CFA Institute

INVESTING WITH PURPOSE: EXPLORING CLIENT INTEREST IN RESPONSIBLE INVESTING

SANDRA CARLISLE
Head of Responsible Investment, Newton Investment Management

2016 Wealth Management Conference
16 March 2016
Minneapolis

In this informative presentation, Sandra Carlisle, head of responsible investment at Newton Investment Management, discusses what financial professionals need to know to respond competently to client interest in responsible investing and what the data say about the myths and realities of ESG (environmental, social, and governance) and responsible investing.

Sandra Carlisle: I brought this with me, which is something that in UK we call a "stick of rock." I understand that doesn't translate in the US. It means something quite different. I have to call it a "candy cane."

"Rock" is not what this is in a US drugs context. It's actually a stick of candy. There's a bowl. Please feel free if you have a sweet tooth or you need some sugar. But I'm going to use this as a prop when I talk about responsible investment at Newton.

We're saying responsible investing is better investing. Now I do not mean better in any moral sense. I just mean it is a source of alpha. It is entirely consistent with alpha generation.

For those of you who responded saying, "My clients don't ask, don't care, don't know," the fact of the matter is they don't have to know about responsible investing and have an interest in it to have it done within their portfolios and to have it as something that is helping protect the value of their investments and generate sustainable alpha.

You may find that a controversial statement. Please feel free to ask me lots of questions about what that means.

I'm going to talk a little bit about what we at Newton think responsible investment means, what we think it doesn't mean, and what we do about it; touch on some of the areas, particularly in the US market, that seem to be gaining a lot of interest, appetite, traction with US investors.

Because it would be true to say that the US market, despite being the biggest capital market in the world, the most liquid, the most advanced in many ways, has really been the laggard market in terms of thinking about this investing with value and values and investing with purpose.

We've gone from an environment where nobody in the US really cared and the assumption was, "Responsible investment, that's just ethical screening. That's just taking stuff out of your portfolio. If I take stuff out of my portfolio, by definition, I am concentrating my portfolio. I am not diversified, and I am probably failing to fulfill my fiduciary duty to my clients to generate the best risk-adjusted return."

That has been the traditional US market approach — ethical investing, synonymous with responsible investing; niche investing for a subsegment of the market, not for everybody. Well, we think it's for everybody, and I'm going on to talk about why.

Responsible investment, certainly at Newton, is about risk-adjusted return. That is language you'll all be very familiar with, risk-adjusted return. Our very strong investment belief is that these issues that get described as responsible, environment, social, governance issues, can have a material effect on company value. They create risk. They create opportunity. They're a source of idiosyncratic risk. They're a source of alpha.

Now as soon as I start talking about risk and return or alpha generation, I'm in the world of investment. Responsible investment is investment. If it's not investment, we do not do it as part of our day-to-day business.

Why do we do it? We do it because we need to know what degree of risk we are taking in any company or security we're investing in. That includes ESG risk. In order to adequately price the return that's on the table, we need to know what the risks are. We'd rather know than not know. There is nothing more horrifying to an investment manager than when a company does something that you did not know about and the share price responds. You can probably think of some good recent examples. I've got some we can talk about later.

I'll mention one very large German car company. Guess what? The company lied to us, lied to its customers. It lied to its investors. That is the worst possible place we could be. We'd rather know and then decide whether we think we're getting paid to take a decision to invest in that company. The fundamental principle around responsible investment — impact on company value, protecting the interests of all shareholders, and for us, as an investor, that means minority shareholders.

We need to know that when we're investing in a company, that company is well governed. That means, what is the structure of oversight of the company? What does the board look like? Is the board setting the strategic vision for the company and supervising the management team?

It means, what does the composition of the board look like? How diverse is the board? How long have they been sitting in their seats? Because if someone has been sitting there for 45 years getting a paycheck, they're probably not really contributing very much to the overall value creation of that company.

Worst case, do we think that the company might run away with the money that we're giving it on behalf of our investors? Can we trust the company to use the capital we're allocating to it wisely?

Again, once you get into certain markets, and I would cite emerging markets, but not exclusively, you will see that in markets like India, for example, you get these very complicated holding structures, lots of related party transactions, and essentially cash that rightly belongs to investors is being filtered out through the company to the friends and relations of the founders, or the local government, whoever the heck it may be. That is something that we are not prepared to take on board as investors. Protecting the rights of all investors and for us that means minority shareholders.

The other issue is reputational loss. The primary focus is financial loss: Are we getting paid to take this degree of E or S or G risk on board? Are we comfortable with that? Are we convinced this company is protecting the rights of all of its shareholders?

