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WHAT DOES IT LOOK LIKE FOR

ASSET OWNERS TO LEAD

RIGHT NOW?

AN ANALYSIS LOOKING AT ESG AND SYSTEMS-LEVEL INVESTING

THE CHURCH OF ENGLAND
PENSIONS BOARD

Wespath

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Introduction

A Foundational Role

Asset owners (AOs) have played a foundational role in shaping the Environmental, Social and Governance (ESG), and sustainable investment industry. In many parts of the world, including the U.S., deep thinking about the "socially responsible" means of investing can be traced back to faith-based asset owners in the 18th century.[1] As "socially responsible" evolved into "ESG" investing, AOs were leaders in advocating for the integration of sustainable investment considerations into investment mandates and the broad markets. The Principles for Responsible Investment (PRI) states how AOs "set the direction of markets and therefore play a key role in promoting and embedding ESG."[2]

The rapid expansion and recent pushback on ESG integration makes it an important moment to consider what effective asset ownership in sustainable investing looks like today and moving forward. Having spent the last year reflecting on this question, the author's would argue a key part of this path forward for AOs is to better understand and address systems-level sustainability risks.

This paper begins with setting out the "why" that underlies the authors' above belief. This section also includes an outlining of "what" this paper is (and what it isn't).

Next, the paper will outline common terminology for some of the terms referenced throughout with the intention of providing a shared language for clear dialogue with the reader.

With common language and the "why" set, the authors will engage in a candid accounting about their view of the successes and failures of past efforts to promote and embed ESG within the financial system. The paper will build on the foundation of these findings in level-setting the challenges and opportunities associated with AO action on systems-level risks and opportunities.

The paper will conclude with multiple emerging opportunities for an AO interested in taking a taking a systems-level investing approach.

The Principles for Responsible Investment states how AOs "set the direction of markets and therefore play a key role in promoting and embedding ESG."

[1] https://insights.danainvestment.com/blog/the-history-of-faith-based-investing

[2] https://www.unpri.org/investment-tools/asset-owner-resources

A Brief Explanation of the "Why" and the "What"

Asset owners (AOs) are responsible for delivering absolute investment returns to meet their long-term liabilities and commitments—liabilities and commitments which often revolve around enabling their clients and participants to meet their financial goals. For pension funds alone, this responsibility covers hundreds of millions of beneficiaries worldwide. Achieving these returns requires pursuing investment opportunities while managing a wide range of financial-related risks.

These risks and opportunities take many forms, many of which the financial system is already equipped to understand and account for. However, the financial system is not well-suited to address systems-level opportunities and risks related to sustainability. These systems-level forces are important to understand and account for because factors like climate change will likely increasingly affect the absolute returns that AOs depend on.[3]

Asset owners who are concerned about systems-level sustainability often talk about an impetus for this work being the need to preserve the broad health of the economy upon which their long-term, absolute returns rely. If we extend the analogy of health further, some market opportunities represent healthy behaviors that can strengthen the overall economy, as represented by La Caisse's recent commitment to increase their climate action investments to C$400 billion by 2030.[4] On the other hand, certain risks represent a growing series of illnesses that threaten this health. For example, as argued by Guenther Thallinger of Allianz in a recent op-ed, a risk like climate change could be a terminal illness for a functioning global economy.[5]

C$400 billion
in climate action investments by 2030
La Caisse's recent commitment

These challenges, these illnesses, are serious, as are the opportunities. However most, if not all, AOs still struggle with how to integrate these significant long-term trends into risk-mitigating or opportunity-seeking action in the short and medium term. One of the key questions this paper wrestles with is how asset owners can best take action today to promote the long-term health of the economic system upon which we all depend.

In this paper, the answer to this question is drawn primarily from the perspective of sustainable investment professionals from faith-based AO institutions. These institutions have a long history of leadership in ESG and sustainable investment. As faith-based investors, our commitment to advocating for values-aligned issues such as care for creation and respect for human rights reflects both the responsibility charged to us by our respective Church bodies and the financial materiality of these topics.

However, while our institution's work explicitly has this moral and ethical perspective embedded as faith-based entities, we are not seeking to exclude the many investors who do not share that lens in this paper. Instead, we sought to make the reflections and insights we share relevant to all investors—because **navigating the increasing influence of these system-level sustainability impacts is a challenge facing the entire investment community.**

[3] https://www.ngfs.net/ngfs-scenarios-portal/

[4] https://www.newprivatemarkets.com/how-la-caisse-plans-to-reach-c400bn-climate-action-target/

[5] https://www.theguardian.com/environment/2025/apr/03/climate-crisis-on-track-to-destroy-capitalism-warns-allianz-insurer

A BRIEF EXPLANATION OF THE "WHY"

The paper is also informed by conversations and input from many AO leaders and key partners outside of the AO community. We want to extend our deepest gratitude to the colleagues and friends that have contributed time, wisdom, and insights to this paper.

