RESPONSIBLE INVESTMENT: YESTERDAY, TODAY, AND TOMORROW

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Join Steve Lydenberg, CFA, as he discusses what responsible investment is; how far responsible investment has come since its early days in the 1970s; and what the current states of the practice, trends, and challenges are that characterize this development in finance. Lydenberg also presents potential futures for responsible investment.

Steve Lydenberg, CFA: It's a pleasure to be here. And I am most grateful to CFA Institute for having this opportunity to talk about responsible investment, where it's been, where it is today, and where it's going.

This is a particularly interesting time for responsible investment in the sense that it has established itself to a large degree in the financial community, and I'll be detailing this as a niche market. And there is a very interesting question that I'll be paying attention to in the last part of my remarks about whether or not it will remain simply a niche market, or whether it will continue to spread its influence more broadly and influence some of the fundamentals of finance as it's practiced today.

So I will be going through the history of responsible investment in the first third of my remarks, give you a bit of sense of where it came from, and then turn my attention to its position in the market today, and then spend some time meditating on where it might be going. It is important to give this a context, the history, and where it is today if we are to understand where it is going and where it might be tomorrow.

I want to leave time at the end for questions. I hope these remarks will provoke some interesting thinking on your part and leave plenty of time both to fill holes in what I've been talking about and also to talk about some of the more provocative, I hope, issues that I'll be raising.

So I'll start with a little bit about the history of responsible investment. It, like many disciplines that have evolved over the years, has gone through a variety of different phases. I want to walk you briefly through these phases. I'm not going to give you a lot of detail on each phase. But what I want to highlight on these phases as we go through them is that as a responsible investment has grown, as it has gone through these phases, these phases have left an imprint on responsible investment as it is today. So in order to understand responsibilities today, it is important to understand the phases that it has been through.

The first phase is what I would call the "do no harm" phase. And that goes back to some of the philosophy of various church groups on their investments. This is a quote from John Wesley, the founder of Methodism. And it is typical of some of the attitudes of that time, which is fine with investment. Make as much money as you can in the markets, but do no harm. Do not harm yourself; do not harm others with your investments.

This is a kind of Hippocratic oath — I think it's interesting to think of it that way — for the investments, investment world. It manifested itself specifically in terms of not investing for — or various church groups not investing in alcohol, tobacco, and to a certain extent, certain groups, military products. But the basic idea was that investment fulfills a valuable function in society, but it should do no harm. And this is essentially an ethical position.

An interesting thing happened. This essentially remained unchanged and a very minor part of the investment world until the 1970s, when an interesting development took place, which was that some of the social activism of that time translated itself into a new philosophy building on the do no harm, which is "do good." Use finance to address social injustice issues. So a lot of the concern with civil rights, with the environment, with peace translated themselves into the investment community.

And one particular interesting development was consumer rights being translated into investor rights. And Ralph Nader, the consumer advocate, saw that in his ongoing controversies with General Motors, he discovered that he could actually go to the annual meeting of General Motors and bring up issues of concern with them.

He brought up the issue of diversity on the board, the all-white board, all-white and male board of General Motors. And that led to a very interesting series of events. General Motors appointed an African-American minister from Philadelphia, Leon Sullivan, to its board. Leon Sullivan wanted

General Motors to get out of South Africa. When it didn't, he developed the Sullivan principles for labor practices in South Africa. And those principles became the basis for a lot of the driving force of responsible investment in the 1980s, which was the South African divestment movement.

The point here, though, is that in the early 1970s, investors discovered that they could take issues to corporations through the proxy and engagement process. And in addition to the divestment movement in South Africa, this was the first time that social and environmental issues were brought to the corporate floor through the annual meeting.

