was divided into four sessions. The first session highlighted the tension when considering ethical obligations and financial returns. The second session delved into integrated reporting (the combination of material financial and nonfinancial information in a single document), why it is important, and what steps are necessary to ensure integrated global reporting. The third session explored which ESG issues companies and activist shareholders deem important. The final session focused on the question of whether responsible investing leads to value creation.

In each session the variety of opinions that exist on these issues were displayed, which helps to highlight the potential importance of the issues in the GPFG's investment strategy. A critical point that arose was the lack of theory regarding what a universal owner should be doing. The issues were summarized at the end of the day with the questions of who, what and how by David Pitt-Watson, founder of Hermes Focus Funds and executive fellow at London Business School. First, in talking about responsible investing, who are we being responsible to? He pointed out that the GPFG is responsible to the people of Norway and thus, the Fund needs to consider which issues are important to the people. The second question - what is going to provide a return to the people of Norway? He cautioned that ESG issues should not become divorced from financial returns, maintaining that while excess performance, alpha, is preferred, as a universal owner, the GPFG needs to weigh heavily the overall market returns, beta, and the improvement in ESG issues. The third question - how will responsible investing be achieved? In order to cause change, the Fund needs to determine which issues are important and then communicate these ideas to companies. The right level of involvement from all stakeholders is difficult to determine, but it starts with first clarifying objectives. The conference provided a forum to discuss different implications from responsible investing that the GPFG will consider as they update their policies.

1 Session 1: Responsible Investing and Screened Portfolios

The central theme of the first session of the summit, chaired by Professor Elroy Dimson, was the relation between responsible investing, screened portfolios and portfolio return and risk. Standard financial theory suggests the optimal portfolio is the market portfolio. Thus, according to this theory an investor who screens firms from a portfolio faces a constrained investment set and could expect lower risk-adjusted returns. Combining this theory with the assumption that the goal of an asset owner or manager is to maximize risk-adjusted returns leads to the conclusion that socially responsible funds could be a worse investment than conventional funds. However, this reasoning may not hold if investors receive utility from something other than maximizing returns or if companies that are typically excluded from the opportunity set tend to underperform for some systemic reason.

There is mounting evidence that many investors care about moral considerations even if they face sacrificing financial returns. The tension between non-financial benefits and maximizing expected risk-adjusted returns was one of the most important issues discussed at the summit. Abstracting away from the non-financial benefits, a tension exists due to the conflicting hypotheses regarding the performance of SRI funds. The first hypothesis is that SRI funds underperform because of their reduced opportunity set. The alternative hypothesis is that SRI funds outperform because they are investing in firms that have better corporate governance as well as enhanced awareness of the environmental and social issues investors are concerned with, thus either gaining additional returns, avoiding risk or both. Finally, the differences in performance may offset or be small enough that we don't find a statistically significant difference between SRI funds and conventional funds.

Before the consideration of the empirical evidence on performance of SRI funds, the foundation for ethical responsibilities was presented by Professor Katherina Glac of the

Opus College of Business. She discussed the ethical responsibilities of investing, in particular emphasizing the role of a large asset manager such as the GPFG.[1] She focused on the three of the five ethical responsibilities[2] as outlined by W.D. Ross as part of Kant's ethical theory[3], which are most relevant for today, namely non-maleficence, beneficence, and fidelity. Non-maleficence also known as "do no harm," is typically accomplished via direct support and action as one does not want to benefit from activities that are counter to one's personal values. For example, the negative screening process in which firms are screened out of a portfolio based on ethical issues arises from this principle. Professor Glac pointed out that one challenge in such a policy is where to draw the line. For example, if you exclude a firm based on its product, then what about those firms that distribute the product? Thus, the primary challenge is coming to a consensus on the values used to determine the ethical margin, similar to what the State Secretary Hilde Singsaas mentioned in her introduction.

The second ethical responsibility that Professor Glac highlighted was beneficence, in other words, promoting good - the challenge of the duty to act, rather than the duty to refrain from action. The two main principles behind this responsibility are what she termed "rescue" and "Spiderman." Rescue suggests that if something harmful can be prevented, then one should prevent it. Spiderman is the concept that with greater power comes greater responsibility. As a large asset manager, the responsibilities that develop from beneficence require more action, usually in the form of activism. Thus beneficence comes with its own set of challenges because of the existence of legal limits, a need for consensus, and the limited and practical scope an investor has. She also pointed out that among the greater challenges that arise are the shifts in what issues are pursued and are relevant. Professor Glac argued that ideas are changing about investing, that it is no longer just about financial returns.