The colleagues and perspectives referenced above are primarily based in the investment community in North America and Europe. We acknowledge that limited sectoral and geographic representation will cause certain blind spots or unintended biases. We are aware of some of these shortcomings, such as an avoidance of an in-depth wrestling with important topics like the just transition which felt beyond the scope of this paper. There are doubtless many other topics we are unaware we missed. We must ask your grace in these shortcomings.

Lastly, it is important to note that the intent of this paper is not to argue the case of systems-level investing from a pure quantitative perspective, nor to meet the academic rigor of a peer-reviewed research report. Instead, we hope this can serve as a practitioner perspective that helps spur further academic engagement.

Examples of different sources of work that were consulted in this paper include recent publications by Scottish Windows[6], previous work from ICGN[7], and continued academic research from academic institutions such as Columbia University[8] and London School of Economics[9].

All of these caveats are shared transparently to name both the paper's intentions and its limitations. They also highlight a central framing—the authors do not intend to present this work as a definitive authority on all systems-level investing. It is also not a presentation of a "how-to" guide on systems-level thinking. Instead, it is the hope of the authors to contribute to an ongoing conversation that explores the issues and the opportunities they see in discerning what future leadership could look like for asset owners committed to sustainable investment. We look forward to continuing the conversation with many of you in the days to come.

We explore the issues and opportunities in discerning what future leadership could look like for asset owners committed to sustainable investment.

[6] https://expertise.scottishwidows.co.uk/investment-perspectives/july-25/why-systemic-risks-matter-for-investors/

[7] https://www.icgn.org/sites/default/files/2021-05/1.ICGN%20Viewpoint%20on%20Systemic%20Risk.pdf

[8] https://risk.columbia.edu/

[9] https://www.systemicrisk.ac.uk/

Terminology

ESG: The paper will use the term "ESG" as a catch-all to cover a broad range of activities, including ESG integration, impact investing, active ownership, and disinvestment. The authors recognise this is an imperfect framing that broadly neglects nuances between approaches, but we feel painting with a broad rhetorical brush is well-suited for systems-level analysis.

Long-term: Recognising that there are not universally-accepted definitions for the duration investors reference when using the terminology of short and long-term, for the sake of simplicity the paper will use a definition of "short-term" as five years or less, and the definition of "long-term" as over five years.

Sustainability: For the term sustainability, rather than provide an exhaustive definition of all topics, the paper grounds in factors often considered by sustainability-minded investors such as climate change, biodiversity, and human rights as good examples of well-established sustainability-related financial risks.[10] While a particular company might face (idiosyncratic) risks related to a particular breach of human rights, or regulatory risks due to its biodiversity footprint, these topics can rise to the level of systemic or systematic risks as defined below when and where they have the potential to impact a number of companies or broader financial systems.

Systemic and Systematic Risk: These two terms are anchored in definitions from the Certified Financial Analyst (CFA) Institute:

- **Systemic Risk:** "Systemic risk refers to the risk of a breakdown of an entire system rather than simply the failure of individual parts. In a financial context, it denotes the risk of a cascading failure in the financial sector, caused by linkages within the financial system, resulting in a severe economic downturn."[11]
  - **Author's Note:** In a portfolio context, these can also be defined as risks that affect a significant number of companies and are unlikely to be mitigated by single company (or single investor) intervention.
- **Systematic Risk:** On the other hand, "Systematic risk (also called market risk or non-diversifiable risk) is inherent in the market. It cannot be avoided and it affects all assets in the market. Examples of factors that constitute systematic risk include inflation, economic cycles, politics, or natural disasters."[12]

Systems-Level Investing (SLI): The term "systems-level" acts as a wrapper to include both systemic and systematic-risks, with "systems-level investing" being the active consideration of these factors in the investment process. Joining you in a collective groan, the authors feel a need to wrap many of the above terms into an acronym for efficiency and ease of reading. To avoid adding to the existing alphabet soup in our industry, we will follow the lead of published works from authors such as Lukomnik and Burckart[13] in using the term System-Level Investing (SLI).[14] While our paper will primarily focus on sustainability-related SLI risks and opportunities, we do think many of the insights are relevant for systems-level investment considerations writ large.