And that was basically the story of responsible investment in the 1970s through the mid-1980s. Then two things happened in the late 1980s and going into the 1990s. First, the idea of sustainability was introduced into the vocabulary of responsible investment. This came primarily through work of the United Nations and its "Our Common Future" study, which was from 1986, which tied sustainability and the environment with economic development. So then on top of do no harm and address social injustice issues, you now have environment coming to the fore, and the idea that social responsibility is tied to — responsible investment is tied to opportunities for economic development and lifting people out of extreme poverty.

The other thing that happened in the late 1980s and early 1990s that responsible investment and corporate social responsibility were starting to be seen as a version of soft law that could direct corporations and investment toward public goods. And this came out primarily of Europe. And it was a byproduct of the privatization that swept through Europe of the large national companies that took place in the 1980s and 1990s, where the governments gave up direct control of the national corporations.

And that prompted a lot of concern about globalization and the responsibility of those companies that had been set free from government control. And European governments in particular saw responsible investment and corporate social responsibility as a means of soft law to direct corporations in this way. The attention that the UN and European governments were paying to responsible investment in this slightly new format was a tremendous boost to the whole concept of responsible investment and helped it very much become part of the mainstream.

During the 2000s, again, a couple of things happened here that tied responsible investment more to the practice of mainstream investment. And the first came out of a combination of data available on the behavior, the environmental records and social records of publicly traded companies, and along with the pressure from the government on institutional investors in particular to take an interest in this topic and become active in this way. So the data made possible conceptualization of how this data could be integrated into the material issues, the stock valuations that are the normal practice of finance, of mainstream finance.

At the same time, the 2000s saw two major financial crises: the Enron/WorldCom crisis of 2000, 2001, and the 2007, 2008, 2009 financial crisis. Both of these suggested that there was some kind of instability in the financial system itself. And the idea that responsible investment could also play a role in assuring stability, restoring stability, playing a part in keeping stability in the financial system was also introduced. So the 2000s saw a couple of different ways in which responsible investment then became part of the mainstream community, both the availability of data and then this question of, can it help instability?

So that brings us roughly up to today. During this decade, we have seen an increasing interest in responsible investment. And I'm going to talk in a moment about the specifics of that interest, how it manifests itself. And it has won a general acceptance. In its evolution, it has created a very multifaceted approach, involving both people who don't want to do harm, people who want to address social injustice, people who want to be involved in economic development, who want to improve their practices, mainstream practices. So it serves a substantial variety of clients.

And CFA Institute in October of last year published an excellent overview of where responsible investment is today. I recommend it highly. It's very concise. Addresses all the major issues, and I think it does a very good job of giving an overview.

So just to recap, we now have these aspects of responsible investment. Do no harm, which you can see today, just to cite one example in the CFA Institute Code of Ethics, where it talks about the integrity of finance in serving the ultimate benefit of society. And ethical issues are very much part of the concerns of investment.

So you see that. You see the concerns with building a better world, and the very substantial interest in social entrepreneurship and impact investing. You see the interest in sustainability and soft law, and such things as the creation of a carbon market as a kind of form of soft law addressing the challenges of climate change. You see it in portfolio management, and such things as the Financial Stability Board, which was set up by the G–20 to look at its Task Force on Climate-Related Financial Disclosures and financial stability. So tying together disclosure on climate change and stability of the financial markets.

So that's where we are. That's where we've come to. That's sort of the traces that responsible investment has left today.

So today, socially responsible investment has established itself as what I would call a "niche" market in most aspects of the financial community. The real question is, how much of a penetration is made? How much of an influence is it on the rest of the financial community? And will it just remain a niche market or something broader? And I will turn to that in a moment. But I just want to dramatize a bit where it is today and the different aspects of the financial community.

First, it has worked its way into security valuation at many, if not most, of the largest financial institutions. It has done so primarily because of the availability of data. Typically, this looks like a small ESG team at a large financial institution that goes around talking to the individual portfolio managers and adding to their consideration of factors, ESG factors that they may not be aware of.