Again, as you know, if a company does something that it should not do, whether that is pollution in the Gulf of Mexico or rigging emissions data or causing a huge nuclear explosion, it doesn't matter what the issue is. You can bet your bottom dollar the share price will respond and your credit ratings will respond.

If you think of the case of that disaster in the Gulf of Mexico in 2010, the share price of that oil company fell by 45% as a consequence of that disaster, and its debt was downgraded to one notch above junk. Investors ended up losing an awful lot of money, and the reputation of that company has still not fully recovered.

The major issue is financial, but there is a reputational impact here. It's important for the companies not to do the stupid things that cause a loss of value and a loss of reputation, but it also means for your clients.

We get clients who come to us all the time saying, “Please explain to us why you are invested in that company that has done X, or Y, or Z.” We need to know whether the company really has done X, or Y, or Z, and we need to be able to respond to our investors, and say, “We’ve looked at that issue. It’s absolutely the case that the company was involved in something you may feel uncomfortable about. It’s had an impact in the market. That said, we do not think the damage is going to be that reputational damage that’s going to sustain through the long term, and we still think we’re getting paid adequately to own that stock, to hold that company in our portfolio.”

Nothing to do with ethics; nothing to do with taking things out of the portfolio. That may be relevant for some clients. I’ll touch on that later. It’s all about generating sustainable long-term returns for investors. Easy to say, hard to do. I’m going to talk about a little bit about how we do that in practice.

Just think about it intuitively. It seems to me to make good sense that a company that is not well run, has no proper oversight, pays its board members for occupying seats they sit around in for 40 or 50 years, and that is quite common in the US.

The longest director that we found in a US boardroom had been there for 69 years. OK, 69 years. You may think that’s terrific. We can debate that. We just think it is time, long time past, that the guy went.

Companies that pollute, companies that do not treat their employees properly, companies frankly that pay their senior executives without attaching any performance conditions to that, those are not companies that we believe are responsible companies acting in the best interests of their investors for the long term. They may do very, very well in the short run because frankly, you can engineer earnings all day long. You know that better than I do. In the long run, will that be sustainable? Will that generate sustained returns back to investors, who are investing for 20, 30, 40, 50 years? It will not. We do not believe that that is the case.

Intuitively, I don’t think I’m saying anything particularly controversial, but people have a hard time getting their heads around this. Let’s talk about what this means in practice and why we think it’s prompting interest in the US market and particularly now.

I’m not going to dwell on this one. We’ve been doing responsible investment since 1978. You’ve got the slides in your deck. What you will see here is every time something bad happens in the UK… the Corporate Governance Code was put in place in 1992, think the Cadbury Code, and it’s been revised ever since.

That was put in place in response to two big corporate scandals. Two notorious corporate scandals, where the chief exec, in each case, of the company was pilfering the assets of the pension fund to both bolster up a business that was clearly in bad shape but also do nice things like buy speedboats and houses and all the rest of it.

We had two big corporate scandals and that prompted really the beginning of the modern corporate governance regime. We've had a succession of scandals ever since. I don't need to mention WorldCom; Enron; more recently, the spill in the Gulf of Mexico; the techno/nuclear disaster in Japan; the biggest bust of all, the financial crisis. You can see that people will get away with what they can get away with.

Sometimes it looks great. Enron was the best company in the world for a long, long time. Not a long, long time, but for several years. Turned out not to be. WorldCom, again, looked terrific.

Our job, as an investor, is not to be seduced by this momentum and the big speeches of chief execs and the quarterly earnings numbers that look terrific. Our job is to dig down into what is going on at the company.

There's one example on this slide I won't dwell on, but I will mention because it's very important in the context of the financial crisis. In 2002, we were the largest shareholder in a bank in the UK called Northern Rock. It was a very, very straightforward, boring mortgage bank. A very simple business model, only operating in the UK, so no international exposure. It wasn't building dams in Brazil. It wasn't doing subprime. It turned out it was really doing subprime, but that's not what anyone knew at the time.

By 2005, our head of financials was so uncomfortable with this company, with the funding model; we'd had several conversations with the management team and the board and we were getting absolutely nowhere. They would not answer our questions in a way that we thought was responsible and rational and based in economic reality.

By 2005, we had sold out of everything we owned in this company. We were no longer comfortable. We had an active manager; should have said that at the beginning. We kicked everything out of the portfolio. Too much risk; not enough return.

Where was the risk coming from? Business model. We did not like it. The funding model was all wrong. It was basically a version of subprime governance. The chairman wouldn't talk to us. The chief exec just gave us some BS that we didn't believe in.

You went to see the company. I remember going to see this company; the best and the finest wines being served at lunch. You think, "Hang on a minute. This is telling me something." The biggest, flashiest cars you've ever seen, sitting in the company parking lot.