System-Level Sustainability Investing (SLI): shorthand for a larger category of risks described within the paper

[10] https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues

[11] https://rpc.cfainstitute.org/policy/positions/systemic-risk#:~:text=Systemic%20risk%20refers%20to%20the,bailouts%20for%20failing%20financial%20institutions

[12] https://soleadea.org/cfa-level-1/systematic-risk-nonsystematic-risk#:~:text=Systematic%20risk%20(also%20called%20market,%2C%20politics%2C%20or%20natural%20disasters

[13] https://tiiproject.com/why-and-how-investors-are-moving-beyond-modern-portfolio-theory-systems-level-investing-for-the-21st-century/

[14] The authors use this term hesitantly and do not propose it as a definitive framing for the sustainable investment community moving forward. This is in part because of the belief that our community should do a better job mirroring the language of the broader financial community within our own terminology. In the case of talking about "systems-level", such an intention may be reflected better by using terms like "mega-forces" or "macro trends" which appear more consistently in the language of traditional investment professionals. However, since systems-level is a burgeoning topic of interest for our community, we thought it the best place to start this conversation.

1 | Candid Accounting

Asset owners (AOs) alone cannot make significant headway in addressing complex problems like the climate crisis, global poverty, or world conflict. Not even a fully activated finance sector, with all its capital both human and financial, is able to comprehensively address all the investment-related risks and opportunities associated with SLI. AOs can only play a specific role in a broader mobilisation to address these problems.

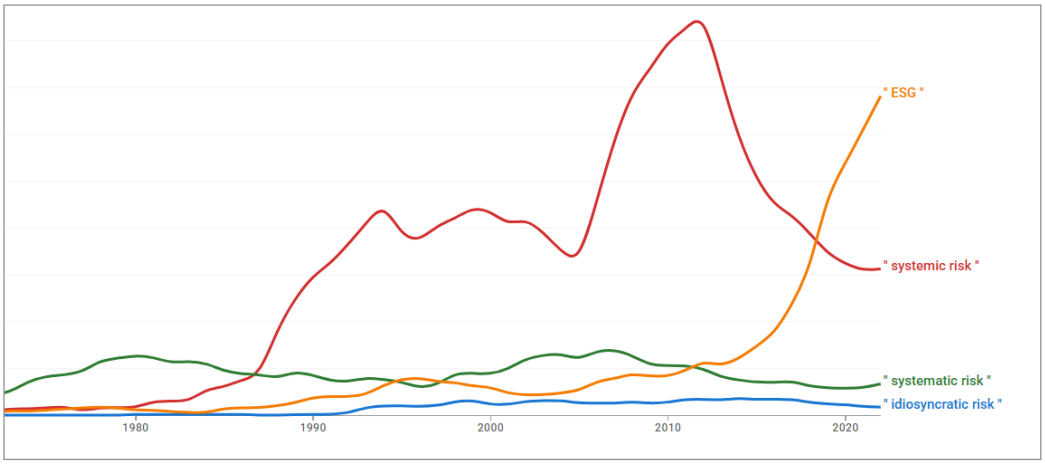
To understand and execute on this role as effectively as possible, the AO and broader sustainable-investor community needs to examine what they do well and what their limitations are.

This examination of what the sustainability-minded investor community has done well and what they've struggled with will begin first by looking at ESG. Due to the wide-ranging participation of various financial actors, this section will look at broad investment industry trends related to ESG with specific call-outs of the AO community where relevant. Additionally, in this exploration of ESG the authors are not suggesting that ESG and SLI are equivalent- they relate to each other but are not the same.

However, it is important to look at ESG to understand SLI because investor efforts to try to address sustainability-related anything will likely be tied in the near and medium term to 'ESG' as a common framing. It also seems to be the phrase that is most prominent in public discourse at this time compared to terms like idiosyncratic, systemic, or systematic risk as indicated in the graph below. So, like it or not, from a practical standpoint **sustainability-minded AOs are likely stuck with ESG as a reference point.**

Use of terms in books listed by Google

(Google Ngram Viewer)



ESG seems to be the term that is most prominent in public discourse at this time

The authors will use the common reference point of ESG as an opportunity for introspection via a case-study. Readers should treat this as a case-study covering the 10 year period from 2015-2025. The authors chose this timeframe because it was an example of a meteoric rise in "ESG" by many markers- AUM/allocation to ESG-focused investment strategies, mentions in public discourse, marketing spend, strength of support by shareholder proposals and integration into regulatory requirements in various markets. This was also the timeframe where the largely unchecked rise of ESG was seriously challenged for the first time.