The final ethical responsibility that Professor Glac discussed in detail was fidelity, or

[1] Glac (2010)
[2] Glac (2013)
[3] Ross (1954)

acting in the best interest of others, that is, fulfilling fiduciary duty. In asset management this is where the tension can arise between maximizing expected risk-adjusted returns and non-financial benefits. One element of fidelity is the duty of loyalty, which is the obligation to act in good faith and in the best interests of the beneficiaries. This duty may potentially limit consideration of ESG issues in investment selections. The other element is the duty of care, which is to conduct service skillfully and maximize returns. This element may lead to potential support for consideration of ESG issues in investment selection given what she argues is the increasing evidence of connection between ESG performance, financial performance and sustainability of economic growth. The challenges for this responsibility of fidelity include the tension between financial and nonfinancial interests, legal fiduciary duties, coming up with a consensus, uncertainty of the market, and the past precedent in terms of fiduciary duty.

Professor Glac stated that W.D. Ross prioritized the ethical responsibilities in the following order: non-maleficence, fidelity, and beneficence. Consistent across all three elements one of the major challenges is a lack of consensus. Coming up with clear objectives and priorities is the first step of good asset management, after which one can operationalize this strategy. Professor Glac's analysis set the stage for the remainder of the day's proceedings.

Professor Luc Renneboog of Tilburg University was the second academic presenter. He discussed the empirical results from two papers, the first of which looked at the tension of maximizing expected risk-adjusted returns versus non-financial benefits (which continued to come up throughout the day).[4] He tested the two hypotheses regarding performance of SRI funds (that they would be expected to underperform because of their reduced investment set due to negative screening or alternatively that the SRI funds would be expected to overperform because of better governance and awareness). He compared the performance of 440 SRI funds from 17 countries with over 16000 conventional funds over the 1991-2003

[4] Horst et al (2007)

period. The SRI funds had various approaches, with some using negative screening and others using positive screening in four categories: sin stocks, ethical issues, social and governance concerns, and environmental issues.

Professor Renneboog compared the performance of the two types of funds to each other and to benchmark market returns using standard academic return measures, the CAPM and the Fama-French-Carhart 4-factor model. He said that his findings show that in many countries, both SRI funds and conventional funds tend to underperform the market. He also showed the results from two further checks on performance by including an ethical factor in his tests and looking at macroeconomic shocks to interest rates, dividend yields, bond term-structure performance, and bond-credit risk premium. Both groups of funds still underperform the market in these additional tests.

The second paper Professor Renneboog presented examines investor flows into SRI funds versus conventional funds.[5] He hypothesized that investors of an SRI fund would be less sensitive to performance because they receive other benefits in terms of the moral dividend. He matched each SRI fund with a conventional fund on the basis of age, size, fees, and investment style. Consistent with his hypothesis, he found that investors in an SRI fund were not as sensitive to financial returns.

In the discussion following the presentation, the question was raised regarding how SRI indices compared in terms of performance to conventional indices. Recent research has found that there is no significant difference between the two.

In summary the session brought out:

- There is a tension between maximizing expected returns and moral considerations.

- In order to make the appropriate decisions, asset managers need to come to a consensus on their objectives and priorities.

- Ethical responsibilities should be prioritized such that a fund does no harm first, then

[5] Renneboog et al (2011)

maintains fiduciary responsibility and lastly, does good.

- There is evidence that SRI funds underperform passive benchmarks, but it is not clear whether there is a significant difference between the performance of SRI funds and conventional funds.

- SRI investors are less sensitive to financial performance.

2 Session 2: Business, Investment and Sustainability

The second session was chaired by Rob Lake. In this session the discussion turned toward the link between corporate social responsibility and firm performance. Despite potential theoretical underpinnings, the central challenges in establishing whether this link exists are the inherent econometric issues. The discussion then centered on integrated reporting, including what it is, why it is important, and how it may develop. The session concluded with a panel of investment practitioners and their perspectives and experiences on environmental, social, and governance issues.