We have no problem with people being paid lots and lots of money to perform well for their investors, but we need to understand, where is that performance coming from? Is it legitimate? Again, is the company acting in the interests of its shareholders?

I would suggest that having the finest claret on your lunch table — that may be indicative of something else going on here. This is not a private company; this is a public limited company. Lots of lots of signs there were things going on in this company that we didn't like.

By 2005, we had sold out; 2007, the whole thing went horribly wrong. There was a massive run on this. It became very clear that the funding model was haywire, that they were lending to people who should never have been given loans. They were lending 125%, 130% of the value of the houses. Their funding model was basically borrowing short and lending long. They were in the wholesale market. The wholesale market was beginning to be very dislocated because of the emerging problems that we were seeing.

All of this came to light. There was a massive run on the bank. Queues around the block, everywhere this bank had branches, of people trying to get their money out, and it went under. That was, if you like, the UK Lehman Brothers experience, much smaller, fortunately, controlled, because in that one market, but it took three years for that to come to light.

Sometimes it's shorter. Sometimes it's longer. We were extremely happy that we had sold out in 2005. That doesn't mean that, for that 2005–6 period, when the share price of this company was still going through the roof, that we didn't have clients coming to us and saying, "You got everybody else loves this company! You must have got it wrong. Look at the share price. Look at the share price, it's going up and up and up."

We were having to say, "That's terrific, but the governance sucks; the oversight is poor; the strategy is not coherent. We do not think that this is a company that we can be committed to for the long run." We do not like to turn over our portfolios. Our average holding period is three to five years. There are stocks that we've owned for a decade and more.

Our view is, "Get it right. Do the work up front, understand all of the risks, all of the opportunities. Make a rational investment decision. Be invested, stay invested." It is not, turn around and go, "'Oh, whoops! We made a mistake,' and kick it out of the portfolio, because that is costly for us, it is costly for you."

It is also not the best way to build up a relationship with a company. If you are constantly churning your portfolio, what is the chance that the senior executives of that company are going to sit down and listen to you when you want to say to them, "Guys, you know what, we really like your business, but there are some things that we would quite like to talk to you about, that we think we'd like to change"?

If they think you're going to be off the register in six months, they are not going to have that conversation with you. If they know that you're going to be sticking with them, for 3 or 5 or 7 or 10 years, then in most cases, in many, many markets, and certainly pretty much all developed markets, they will have a conversation with you. They may not like what you say, but you can have a rational debate. That's why we do this.

This is where the stick of rock comes in. Please come and get this candy cane. It's very easy to put a cellophane wrapping around responsible investing. You can go and buy some ratings, comes off. You can see through it. There's no substance. It's not really part of the investment process.

I would say beware of all of these ratings that are coming out. They're useful shorthand sometimes, but they don't really tell you what's going on under the core, or its branding. Again, you can take that off and chuck it in the bin. Branding is branding. Everyone has it.

What you really want to see is that this integration of E, S, and G into investment analysis is really going through the company in the way that lettering goes through this candy cane. This says Newton ESG, and the idea is, you snap us in half, it's right in there. You break that in two again. It's right in there. In order to be really a powerful way of managing risk and generating alpha, it needs to be core to the investment process. I'm now going to talk a little bit about what that means.

The first thing is research and analysis: my team, I have a team of four. Our sole purpose is to research environmental, social, and governance issues at all of the companies that we invest in. It's not a big team, but we have 18 sector analysts, so I don't have to be an oil and gas specialist, or food retail specialist, or a consumer goods specialist. I have to be an ES&G specialist.

What we have to do is look at every single company that goes on our recommended list for our portfolio managers, our investors, before they invest. We look at E. We look at, what is the company's record? Has it had spills, a history of spills? Is it a one off? Is it consistent? Is it an outlier with its peers in the industry?

How is the management of this environmental responsibility carried out through the organization? Does it report up to the board, or is it in some cupboard somewhere, with some mid-ranking staff member looking after it, which tells us it's not managed strategically? So, it's unlikely to be being managed properly and well. That was one of the lessons of the spill in the Gulf of Mexico.

We do all of this analysis. Who is on the board? How long have they been around for? What other board seats have they got? Because, again, if you are a board member and you are doing the job properly, and you are sitting on 7 or 8 or 9 or 10 other boards, which is very common in markets like the US, then we would argue you are very unlikely to really be doing your job properly.

We need to know all of these kinds of things. What is the diversity of the board? What does the composition of the board look like? Is it really going to be helping the management team understand the changing nature of their customers, the changing nature of the supplier universe? Diversity is a very, very important indicator of that.