How important that data is and how important it's being viewed can be seen in the recent World Federation of Exchanges proposal, which is out for comment now on instituting guidelines for stock exchanges around the world, for requiring disclosure of ESG issues. They model 34 ESG issues. So this would be systematized and consistent across exchanges around the world of having that a basic requirement of listing standards.

I think we're headed for that. In the not-too-distant future, you're going to see ESG disclosure as a listing requirement. That is going to mean a vast quantity of data, comparable data on ESG performance of companies. And you see initiatives, such as the SASB, the standards, accountability — I'm sorry — Sustainability Standards Accounting Board starting up, identifying which of these data, which of these various data are most appropriate for specific industries? After a two-and-a-half-year process, they now have identified these KPIs for 79 different industries.

And you also see this data now appearing on the Bloomberg terminals. SASB is helping focus, and Bloomberg is helping making it easy. So this data is going to be increasingly used for that kind of security evaluation.

You also see responsible investment being applied across asset classes. This is a focus primarily here on equities where you see new product development in terms of indexes that have an SRI tilt. And you see the SRI sector funds look very much like traditional sector funds, but they have, say, a clean tech or an alternative energy or water focus.

But in other asset classes as well, there are initiatives under way to figure out how to incorporate responsible investment issues into product development. So in the fixed-income market, there is a strong interest, emerging interest in so-called green bonds, environmentally focused bonds that are targeted specifically to responsible investors.

In real estate and timber, you see the development of standards that are built into the product itself. The LEED standards, the environmental standards and sustainable forestry standards that are built into the product themselves, which will help investors distinguish products on ESG lines. And then you see it's showing up in asset allocation among pension funds, particularly in the area of infrastructure. Infrastructure, which has a strong public good focus, and is seen as a part of responsible investment in many ways.

So in each one of these areas, it's penetrating the product development and the product standardization. And the question is how far that penetration is going to go and how much influence it ultimately will have on these asset classes.

I would be remiss if I didn't mention also the progress that is being made in business schools in teaching responsible investment-related courses. You won't see this very much in the finance departments, but you see it in social entrepreneurship. You see impact investing contests at the business schools. This gives it a kind of legitimacy and also is responding to the strong interest in the generation that's coming into finance in these kinds of issues.

You'll also see a kind of legitimacy that's coming out of the GIIN, the Global Impact Investing Network, and its related organization IRIS, in measuring the impacts of portfolios on social and environmental issues. Measurement tools of impact and outcome are important if this is going to be a standard practice in the industry.

Probably the strongest signal of the arrival of impact and responsible investing as a market has been, within the last year, the offering by the largest financial institutions of ESG, responsible investment products. So when Goldman Sachs acquires one of the largest and most prominent of impact investing firms, when BlackRock creates an impact investing unit, when Morgan Stanley creates a whole institute for sustainable investment, this sends a strong market signal that responsible investment products are something that have arrived, and virtually assures that most large financial institutions, financial services industries are going to have products in this area.

And finally, the language of responsible investment has started to infiltrate the asset managers, the asset owner — I'm sorry — the asset owners' way of talking about their responsibility to their beneficiaries and to investment in general. So you see focusing capital on the long-term initiative, which came out of many of the Canadian pension funds and McKinsey, which, in its emphasis on the long term has a strong message to be sent in terms of the responsibility of investors to create value and not extract value from the systems.

You see BlackRock now in its second year of sending to the CEOs of all the Fortune 500 companies a letter urging them to pay more attention and report more on their long-term investment policies and practices. Because as an investor, BlackRock is positioning itself for the long term.

Very significantly, you see, coming out of Japan, essentially the largest pension fund in the world, the Japanese national pension fund, the global pension investment fund — almost a trillion dollars — has communicated that it wants stewardship, the word stewardship, the concept of stewardship to be part of the management of its assets. It manages no money internally. This is being communicated to all its managers. So this concept of stewardship is being driven into investment management.