Distinguishing Two Different Forms of ESG

For the purposes of this case-study, it is important to distinguish between ESG as a verb and ESG as a noun.

- As a **verb** or **practice**, ESG broadly refers to investor consideration of financial risks and opportunities associated with environmental, social, and governance factors as part of the investment process. Investors act out their practice of ESG in a multitude of ways informed by different frameworks and perspectives - similar to how there are a large variance of methodologies that fall under the description of "active investing". While this application can relate to or even directly reference SLI, historically it is more often associated with assessments of idiosyncratic or investment strategy-specific risk.
- ESG as a **noun** or **moniker** is more about how the term ESG is understood and interacted with in the broader investment industry and public discourse. ESG as a noun often glossed over the differentiated approaches inherent in ESG as a verb to help with writing articles about large flows of assets into "ESG"[15] or statements about the need for standardisation of "ESG".[16] Eventually, this broad-brush approach became fodder for opponents seeking to label "ESG" as both a financial and political problem that has the potential to "undermine freedom, political self-determination, and economic prosperity."[17]

ESG, done well, is likely to help investors consider all financially material risks and opportunities, thus enhancing their risk adjusted returns over the long-term.

What went right

But before this analysis gets too critical of ESG, even as a noun, it is also important to name some high-level positives of the last 10 years of development. Let's start with what remains a cardinal truth in the authors' eyes- **ESG as a practice, done well, is likely to help investors consider all financially material risks and opportunities, thus enhancing their risk-adjusted returns over the long-term.** However, this statement becomes easier to stand behind when embracing the qualifier that ESG will likely always have a variety of applications and approaches,[18] and some of these will do better than others. This also means that not all applications will outperform or deliver positive impact. Instead, as with any investment process, it will depend on factors such as the thoughtfulness of the strategy, cyclicality of markets, and geopolitical developments.

Looking beyond ESG as a verb or practice, ESG as a noun or label did become a powerful force in many fora of public discourse and remains on track to continue to grow over the long-term despite recent challenges.[19] This expansion of awareness and support of ESG broadly led to a meaningful shift in multiple facets of investment, policy, and business.

[15] https://www.calastone.com/esg-funds-accounted-for-90-of-inflows-in-july-as-the-esg-gold-rush-saw-its-second-best-month-on-record/

[16] https://www.cnbc.com/2022/03/23/standardizing-esg-criteria-will-reduce-confusion-sp-global-ceo.html

[17] https://aier.org/article/the-threats-posed-by-environmental-social-and-governance-policies/

[18] https://www.deutschewealth.com/content/dam/deutschewealth/cio-perspectives/cio-special-assets/esg-investment-performance--drivers-and-management/perspective-special-esg-investment-performance-drivers-and-management.pdf

[19] https://www.bloomberg.com/company/press/global-esg-assets-predicted-to-hit-40-trillion-by-2030-despite-challenging-environment-forecasts-bloomberg-intelligence/

Advanced Understanding:

Shifted general expectations about what is required of investors. Investor-led initiatives like PRI increasingly brought the ideas of environmental and social opportunities and risks into public discourse and investor discussions.

Advanced Regulation:

Advanced collaborative initiatives and institutions that made meaningful positive contributions to regulatory framing. Frameworks like International Sustainability Standards Board moved forward at a scale that helps investors identify and understand financial opportunities and risks across global financial markets.[20]

Contributed to Real-World Impact:

Led to impactful changes to business operations with real economic impact. As one example, the collaborative initiatives Climate Action 100+ facilitated investors engaging on financial opportunities and risks associated with climate change with the largest corporate greenhouse gas emitters in the world. While there is still much more that needs to be done to drive corporate action on climate, it is important to recognise that efforts to-date led to focus companies taking meaningful action to address climate within strategy and operations.[21]

Built Sectoral Momentum:

Another example of this real-world impact is how ESG supported sectoral shifts to help address underlying issues. An important example of this is the Investor Mining and Tailings Safety Initiative, which co-author Adam Matthews chairs.[22] This initiative was backed by $24 trillion in AUM and led to a new widely adopted global operating standard and industry norm, in turn leading to the continuation of this work through the Global Investor Commission on Mining 2030 initiative.[23] This latter initiative addresses a broader set of strategic objectives faced by the mining industry as outlined below.