Professor Ioannis Ioannou of London Business School discussed the link between corporate social responsibility and financial performance, although he pointed out that it is sometimes difficult to draw a causal link between the two because of a lack of quality data.[6] In addition, if a link is found, it could be due to reverse causality, that is, that financial performance may allow a firm to engage in more corporate social responsibility. Professor Ioannou pointed out that despite potential theoretical channels, it is not clear which mechanism leads to better financial performance and therefore which measure of performance to use. The theoretical mechanisms of value creation include a reduction of cost and risk, enhanced reputation, creation of synergies, or a general competitive advantage.

To test the hypotheses that arise from these theories, Professor Ioannou compared the

[6] Cheng et al (2012)

long-term performance of "green" firms (defined as those firms that voluntarily adopted sustainability policies by 1993) with a matched set of firms that had poor CSR metrics.[7] Using both accounting and stock market performance, the authors find that the green companies outperform the matched sample over the 1993-2010 period. The authors argue that their result is consistent with a shift in stakeholder attitudes. Previously, there was more stakeholder engagement and negative attitudes towards CSR firms, but now it seems to be more positive. However, the literature still has not been able to identify more detail on the mechanism of value creation.

In the next presentation, Professors George Serafeim and Robert Eccles of Harvard Business School discussed integrated reporting, which seeks to combine material financial and nonfinancial information in one document.[8] They showed that there are many challenges when combining these types of information, including determining the audience, material information, number of reports, and different global regulations. Professor Serafeim began by describing an ideal interaction between all stakeholders that combines technology and entails two-way communication between all the parties. He argued that integrated reporting is a powerful mechanism for changing resource allocation decisions: "Financial reporting created the markets we have today; Integrated reporting will create the society we want to have tomorrow." He pointed out that in practice, the level of interest in nonfinancial information and its reporting vary quite a bit around the world, with the UK having the highest scores on reporting of environmental and social issues and the U.S. having the lowest scores.

Professor Eccles discussed the struggle to develop appropriate standards for reporting nonfinancial aspects of the firm, comparing the state of integrated reporting on social issues today with that of the SEC in the early 1930s. Prior to 1934, there were many accounting firms, each with its own accounting standards. This changed with national standards and

[7] Eccles et al (2012)
[8] Eccles and Serafeim (2013)

eventually lead to consolidation into the big four accounting firms. Presently there are many organizations working toward better nonfinancial reporting. Professor Eccles described those which he considered most important.

First, there is the International Integrated Reporting Council that is developing a high level framework of what the appropriate elements would be for integrated reporting. The Council is not involved with setting standards. The second group is the Global Reporting Initiative (GRI), which is developing metrics for nonfinancial reporting. The GRI is stakeholder-focused with a multiple stakeholder approach, that is, it relies on all stakeholders, not just investors.[9] Third, there is the Sustainability Accounting Standards Board, which develops varying standards for different sectors and engages all stakeholders to define materiality for each of 10 sectors and 88 industries they follow.[10] The key to their approach is that from transparency to performance, material metrics would vary by sector. The final organization is the Carbon Disclosure Project. This organization is a topic expert that started with a focus on corporate reporting on carbon issues and recently extended that focus to include reporting on water issues. Professor Eccles pointed out that it is important to think about the audience for the reporting and how the audience thinks about materiality. He also stressed that investors should start having conversations with companies about their integrated reporting.

The session concluded with a panel discussion by three practitioners: Erwan Créhalet, an analyst from Kepler Cheuvreux, Julie Hudson, a Managing Director at UBS, and Jake Reynolds, the director of Cambridge Programme for Sustainability Leadership. Mr. Créhalet started by providing an example of issues from the oil and gas sector in which operational safety can have effects on the riskiness of the firm. Typically, analysts only have access to indicators after the risk has occurred, although leading indicators would be preferable.

[9]Eccles and Serafeim (2011)
[10]Eccles et al (2012)

In practice, analysts adjust beta for firms they think have exposure to injury risk when determining target prices. He pointed out that it is important to focus on two to three key issues; to find financial value for a sector, then examine the key ESG issues.