And similarly, the ICGN, the International Corporate Governance Network, has now out for comment a series of stewardship principles. And this idea of stewardship is, I think, a very important one. Again, it has resonance with the idea of responsibility stewardship. It's not entirely clear what they actually mean by stewardship and how that will evolve, that concept will evolve. The Japanese are very much in the process of figuring that out. But that is a very strong sense that the direction that institutional investors, particularly large institutional investors now are taking, has resonance with this idea of responsible investment.

So just to summarize where we are really in this area: Clearly, responsible investment has become part of the investment landscape. It has a seat at the table. It is a niche market. It is almost certainly here to stay for a good long time. But where it is going within the larger context of the financial community is still not clear. It could remain a niche market, or it has the possibility of influencing investment more broadly.

And I'm going to turn my attention now to this larger question. Because in my mind, the future of responsible investment really turns on this question of niche market versus larger influence. And I'm going to spend a bit of time on this particular question.

Before I get into my visions of what this issue turns on, I want to comment briefly on two phenomena, one of which is a relatively discreet, recent phenomenon, and another, which is a much broader one. Which, to my mind, assures that the question itself about the role of responsible investment will be a current question for a substantial amount of time.

This is not a question that is going to go away, both because financial services products and financial services firms are now being rated on their "responsibility" — and I'll go into that in a moment — and because the characteristics of the 21st century are going to make the role of finance in maintaining the basic systems of our society much more important, crucial, and clearer.

So first, let me comment, just within the last year, there has been a movement to rate financial products on ESG lines. This is as opposed to rating corporations; this is rating the products themselves. So it began with this so-called carbon footprinting. Which in essence, organizations like the Carbon Disclosure Project, now known as CDP, and South Pole that track the carbon footprints of individual companies started to roll up the carbon footprints of all the companies in a portfolio so that they could give a score, a rating to the exposure of that portfolio to climate change issues in general.

This functioned sort of in the background and did not cause a lot of attention to this whole process until starting last February, Morningstar announced that it would be — it is now — rating all the portfolios that are covered in its database on their ESG score. Side by side with the financial star ratings for the companies, there is now an ESG rating, a social responsibility rating for the portfolio itself.

The way they do that is they use the scores, the ESG scores, that Sustainalytics assigns to companies. And they do the same process of rolling up these scores so they accumulate to a score for the company. Sorry, for the product itself. This is going to be already very influential, and it is going to drive a whole 'nother layer of assessment of financial products and financial service companies on their responsibility. At a retail level, but you can be sure that if it's even happening at a retail level, that it will be happening at an institutional level as well.

One of the questions, the key questions that these ratings don't answer is the question of intentionality. Is a portfolio — does it have a high ESG score simply by chance, or was the selection of the portfolio done by the provider deliberately? And the other question that it doesn't answer is, What else is the provider of the portfolio doing in the way of engagement, proxy voting, field building, partnerships with NGOs, public policy, advocacy? All of that is left unaddressed by the rating system as it is now.

That won't stay for long. They soon will figure out how to rate not only the portfolios, but in essence, the whole investment philosophy behind investments for both the retail portfolios and, if it's being done for retail portfolios, institutional investors certainly will want it done for the institutions.

I don't think I have to remind you of the changes that are going to take place in the 21st century. The 21st century will be different from the 20th century. Finance will look different in the 21st century than it looked in the 20th century.

It's relatively easy to see why things will look different. A population of 9 to 11 billion people will make different demands on the world. The raising out of poverty of 2 to 4 billion people, empowering them with investment power. Assets under management are going to grow tremendously. The aspirations for higher standards of living are going to place demands on the environment.

We are going to see a much more interconnected, and in certain senses, fragile world in the 21st century. What the role of finance will be in that, it's not clear what finance will look like. But it is clear that finance will play an important role in that, and that also will keep the question of finance as a responsible investment, as a factor in finance in the fore.