Again, I can think of a very large US fast food company you'll all be very familiar with. It's had a company that's had a very difficult few years, and one of the things that, if you looked at that company a few years ago, you would have said, "Hang on a minute. This board needs some refreshment: (a) Some of these people have been around for decades, (b) they all look the same, (c) there is no diversity on this board.

Think about the customer base. There is nobody with technology expertise. How is this company going to change its business model to offer the products that it needs to sell in the modern world, where technology is key in the fast food industry? It doesn't have anybody in the boardroom who understands technology.

In the last several years, the company has made huge efforts to change the diversity in its boardroom. That's not saying it does not face business challenges, but what it is saying is the company has realized it is challenged and has gone out there and started to do something about it. That, for us, is a very, very good sign.

When we look at that company, we are more likely to say, "Guess what, the risk–return has shifted in our favor. There is a greater alignment between the company, the oversight, the executives, and the shareholders. That will unlock value."

Another good example in the US market: a very, very large US technology company. You'll all be familiar with it. It begins with "M," like the other company I've just mentioned. I'm sorry, I'd love to mention companies, but I work for BNY Mellon; ultimately, Newton is owned by BNY Mellon Group, so we have compliance, and compliance doesn't like me mentioning companies. That's why I'm anonymously talking about companies.

This other very large company, hugely successful founder, found it very hard, not surprisingly, to step away from the business. In essence, the board was stuffed with his fellow founders and cronies. That creates challenge. Why? Because you cannot see the direction sometimes the company needs to go in, the changes that need to be made if you are so close to it, particularly if you've founded the business. We see this a lot.

In the course of the last several years, this company has been able to transition very successfully from a founder-led business model to having, not best practice maybe, but good practice. Four independent directors on the board; founder has stepped right out of the business.

Another thing that they've done is that they have begun to put in place performance conditions around pay. It's not 100%, but it's 50%. That's in response to a lot of demand from shareholders saying, "Guys, you can't just pay yourselves for sitting in seats. There've got to be performance conditions around pay."

They've also done something else, which is very progressive in the US market. You may be familiar with the whole proxy access campaign that's being led by the big public sector funds — essentially giving shareholders the right to nominate directors to the boards because, again, maybe you don't know this, but in the US, shareholders don't have the right to nominate directors. Basically, it's like a country club. The board chooses its mates. That's why you get people sitting on the board, who've been there for 20, 30, 40, 50 years. Even where shareholders vote against a director on the board, and a majority of shareholders say, "This guy has got to go."

What happens next? He tenders his resignation to the board. The board turns around and says, "Well, we don't accept your resignation." Even in the face of a shareholder vote to get somebody off the board, the board will overrule and keep the crony on board. We do not think that is acting in the interests of shareholders. That is not OK. I'll show you some stats about how we vote in a minute.

This very large US technology company has taken this on board and given shareholders the right to nominate directors to the board. If you go back to the office and you put the ticker into your Bloomberg or whatever system you use, you will see that this company has nicely outperformed the index. Is that exclusively because of those improvements in governance? No. Absolutely not.

Do we believe that the more robust governance arrangements, the independence in the boardroom, the better focus in the boardroom, the stepping away of the founder, the creating of performance conditions, and the knowledge that shareholders have oversight through the director elections process, do we believe that is an integral part of the overall performance story of that company? Yes, we do.

Do we believe that we are being paid adequately to own that company, despite the fact that it is not perfect? This is not about being perfect. This is direction of travel and going in the right direction. Yes, we do. We are a very, very happy investor in that company.

Research and Analysis

We then do this thing called "engagement and stewardship." Stewardship is a word that we use in the UK. We call it "active ownership," more broadly. That's a term that you will begin to hear a lot, I think, in the US. What does that active ownership mean?

It means you're not a passive shareholder. You don't just sit there with your arms folded and saying, "Oh, fine. We'll see what happens." You actually are committed to having a dialogue with the companies that you invest in. Again, this is a revolutionary concept to the US market. In the UK, we do 800 company meetings a year. That's globally. That's just not in the UK.

We will get chairmen, chief execs of companies. We will get senior independent directors, board directors, chairs of remuneration. You name it. They will come in and they will talk to us about what's going on at the company.

They come in without advisers. They come in without bankers. They come in without lawyers. We all know we're in the public domain, so no one is saying anything they're not supposed to, but we have a very open dialogue.

Yes, it's behind closed doors. That's entirely normal because we are the investor. We are asking the company about their strategy and how they're going to really look after us as investors, but it's an open dialogue. That doesn't happen in the US because as you will know, you can't go anywhere without a phalanx of advisers. You trot out. You do your quarterly earnings call, and then you trot back into your ivory tower of your corporate headquarters and you don't really talk to investors. Guess what happens in the US? This is where we have ended up.