Ms. Hudson recounted the formation of an SRI team eight years ago after a client requested more information on where the next litigation risk would arise in their investments. She stated that the ESG market has gone through three phases since 2005. From 2005-2007, there was erratic enthusiasm; from 2007-2010 there was a growth in interest, culminating in her firm launching an ESG analyzer beginning in 2010. Her team now sends surveys to different industries to determine which issues are important for industry cash flows, which in turn helps clients determine the companies that are managing these risks. She gave the example that fully one half of sectors believe greenhouse gas issues pose risks for their future. She also believes that companies are ahead of investors on ESG issues and risks.

Finally, Dr. Reynolds discussed his role working with the university and companies to promote sustainability. He brings together corporate managers and investors for discussions on the issues. He recounted many of the questions he deals with and touched on the companies that are the best at sustainability and managing risk.

During the discussion it was pointed out that this session provided evidence from an academic perspective that sustainability appears to add value and that it is important to develop standards for information about a company's sustainability. It also became clear that most of the work on corporate ESG policies and actions is focused on the U.S. and Europe. An important factor in studying ESG in companies in developing countries is the lack of data.

In summary the session brought out:

- Firms with good corporate social responsibility are associated with good financial performance, but the exact mechanism has yet to be identified.

- Integrated reporting is a crucial next step in responsible investing, which ideally leverages existing technology to facilitate a conversation between all stakeholders.

- ESG issues are an important consideration for practitioners and academics alike.

3 Session 3: Responsible Exercise of Ownership Rights

This session, chaired by Hege Sjo, provided a more in-depth look at each component of Environmental Social and Governance investing. While governance issues have received a great deal of scrutiny from academics and institutional investors, environmental and social issues are just recently drawing more attention. Consistent with the previous session, the attention it receives varies globally.

Professor Andrew Karolyi of Cornell University presented results from a recent global investor relations survey. The survey took place in 2012 and asked 72 questions on a wide range of issues including company's ESG goals and policies. The sample was a representation of global companies, except the survey relies on bigger companies that are growing more quickly. They found that while ESG issues are drawing more attention, 60 percent of companies still do not consider these issues as important. Similar to the findings discussed in the previous session, the survey found more attention paid to ESG issues in Europe than in North America.

Professor Karolyi continued by asking the natural follow up question: How do we improve these numbers? He stated that regulation is the obvious answer and is encouraged by developing markets. In addition, some of the change is going to have to come from the company and via exchange listing requirements. Next, he showed results from splitting the issues between governance and social/environmental issues. The number of firms that consider governance important is significantly higher than those that are concerned with social and environmental issues. Conditioning on country, he found that issues involving boards and controlling shareholders are more important in emerging markets while executive compensation is more important in developed countries. He concluded that the lack of social and environmental demand around the world requires further exploration.

Next, Professor Laura Starks of the University of Texas-Austin gave an overview of the importance of institutional investors in general and specifically with ESG issues. Institutional investors play a unique and important role in governance because they have large and concentrated holdings that they can use to influence management and solve the conflicts of interest that arise between shareholders and management, i.e., the "agency problem."[11]

She pointed out that two main approaches exist for an institutional investor to mitigate agency problems. First, they can sell their shares, also known as "exit" or "voting with their feet," which has price impacts and can indirectly incentivize management to correct deficiencies. Second, many institutional investors are large enough that they frequently have direct conversations with management and boards, commonly referred to as "voice." Different institutional investors may focus on passive or active strategies with regards to influencing management, but the majority tends to fall somewhere in-between by voting in proxy fights and having discussions with management. Some institutional investors, such as GPFG, are such large universal owners that "exit" is impractical as a strategy for influencing many firms. In practice, large institutional investors interested in influencing management tend to participate in private monitoring via engagement or more public monitoring via activism campaigns. Smaller institutional investors tend to first vote with their feet, then participate in private activism and rarely participate in public activism due to its large costs. The typical firm that is targeted by activism campaigns tends to have poor performance, poor governance, high institutional investor ownership, and low insider ownership.

One approach to the exercise of ownership rights is through submission of proxy proposals and voting on these proxies. In the U.S., proposals on executive compensation, declassifying boards, and eliminating super majorities have received lots of recent support, while other

[11] Gillan and Starks (2007)

corporate governance measures have not. Social and environmental issues are also not receiving many votes, although part of this lack of support may be due to the specificity of the proposals.