So if responsible investment were to have influence beyond simply the niche market that it is in today, what would that look like? That's a question I've been struggling with over the last, oh, 18 months or so. It seems like it should be an easy question to answer, but I think it's actually a very difficult question to answer.

My instinct is that it will have something to do with systems. What's happening on the systems level, not just the portfolio level? Moving finance beyond looking at just the portfolios to understanding the implications of what goes on at the portfolio for the larger systems, and what goes on at the larger systems for the portfolios.

I think these lessons were brought home in part by the 2008 financial crisis. When that hit, there was no place to hide. When instability in the fundamental system takes place, you cannot hedge your risks.

This same lesson is going to confront us as investors with climate change. And there's a very interesting study done by the University of Cambridge Center for Sustainability Leadership called "Unhedgeable Risks," which I recommend, which looks at the three scenarios under climate change and four portfolios and hypothesizes under those scenarios what the changes will be, what the effects at the portfolio will be. And for the most aggressive portfolio, it found that 50% of the adverse effects of climate change would not be hedgeable.

So this systems level is something that I think is going to be the concern of responsible investment. And if responsible investment is to influence the rest of finance, it is going to be by helping finance think beyond the portfolio to that systems level.

Because I've been thinking about this, I've been instrumental in the creation of a project. It's called the Investment Integration Project, the goal of which is to help think about this feedback loop that takes place between investments and systems, and systems and the investments that they take place in.

This way of thinking about systems, I think, represents a fundamental evolution in how we think about finance. In the 20th century, we went from thinking about finance as being — responsible investment meant, don't invest in a risky security. And you had the legal lists that were put forth for fiduciaries, telling them exactly what they could invest in and what was too risky. And that all was reformed fundamentally by the introduction of modern portfolio theory, and the understanding that you can manage risk at a portfolio level. You can invest in risky securities, as long as risk is managed at a portfolio level.

And what I'm suggesting is that a natural evolution of finance is then to take that from the portfolio level also. Not forgetting your portfolios. You live and die on your portfolios every day. But understanding how your portfolios also affect the systems that you have repercussions in, and how those systems can affect you, and managing risk at that level. So understanding that, promoting dialogue on that, developing tools. So investment managers can think about that as part of the mission of the integration of this so called T-I-P-P, TIPP Project.

In a certain sense, this seems almost common sense that you want to understand the relationship of what you're doing to the world around you, and the world around you to what you're doing.

Making the transition from how we are conceptualizing finance to that almost common-sense next step is not entirely easy.

And I just want to conclude these remarks by taking one example of how conceptually difficult this may be and what direction it might head up. And that is to answer the question, if you are thinking about both your portfolios and the system levels, what would reporting look like? And this is an idea in gestation still. This is as far as I've come on this, thinking about this.

Here is where we stand today. We have a portfolio that's made up of a diversified set of assets. And to our clients, to our beneficiaries, we report on how that portfolio has performed in the market. And that performance is essentially price based. That's how we measure performance. That's what the market is good at, is setting prices. We have a very sophisticated way of reporting on portfolios, their performance, risk management, and portfolios.

If we are talking about managing risk and rewards — and I don't want to forget the rewards part of this — if we're talking about managing risk and rewards, at the systems level, that these larger systems level, what would that report look like? That's really the next step here. If we can figure that out, then I think you will actually have figured out how to make this easy.

But the temptation is to collapse that report into the price report. But my instinct is that that report will need to be a separate report done in a language that is separate from the language of finance. That language might have to do with stress testing. It might have to do with scenarios. It might have to do with alternatives to definitions of progress in finance. I'm not sure exactly what it would look like. But my instinct is that there would be a separate set of reports in that level.

So that is just one illustration of the kinds of issues that if responsible investment is to progress beyond a niche market into this broader area, that it would want to deal with. There are a number of other issues. Issues of collective action, issues of measurement, etcetera. Definitions of what constitutes a system. Those are issues that would need to be contended with. But this is a direction that I think, given the quality of finance and the larger world in the 21st century, that I think responsible investment may, in fact, go on.