You end up either in the awful situation where you end up with class-action lawsuits because things go wrong, and ultimately you litigate, or you get activists on the register. Now, activists can be a very good thing. We have no problem with activists. They can unlock a lot of value, but activists are interested in themselves. OK? The value that they are trying to create is for themselves. You may get to go along for the ride, as the long-term institutional investor. Most of the value is going to sit in the pockets of the activist and the activist's agenda, which may be 2 or 3 years, is not necessarily aligned with the interests of an investor investing for 20 or 30 or 40 or 50 years.

There is not necessarily any alignment of interest and a lot of the value creation that might be unlocked is going to go into the pocket of the activist. Plus, they're waging the campaign in the media. That is not a very comfortable place to be talking about investment issues.

Why are you doing it? It's clear. Creates a lot of momentum and you get people coming behind you. We would argue, don't wait for that to happen, have a dialogue with your long-term shareholders in the spirit of openness and trying to improve the overall way that the company is managed.

That is beginning to change in the US. There is a realization amongst institutional investors that activism isn't necessarily acting in their best interests, as long-term deployers of capital, owners of companies.

There is a realization among company directors that not talking to your long-term shareholders and waiting or hoping, oh my God, the activist doesn't come along; that is not a sensible, coherent, long-term strategy. This engagement, this active ownership, simply means having that dialogue.

My experience, our experience, is, when you have a dialogue with companies, most, they may not like what you say. They don't have to like what we say. We're bringing a view. But, they will have a grownup conversation with you and, often, the changes that we request, as shareholders, are changes that the company will make over time.

Think about the two "M" examples that I've given you in the US markets. Shareholders were advocating for those changes. They were also doing something else to push for those changes. This dialogue, this active ownership, is partly a carrot, a dialogue, but there is also a stick if you want to use it.

That stick is the next thing. I hope this works. I'm slicing up my candy cane again. The stick is your annual vote at the proxy round. Now, why is that a stick? Very simple: You can support management. You can say, "You're doing a great job," or you can do something else. You can say, "We do not support what you are doing. We have had a dialogue with you. You are not listening, and we are going to exercise our right to withhold support from you."

That is a matter of public record. Shareholders have this really powerful tool to express their discontent with management direction, policy, board structure, whatever the heck it might be, by voting against. Again, active voting, tick in the box, X in the box. It's a really, really powerful tool.

No company likes to have its shareholders vote against it. I can tell you that because sometimes we do this. We have our dialogue with companies and they know exactly what we think. By the way, we tell our clients as well, so it's all in the public domain.

Sometimes they don't like what we say. They will pick up the phone. A chairman or a chief exec will pick up the phone, to my chief exec, and say, "We just had a meeting with your ES&G team, your responsible investment team, and the sector analyst. They clearly don't like what we're doing. We think they're going to want to vote against us because basically they are saying they can't support us. Can you essentially go and influence them, change what they're thinking?"

The response is always, "No, because the team is independent. They're acting in the interest of our clients. If they have respectfully had meetings with you and told you what we think and why, and you have listened but you're going to not do anything about it, then we're going to vote against, and it is the team's decision."

Companies hate it and will go so far as to ring up the chief exec and say, "Do something about this. We do not want you voting against us." Never, ever let anyone tell you that your vote doesn't count.

If anything, the issue that we've had is investors have been pretty weak about casting their votes actively. Why? It's hard work. We own about 700 companies so it's not that much. We're active managers. We're not index constrained in any way. There's much more of the market we don't own than we do.

But imagine if you're owning thousands of companies and you're trying to look at this actively. Really hard work; easier to vote with a policy, and ISS will give you a lovely policy, and you can just do what it says, what the ISS recommendation says, and if it's a hard issue and you can't make your mind up, you can sit on the fence and do what's called "abstain," not make a decision.

We do not abstain. Our view is very clear. If you're going to be a responsible investor taking ES&G seriously, you need to either tell management you're supporting them or withhold support and vote against. Sitting on the fence is not an active decision. It is a no decision.

The carrot is the dialogue, the engagement. That is prompting a lot of debate with clients in the US at the moment about what that means and what it means for me and the changes it's going to make because of this realization that so much value has accrued to activists, and that's not necessarily in the interests of other shareholders.

The stick can be your vote. Use it actively. If you're using external managers, if you're in that kind of relationship with sub-advisers, I know there's a huge great diversity of people in the room, but make sure they're voting and actually ask them. Say, "OK, my clients care about this," or "I care about it, so how are you casting your votes? Is it 90% of the time in line with ISS, and if so, why, if you say you're an active manager, because your clearly not spending any time thinking about this thing that you say matters such a lot? If you think governance matters, if you think E and S, the management of E and S issues, needs to be thought about strategically at board level, then why are you just tagging along and voting in line with an external voting adviser? It doesn't make sense."