Professor Starks stressed that there are several impediments to activism. Activism campaigns can be expensive and institutional investors must uphold their fiduciary duty. In addition, they face their own risk aversion, industry standards, and regulation. She concluded that empirical evidence shows that private activism appears to be successful, public activism has mixed success, and there has been little success to date with public engagement on social and environmental issues.

Dr. Phillipp Krüger concluded the session with some reflections on the presentations by Professors Karolyi and Starks. He suggested the perception that institutional investors' and companies' lack of concern for environmental and social issues may stem from a perception that requests come from special interest groups. He also emphasized that some of the large differences between European and U.S. firms may be due to differences in board representation. For example, in Germany labor has board representation, which will likely lead to more interest in the welfare of the non-management employees. He concluded that one potential solution is to make these concerns more open with fewer special interest groups. Dr. Krüger also briefly discussed his research on the excess short term returns he has found upon firms' adoptions of ethical issues.

In summary the session brought out:

- Governance issues remain of interest to most stakeholders, but environmental and social issues fail to receive much interest from companies and institutional investors.

- The U.S., in particular, seems to be less concerned with social and environmental issues whereas Europe may be more balanced because of the different board representation.

- Larger institutional investors tend to take a more active stance to promote change, while smaller institutional investors are more apt to "vote with their feet."

4 Session 4: Social Returns versus Financial Returns

The final session was chaired by Idar Kreutzer. In this session we returned to the issue of financial performance in socially responsible investing. One puzzle is why vice funds outperform SRI funds. It was suggested that sin stocks might have lower valuation multiples, which would lead to more growth potential and higher expected returns. Similarly, demand for socially responsible stocks may drive prices high, which could moderate expected returns. In order to gain more insight into this mechanism, the presenters in the session looked at the return properties of firms that were engaged in social and environmental issues and the performance of random pseudo-portfolios formed on the basis of negative and positive screening on these issues. The session concluded with several overview presentations that tied the key points from all of the sessions together.

Professor Elroy Dimson discussed the growth in morality investing that began with investors avoiding South Africa as a protest to apartheid practices. He presented the results of his research into one fund's active engagements on ESG issues.[12] Although there has been previous research on outcomes of active engagements on governance issues, Professor Dimson's research is the first to examine shareholder activism on environmental and social issues. He focused on the fund's extensive sequences of engagements with U.S. firms and matched each firm that is engaged with another firm on sector, size, and market-to-book. Using this matched sample he looked at the differences in performance by measuring which firms were engaged and which engagements were successful. Similar to what we saw earlier, the data is 60 percent governance issues with the rest split between environmental and social engagements. He found that the firms that were engaged tended to be larger, older, value companies. They also tended to be more liquid, less well governed, with more analysts and institutional investors. The engagements usually went through several stages, lasted 500

[12] Dimson et al (2013)

days on average, and were only successful 18 percent of the time.

The engagements that tended to be successful involved large firms who not only had excess cash, but lower CAPX and R&D spending. Taken together, it appears these issues became more relevant for firms that are mature and had the capacity to undertake these issues. He also found that successful engagements tended to outperform their matched counterparts, and unsuccessful campaigns didn't significantly underperform. He concluded with the conjecture that this outperformance was due to increased demand from socially conscious consumers and increased employee loyalty.

The second presenter of this session was Professor Jacquelyn Humphrey of the Australian National University. She pointed out that while responsible investing is conducted using both positive and negative screening, along with activism, in practice, there are different screens used around the world because of legal and sector differences. For example, there are more environmental screens applied in Australia, while in the U.S. there are more screens on tobacco and alcohol. There are also variations across countries in which types of screening are used, for example, France uses little negative screening and instead frequently relies on best of sector classifications.

Professor Humphrey also pointed out that there exists mixed evidence and theory on which screens should add value. It has been suggested that positive screening may reduce risk and increase returns, but as discussed earlier in the day the mechanism is not clear. One interpretation of the puzzle of sin stocks is that negative screening may increase risk and reduce returns. Professor Humphrey presented results comparing the performance of an unrestricted S&P 500 index portfolio, the remaining firms in an S&P 500 index portfolio after the use of positive screening, and the remaining firms in an S&P 500 index portfolio after the use of negative screening.[13] For each of the three groups she randomly selected 100 stocks, rebalanced them annually, and compared the performance between the groups after

[13] Humphrey and Tan (2013)

15 years and 10,000 simulations. These simulations rely solely on the underlying securities - a process which then eliminates effects from fees and management skill that exist in the studies on SRI funds.