So I have covered a lot of ground. And I've listed here a couple of resources in case you want to delve into these areas further. The first is an article that I did with a French academic, Céline Louche, on essentially the evolution of responsible investment. It's a little hard to find it, but it will give you an overview.

But also, the CFA Institute piece is really excellent on that. And if you want additional thoughts on why systems-level thinking might be of use, there's a reference to a background paper and the TIPP website that you could delve into more.

So with that, in the way of background, I'm hoping we have some interesting questions and time for a discussion. Thank you.

[APPLAUSE]

Susan Spinner, CFA: Thank you, Steve. And thank you to everyone in the audience that provided a question. We have so many here. I've spent most of my time now trying just to sort through them, and I'll try and get through as many as possible.

I think probably one of the key points that you mentioned at the beginning was the turning point when data became more available. And that's also something that several of the questions are concerning. Of course, at the beginning, it's great that we have data. Through time, that can become also a monster in terms of all the information available. The question is: How should we address the subjectivity in using the data in analytics, especially with respect to ESG scores?

Steve Lydenberg, CFA: Right. Let me sort out two different questions. One, how to deal with the proliferation of data and the fact that the data touches on lots of topics. So I think the increasing use of key performance indicators in the sustainability world and what SASB has done is going to help address that.

What is one of the things that's interesting about corporate social responsibility data as opposed to accounting data is that accounting data is essentially the same for all companies. Well, not essentially the same, but there's a basic kind of consistency across that. And with ESG data for companies, it is very varied, and its usefulness is very varied. The issue of water is completely different from one industry to another. So figuring out, what are the key ESG issues for each industry is an important thing.

As to subjectivity, I think that part of the point of the key performance indicators, particularly as SASB is doing them, is to tie them to studies of materiality. So increasingly, as this data becomes available, more and more academics and more and more practitioners have done studies of which data is most material to stock performance. So I think relying on materiality helps address that subjectivity issue.

I will also say that clients, particularly in the area of retail and high-net-worth individuals, come to responsible investment with very subjective concerns. So matching those subjective concerns with a particular issue is a challenge, but a doable one.

Susan Spinner, CFA: So you don't have a lot of concern? There's actually two questions very similar here, that you're not concerned that this would become just a ticking-the-box exercise from an investor standpoint.

Steve Lydenberg, CFA: Well, there is a — yes. There is a concern about ESG data that is gathered in what I would call a "policy tick-the-box" methodology. So that leads to such things as Volkswagen receiving a very high rating, BP receiving a very high rating.

And I think that one of the virtues of the key performance indicators and the use of ESG data to evaluate quality of management, which I think is particularly well suited for, and to understand the quality of management in dealing with issues that are coming down the line, is that those are less tick the box. You can't deal with them in tick-the-box issues. So those users of the data that are looking at issues of quality of management, corporate culture are, in my view, likely to make much better use of it than simply ticking the box on policy, and not so much practice.

Susan Spinner, CFA: OK. And of course, as you anticipated, there are quite a few questions about performance with respect to SRI portfolios. How to balance, first, that performance using SRI in the portfolio. And then additionally in terms of your fiduciary, if, in fact, that means higher costs, is that actually appropriate?

Steve Lydenberg, CFA: Yeah. So two separate questions. One on performance of the portfolio, and one on costs that are incurred. In terms of performance, there have been many academic studies over the years. I recommend highly the website called sristudies.org, maintained by Lloyd Kurtz. He has picked out, in my view, many of the most relevant academic studies.

In my view, the net on the performance issue is that in capable hands, it's a wash. There is no necessarily gain, as some would argue. There's no necessary loss.

I'm particularly influenced by the performance that has been analyzed in substantial detail of the MSCI KLD Social 400 Index, which has been the largest index — the longest-running index. It's got a 25-year track record.