Next thing, I'm not going to spend a lot of time about this one: Sometimes change can't happen from the bottom up. We could do everything that we wanted with other committed investors, and we do work with other investors who like us believe that responsible investment is about risk and return.

But sometimes you need a systemic change so we will also work through industry bodies. That might be things like the International Corporate Governance Network, through the CII, the Council of Institutional Investors. It can be through dialogue with the regulators, all sorts of different ways where we think a systemic change is necessary so something like the SASB Initiative, the Sustainability Accounting Standards Board.

Let's drive a uniform standard because one of the biggest issues that we have in this segment of the market is a lot of the information is hard to find. It's getting better, but it's still quite hard to find, and there's no agreement on what it should look like.

Those kind of systemic initiatives to get us to the stage of uniformity are quite useful. It just makes life easier. It doesn't mean you can't do the work. It just makes it harder to do.

Then the final thing I said I was not really going to talk about, but I do have to mention ethical screening because for some clients taking companies and sectors out of the portfolio if it is consistent with their values — so now we're into values-based investing, not financial value — that is an entirely legitimate decision for the client.

It is not a decision for us as the fund manager. About 5% of our public business is ethically screened and screens, you won't be surprised, it's the normal stuff, tobacco. Increasingly for some clients, it is taking some sort of fossil fuels out of the portfolio, most significantly coal, which is pretty easy to do as there aren't very many pure-play coal companies listed in the equity markets.

Screening is a legitimate way to be a responsible investor if you are values based. That's the most important distinction. What we do at Newton is what we call "integrated" so it is just part of the investment process.

It is the day job. It doesn't really matter if you're interested in it or not. You get it because we believe that it is consistent with alpha generation and that is why we do it. It's just in there. If you want to find out more we can unpack it for you, but you just get it.

That is the approach that most investors in the US are now waking up to and saying, "Hey, why wouldn't I have this?" If this is just casting a bigger light and looking at more things and once you've called them risk, then you have no choice but to look at it because risk is financial.

So they're saying, "Right. Tell me how this is integrated into my investment process. Tell me how you think about these things, and tell me what particular things you think are creating that idiosyncratic risk or that source of potential alpha in a given sector or given stock." That's integration. Any fund manager can do that if they want to. It's just the day job.

The next bit, which I think is what's going to happen in the next session, is about impact investing, and that is really where you set out ahead of time, ex ante. You have a financial objective, but you also have an explicit social or environmental objective.

For some clients it means giving up return and, again, it is their decision if they're happy to accept return give up. Others will say, "I want to be impactful, but I do not want to give up return." In that sense you're probably back at doing integration because then you are looking at how companies are responsible businesses.

The contention is that responsible businesses are better businesses, compounding returns back to investors, taking their environmental responsibilities seriously, their employee and other stakeholder relationships seriously, that are generally well governed. That is, if you like, it's an implicit impactful strategy, but it is not setting out a defined environmental or social objective.

We don't go that far. We aim to be impactful investors because we integrate ES&G into our investment process. We can screen if you want to but remember screening is values based not financial value based and will only be appropriate for a subset of clients.

I think I've talked about this in some detail so I will leave you to ponder that, the way we do this embedded invested analysis. We do have material that is publicly available around some of the issues that we think about.

Please do go have a look at the one on "US Corporate Governance Fit for the 21st Century." US corporate governance is not fit for the 21st century. We know that. Changes are happening. That is terrific, but the US market has a long way to go, which is a shocking statement for the biggest market in the world.

But, again, would I then not be investing in the US market? No, that would be insane. That would be insane. Imagine how concentrated my portfolios would have to be and the opportunities I would be forgoing.

I am trying to pick the best opportunities in the US market and, where there is change that needs to happen in the company, trying to drive that change to generate long-term, sustained, and better returns. That's what it's all about.

Then we're asking companies to talk to us so we need to talk back to them so everything we do is disclosed and, again, we produce a quarterly report with all our voting facts and figures and this dialogue that we've been having with companies. It's all available. If you want to find it out, we can tell you how to do it.

I mentioned 800 company meetings. My team does about somewhere between 80 and 100 to 120 in-depth meetings around ESG. Where we've really identified an issue that we think creates a high degree of risk and we need to really dig down into that.

Before I hand over for questions, this is how we voted in 2015. We voted just under 600 companies, pretty concentrated in that case. You can see that, in terms of voting against management, we vote against management in aggregates somewhere around a third to 40% of the time, so active decision. You have got to tell the management what you think and cast your vote accordingly.

As you can see, North America, it's not a great picture. In 85% of the time, that means one or more resolutions on the ballot. That's not voting against everything the company does. That would also be insane.