She compared the performance among each of the groups using raw returns and several measures of risk-adjusted returns. Regardless of the measure she used, there was no difference in performance amongst the three groups. She then showed the results are the same if she allows perfect screening, different rolling windows, or a different number of stocks in the portfolio.

In summary the session brought out:

- Successful engagement on environmental, social, and governance issues leads to excess returns while unsuccessful engagements do not underperform.

- The sin stocks puzzle is apparently not caused by a reduced opportunity set because random portfolios that use negative or positive screening do not have different return properties than unconstrained portfolios.

5 Summit Conclusion

The summit concluded with overview presentations about responsible investing and its implications. In his presentation, Roger Urwin of Towers Watson noted that asset management is a unique industry business because globally there are 20-25 times more professionals than investors. He discussed the problem of how to disentangle the skill of a manager from the success of the company and pointed out that because the world is reactionary, behavior only really changes after results. In order to make improvements in the world of responsible investing the first step is going to be unifying investment beliefs and purpose. This would entail some combination of fiduciary duty and sustainable investing. Currently, 95 percent of asset managers have traditional financial goals, while only 5 percent are integrated with sustainability issues, typically the universal owner. In order to achieve a more adaptive and integrated system, it will require the cooperation of society, asset owners, governments, and companies. He pointed out that measurement and evidence are critical to the area and will give it respect. An additional issue is that we very often do not have the counterfactual (although Professor Dimson's research has shown us some of the counterfactual).

David Pitt-Watson began by emphasizing that we chiefly need to consider the concerns of the claimants of the GPFG. Since they are universal owners and they have such a long-term perspective, they should really care most about the returns from beta. Alpha would be even better, but future generations are ultimately going to rely on the returns from beta. Given that the Fund invests in 7000 companies, his suggestion was to take responsibility in ESG initiatives by starting with companies that aren't acting in the interest of their claimants, for example, hand gun safety. He concluded with a discussion that the key for the GPFG is to communicate their expectations. They want to encourage companies to race to innovate and improve, but the first step is to discern what their objective should be.

The question was then raised if investment consultants are creating or solving problems on ESG issues considering that consultants' objectives are short-term. Mr. Pitt-Watson agreed that ESG issues aren't typically the first concern (or even among the top five concerns) and there is only a finite amount of time. He stressed that consultants are a relatively small player whereas the GPFG is of the scale they can make a profound difference. He continued that alpha is difficult to achieve, but they do a good job with low fees and a long-term strategy with the final element being sustainability. The greater concern for future generations is sustainability and market returns, alpha would be ideal, but it is not as important.

Next, it was pointed out that there exists a lack of government regulation on sustainability issues and it is not clear whether it is more important for investors or governments to engage companies on these issues. The primary relationship is between the investor and the company, but as usual, the government's role is to eliminate inefficiencies. The tricky part without an obvious answer is finding the right amount of regulation.

The final question asked: if long-term fund performance depends on sustainability, what should funds do to maximize performance? There was agreement that there is a lot of potential for the biggest pension and sovereign wealth funds to work together on these issues. Total assets under management of the largest 50 funds are estimated to be around $12 trillion and with that scale they can become even more influential by collaborating than they are on their own.

The Director General of the Asset Management Department for the Norwegian Ministry of Finance, Pål Haugerud, was our next speaker. He emphasized that this summit is the most visible sign of the strategy council's work so far. The purpose was to bring together expertise to deepen our understanding of current knowledge in the area of responsible investing. The combination of the expertise throughout the room and the organization of the summit was a great success.

Professor David Chambers of Cambridge Judge School of business was the final speaker and with a very appropriate quote from John Maynard Keynes (in a memorandum for the estates committee at King's College): "But it is true, unfortunately, that the modern organization of the capital market requires for the holder of quoted equities much more nerve, patience and fortitude than the holder of wealth in other forms." The one amendment he suggested was adding the word responsibility as a requirement of the holder of quoted equities.

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