The first 18 years of that track record were analyzed by Lloyd Kurtz and Dan diBartolomeo of Northfield on a risk-adjusted basis. It outperformed on a non-risk-adjusted basis versus the benchmark in a non-screened index. And this is an index that eliminates basically half the S&P 500. It's very broad in its screens. So on a risk-adjusted basis, it was 1 basis point of difference of the performance. So my basic position is that in capable hands, it's a wash.

The issue of cost is real. It's additional cost to do the social and environmental research. You can argue that that's additional due diligence, and that's a cost that's worth bearing.

You can also argue that the cost to the portfolio — if the cost to the portfolio is offset by benefits to the system, and if we can measure the benefits to the system, that that cost can be offset by the benefit to the system. Or put another way, those that don't consider ESG issues, if those are damaging the systems, if it's destabilizing the financial system, if it's destabilizing the social or the environmental system, that it's extracting value from those systems, that is, the cost saving on the portfolio side comes at a cost on the system side.

Susan Spinner, CFA: Yeah. OK. There was also a lot of interest — you touched on it, but maybe you could go a little bit more deeply just into the valuation process for individual securities. What is the main source of ESG ratings for individual securities, and what process would you recommend as the best for evaluating an individual security?

Steve Lydenberg, CFA: So there are numerous sources of data now. And there's been a fair amount of consolidation in the ESG rating business. I would advocate that these are good sources. But ultimately, the ESG decision is your decision.

And you need to understand in the sources, because they don't all agree on what's a responsible company, and what isn't. So they need to be taken all with a grain of salt. You need to have your own particular perspective. And you need to understand the limitations of all these systems. They all have their strengths. They all have their weaknesses.

As I say, my particular bias is toward systems that are most attuned to how companies handle things that are difficult to quantify. How have they handled a particular crisis? There's no tick-the-box answer to that.

What is the direction? What is the trend within the corporate culture? Do you see a pattern of problems across different stakeholders? Does this company have a problem with both employees and the environment and consumers? So it's that kind of overview of issues that are, in essence, hard to quantify. Unfortunately, that means you have to do some of the work. But I think that's your responsibility in any case, on all areas, and the financial area as well.

Susan Spinner, CFA: Maybe just one, the terms — ESG, sustainability, SRI. They're all used sort of interchangeably. Specifically, do you see a difference in your opinion between SRI and ESG? And if so, what is it?

Susan Spinner, CFA: I could make up a difference between them. Essentially, I view these terms as dealing with the same — underlying all these issues. And there are real differences between the different terms.

So impact investing tends to refer to small-scale, private-equity investments and private placements that deal with very specific social issues. SRI tends to refer to the public markets. Sustainability tends to have an environmental focus, bias, stress.

Underlying all these different approaches, though, I see as a fundamental concern with the systems that make investment possible, and they form a kind of mosaic. And it's important to have that mosaic. It's important to have those different approaches. Because if we are to look at the whole of the systems that support investment today, you need to have people paying attention more to this issue, and more to that issue, and more to that issue, specializing in these different areas.

Susan Spinner, CFA: Thank you. There was a few questions also, sort of just looking at the potential downside to this type of investing. First of all, is it the case that in fact, you're actually kind of restricting your investment universe, of course, if you're just investing responsibly? And then beyond that, if everyone goes out and sells the non-responsible stocks, be it coal, oil, etcetera — this morning we had the wonderful plenary session with contrarian investing — isn't that a super opportunity, and shouldn't a good investor be looking into that?

Steve Lydenberg, CFA: Yep. So see how to answer this question —

Susan Spinner, CFA: The two sort of different ones.

Steve Lydenberg, CFA: — properly. I'm sorry. The first question was —

Susan Spinner, CFA: The first one was just in terms of restricting your —

Steve Lydenberg, CFA: Oh, restricting the universe, yes. When I referred to responsible investment as in capable hands, mean, essentially it was to address this restricted universe issue. I think that in the world, in highly liquid markets with multiple investment opportunities, restricting your universe is something that can be handled. In theory, there may be a cost in practice. There has not been a real cost.