It means that, one or more resolutions, we're voting against the company management 85% of the time, and in Q4 2015, I can tell you that it was 100%. Every single US company we own, we voted against on one or more resolutions. We are not shy of telling companies what we think, and we are not afraid of having a really robust dialogue with them. We think, again, that is a way we protect our clients, we protect our assets, and we generate sustainable alpha for the long run.

If you've got specific questions on the breakdown I'd be happy to take it, but take that away and have a look at it. Active really means active in this case. That's being a responsible investor.

Final word, I said policy work. One of the things that we're doing in London in April, my chief exec, Helena Morrissey, has set up something called the 30% Club, which she wants to get 30% of women on boards. We're at 26.7% in the UK from 12.7% when she up the initiative, so that has had a big measure of success and is now gone global.

We're are now having a seminar in April with Christiana Figueres, who is the UN's chief climate change negotiator. We've got people from Mercer coming in, large pension schemes. A woman called Nancy Pfund. You may know her. She's a venture capitalist. She was the first investor in Tesla.

We are bringing together a group of people who are looking at climate change from a regulatory policy, investment governance, investment opportunity, investment risk point of view, into London to really talk about this issue and how we think investors can really get to grips with it and the kinds of tools that they can use. It's a practical working session. That's the kind of work that we do. Again, happy to invite you if any of you would happen to be in London on the 11th of April.

This is the quarterly reporting I mentioned. The governance one is the one second in from the right. Please do read it. It's my favorite article. I was practically chased out of a room by a finance professor from the University of Ohio when I said US corporate governance was the worst developed market, worse than many emerging markets. That was not a popular comment with him, but I'm still here, and we still say that, so we stand by what we believe.

Just to wrap it up: It's not cellophane. It's not branding. It needs to run through your DNA. Responsible investment is better investment. It is about risk. It is consistent with long-term wealth regeneration and making money for clients, and that is why I believe the demand for, and inquiry into, responsible investment in the US market is on the rise because it is about risk return. That is what we're all about in this room today.

Moderator: Sandra, a number of questions have to do with the available ESG datasets. The MSCIs, the GMI. Can you comment on all of those?

Sandra Carlisle: Yes, I can. We use data providers. We don't rely on them because we do bottom up proprietary so you're right. MSCI is well established. There's also a company called Sustainalytics, which you may have come across, and FTSE Russell is now particularly around environmental.

Data is great. Data is really, really useful, but there is no substitute — and please use the data because it's helpful — but there is no substitute for sitting in a room and eyeballing a company and saying, maybe with that data, "This is what we're finding. This is not consistent with what your sector peers are doing. It's not consistent with what we see in our proprietary research. Can you talk to us about that?"

That ability to sit in a room as an engaged investor and have that dialogue, is not something that data is going to solve for you.

By all means, use data, and an anecdote about what FTSE Russell is doing. Please do look at what FTSE Russell is doing around low carbon. It is terrific. It is really terrific. We had a meeting with them recently and they showed us their data. They've got this wonderful three-by-three really simple matrix, and their job is to provide data, not tell you what to do with it. You make the investment decision using their data.

They said, "You know what? We're going to map out 7,000 companies. We've done 2,000 so far. In a lot of cases just on E issues, environmental issues, we don't have the data." I said, "Well, what do you do if you don't have the data? What happens then?"

They say, "We have to go and talk to the company." So they are doing exactly, as a large data provider, exactly what we do, which is go and sit down and talk to the company to find out the information they need. Then they're coming up with some sort of synthetic data set in that case.

One of the biggest data providers out there is doing what we do as a day job, so there's no substitute. Data is great, but it only gives you half the picture.

Moderator: Did you mention Morningstar? They have something that...

Sandra Carlisle: Yes.

Moderator: Is that part of the...

Sandra Carlisle: Morningstar is using Sustainalytics and what Morningstar is going to start doing is essentially give you a handy way to assess the ESG quality, if you like, of funds, but again it is based on... We use Sustainalytics so I'm happy to say, in terms of what they do, they do a very good job, but they take no account of this active ownership. They do not do governance, and they'd probably be the first person to admit that.

They're not sitting in a room with company management. Again, it's a useful ready reckoner, but it is not really going to tell you, in depth, how embedded is this in your investment approach, and is it used as a source of risk management or outflow generation?

I think anything that makes this industry more mature — I've been doing this as a specialist role since 2005 when I set up a team at Citi, and we were the deep, dark niche in a dungeon somewhere and nobody wanted to talk to us.

Now, people can't talk to us enough. So anything that makes the industry more robust, more professional, gives us more tools, is a great thing, but there is no substitute for doing the in-depth analysis and engagement. Look through those ratings, would be my advice.