And the second part of the question was the —

Susan Spinner, CFA: Contrarian.

Steve Lydenberg, CFA: — don't you create investment buying opportunities? Yes. You do create investment opportunities for others, but that leaves — let me take the case of coal, for example, or oil in the energy area. Because it's a particularly interesting and difficult question for investors to handle now. Because it does dramatize the situation of a — I'm going to call this "hedging your bets" on climate change or extracting value from the climate change concern with climate change, while the system itself, the climate itself, deteriorates.

You can do that. It leaves the investor in an uncomfortable position, which is, basically, my portfolio is OK. But I really don't care what happens to not only other portfolios, but the rest of the world. And that is a kind of approach that a system can bear a certain amount of but will suffer. The whole system will suffer, and everybody's portfolios will suffer if it is common practice.

Susan Spinner, CFA: Deciding which way I want to go here. I think we'll talk first maybe just about, obviously there's a huge amount of interest now in passive funds. And the question would be, how do passive fund fit into the picture of responsible investing?

Steve Lydenberg, CFA: Yeah. Very interesting question. Because theoretically, passive funds buy a whole market, whatever their particular market is. And theoretically, passive funds are essentially buy and hold. They can't "get out" of individual stocks.

And so there are two approaches to that. The first is the ones that — very large money managers who invest very large portions of their holdings passively, such as BlackRock or PGGM, would do. Which is to say, we are committed to these companies. We cannot get out of them. Therefore, our only option is to improve their performance in terms of social and environmental issues. So they engage. They have an elaborate program of engagement with companies which are in the index. So that's one way of handling it.

The other way, it's not strictly true that a large-cap investment has to be invested in oil. You can have an index that simply eliminates the fossil fuel development areas. MSCI has something like 90 different indexes now, many of which have social and environmental tilts. So you can invest in indexes that have environmental tilts to them. So either of those approaches gets part way to addressing that problem.

Susan Spinner, CFA: If we move back into active investing, there's actually several questions with respect to the view of a retail investor, and actually, coming from two different angles. First the investor themselves. How do they gain better access to information about a particular company in terms of responsible investing so that if they're holding stock, they can vote their proxy appropriately? And then from the other angle, what should a company be doing to inform an individual investor better about what they're doing in terms of responsible investing?

Steve Lydenberg, CFA: Right. So in terms of the proxy voting, there are a number of investors, including CalPERS and the Domini Investment that post not only their guidelines on proxies, but before the voting is due, they post how they will be voting so that retail investors can get a sense of how others are voting, others who have access to proxy voting background material such as Glass Lewis or ISS. So that's one way around that problem. In terms of — the other question was about the —

Susan Spinner, CFA: How the company itself can offer more specifically to a real-time investor that information?

Steve Lydenberg, CFA: Yeah. So virtually all large corporations now do ESG sustainability, corporate responsibility reports, whatever their particular name. So that's available on their website. So for large, publicly traded companies, that's simply the best and simplest access to that.

There's a movement to have ESG reporting integrated into financial reporting so that it'll all be in one place, and you can have the financial and ESG all together in one place. And that's gaining some traction, and a number of companies are also doing that. And that'll make it simple to get both information at the same time.

Susan Spinner, CFA: OK. Do millennials see responsible investing differently than the baby boomers did?

Steve Lydenberg, CFA: I think both baby boomers and millennials, a large portion were concerned about the social and environmental implications, and wanted to have impact. The opportunities that were available to the baby boomers were few and far between.

What the opportunities are to the millennials, as they are coming up now, are substantially greater. And they are encouraged. They are informed better, both through the publicity that social entrepreneurship gets and impact investing gets, as well as through curriculum that's being taught at schools. So they are in a much better position to actualize their inherent interests.