Moderator: A few questions with respect to your average holding period for your stocks.

Sandra Carlisle: Yes. Again, as I said, we tend to own in a portfolio somewhere between 50 and 70 companies. We're benchmark agnostic. We're active managers. We will always own less than we will own, and because it takes us such a long time to make an investment, we do not want to have to then trade out. It's very expensive.

If something changes, we will change the portfolio. We will not sit on something forever. That's why I said average is three to five. I could think of one utility company we've now owned for 12 years. We may change the way. It may go up. We may slice. We may top slice. We may reduce a little bit, but basically core allocation to that company.

If you have to change your mind — I think it was Churchill who said that, or maybe it was Roosevelt. I can't remember. When the facts change, I change my decisions. What do you do? It was who? It was Keynes, wasn't it? Was it Keynes? Yeah, it was Keynes. Great man, Keynes. Sometimes you have to change your mind because you get it wrong, but our job is to get it right more than wrong basically.

If I may, one case study that we talk about a lot. There's a very large Latin American oil and gas company, that shall remain nameless because it has to, but you'll know what I'm talking about. We invested in that company in 2000. We still owned it in 2010, so average is average. Three to five is average.

It went from being a very low-cost reserves, more cash on the balance sheet than you can possibly imagine. The governance was not great; emerging markets, but clearly everything's in the context of the local market, but they did a huge equity raise, biggest in the market at the time. Lots of change of regime and massive amounts of political interference that we began to suspect. We went to the company in 2010 with other investors and said, "We need to see some independence on this board, because we're concerned that you are basically appropriating shareholder funds for social engineering purposes. That's not OK, and by the way, you shot your balance sheet to pieces as well because you're doing all of the social engineering."

They put one person on the board they claimed was independent who was not. We went back and we said, "One isn't enough. Two at a minimum, and they need to be properly independent." The company said, "Pfft. We don't care."

Our analyst said, "Management is no longer in control of its own destiny (i.e., state interference)," so downgraded that stock from a buy to a sell, and within six months, this company that we had owned for 11 and a half years at that point and made a lot of money, we pretty much sold out completely.

Average is average, but we aim to be aim to be long term. When things change, you have to make a different investment decision.

Moderator: We don't have that much time. We wanted to get a couple more questions.

Sandra Carlisle: More questions, yes.

Moderator: An unintended benefit then is tax efficiency because a lot of these positions you're holding on a longer-term basis and probably low fees for the portfolio as well?

Sandra Carlisle: [LAUGHS] I am not an expert on the tax status of funds in the US so I've got a colleague, Sam, who's in the back of the room. I direct you to Sam, please, to talk about that. Clearly, yes. Active management so they're not passive fees but pretty competitive, given the approach that we take.

Moderator: What's your view if senior corporate executives decide to hedge their positions?

Sandra Carlisle: In terms of through their stock options?

Moderator: Their stocks, their wealth is tied to company stock.

Sandra Carlisle: Yes, and their wealth should be tied to the business. Again, we don't have any problem with people making lots and lots and lots. We want them to, but we want them to make money that creates value for shareholders, so performance.

We need to see remuneration structures. What they choose to do ultimately is their choice. We're not in there telling them exactly what they have to do, but we want to see well-structured remuneration plans that are based on performance conditions. Anything that works against that is not something that we're going to be supportive of, basically.

Moderator: The role of philanthropy: We haven't heard that word, but yesterday we heard Steve talk about that, right? There's a lot of terms that are being thrown about. What's the line between philanthropy and some of these other...

Sandra Carlisle: I do not do philanthropy. I do investment. All I do is investment, and it's all about financial return and generating alpha. Philanthropy is about giving money away. That's absolutely fine but, again, it's not my job as an investment manager. My job is to generate return.

Screening out is not philanthropy either, in investment terms. Where it blurs is this emerging area of impact investing, where it's come from the world of philanthropy, but the idea is, "That's my giveaway bit. Here I have return seeking, and here I have some kind of blend."

It's a bit in the middle. Where philanthropy blurs into impact, I think is a question for the investor. It's going to be different for different investors.

I would say, the fundamental principle of financial markets, "buyer beware" applies, because when you are looking into this world of impact and this quasi-philanthropic return give up stuff, you will find things that are described as bonds, in some cases I've come across, where 100% of your capital is at risk. That is not a bond. Right?

If you are going into this world of impact philanthropy where that blending is happening, be very careful about what you are getting into because you may discover, you know what an equity is, you know what a bond is, in this emerging world, you may be getting into something that you think is one thing that ends up being something else. It is that blended bit in the middle.

Moderator: Thank you. Excellent presentation.