Initiatives like UNPRI increasingly brought the ideas of environmental and social opportunities and risks into public discourse and investor discussions



Objectives of the Mining 2030 Initiative

[20] https://www.spglobal.com/esg/insights/december-2024-where-does-the-world-stand-on-issb-adoption

[21] https://www.climateaction100.org/progress/progress-update/

[22] https://www.churchofengland.org/about/leadership-and-governance/national-church-institutions/church-england-pensions-board/pensions

[23] https://mining2030.org/

Divergence is Inevitable

The earlier observation around divergent use of terms like ESG isn't an original one, nor is it one that the authors necessarily expect to be resolved completely at any point. The complexity and intersectionality of many of the issues addressed through ESG means that there will always be an "eye of the beholder" element to how this concept is understood. This in turn will lead to divergent perspectives on how ESG is best suited to enhance risk-adjusted returns. That is okay and even welcome given that an inherent strength of capital markets is diversity of thought and process. This also means asset owners should practice precision, clarity, and transparency in how they are using terms while asking the same from their partners.[24]

Asset owners should practice precision, clarity, and transparency in how they are using terms while asking the same from their partners

What went wrong

Perceptions of ESG as an unstoppable force brought benefits and carried inherent risks. To better understand these risks, and what we may need to avoid as a community moving forward as we consider how to advance work on SLI, it is important to look at what went wrong:

Lack of precision in investment case:

Many in the sustainable investor community are quietly recognising our industry was likely too outspoken in blanket statements that "ESG leads to better returns." This statement requires material qualification due to a wide variety of ESG applications, as referenced in introduction to "What went right" on page 10.

Over-statement of impact and clarity

Some adopters of ESG terminology were attracted by asset flows into the sector and a potential opportunity to charge increased fees. These adopters would sometimes roll-out investment products without strong underlying investment strategy or over-inflated statements around impact in a rush to market. This dynamic was written about by prominent ESG academic George Serafeim in his paper *ESG: From Process to Product*.[25]

- The ESG programs taking this "product" approach often became easy targets of attack by opponents. Since the process for these products was shallow and largely grounded in marketing appeal, it makes sense that there would not be a high level of conviction within these institutions when the marketing benefit turned into a risk. The rapid roll-back of these types of strategies and commitments is part of what undermined the credibility of ESG more broadly.
- Additionally, some of these over-statements of the impact of ESG as a noun made it an easy straw person for attack since the way it had come to be portrayed in public discourse could be hubristic[26] and far beyond what most reasonable institutional investors were practicing or would be willing to defend. Alternatively, ESG as an investment practice is differentiated based on strategy and often part of a larger investment process and organisational culture. This makes it harder to defend as a singular concept in public discourse.

[24] As an aside, this competitive marketplace of ideas and strategies makes large collaborative initiatives (such as UNPRI, Climate Action 100+, the Transition Pathway Initiative) all the more remarkable, and important.

[25] https://www.hbs.edu/ris/Publication%20Files/23-069_c3b42539-b1f3-4acf-a7d7-60e85806f96d.pdf

[26] https://www.ft.com/content/ff1abe37-fafa-4269-b98a-7ecea88b667a?segmentId=2c1df321-36a4-1206-2c08-112c059dd69d

Victim of success:

Because of ESG's perceived potential to have disruptive impact on incumbent industries, ESG as both a noun and a verb were increasingly seen as a negative force to those aligned with said industries/interests. In some contexts, this has gone hand in hand with and contributed to the politicisation of ESG.[27]

Uncompelling Defense of ESG:

When attacks on ESG first emerged, many in the industry over-estimated the the rhetorical value of arguments around how ESG would "help with long-term returns" and "aligned with fiduciary duty." While these arguments were logically sound, they were largely uncompelling beyond the echo chamber of the ESG sector. These arguments largely did not resonate with policy makers or broader stakeholders who were not familiar with the language and logic of finance. Additionally, it is worth noting that these arguments often did not even resonate with those within the financial institutions who were not already bought into the value-add of ESG.

Risk-Aversion Bias:

As the risks associated with continued attacks on ESG elevated to include policy risks and loss of mandates, investor institutions needed to integrate heavier involvement of C-suite staff to weigh in on the best path forward. The assessment of the risk landscape for these senior leaders often included a significant raise in realised or potential hard-dollar costs of responding to attacks on ESG (costs associated with responding to oversight risks, loss of mandates through policy shifts, and related operational and legal expenses). Assessing these risks and costs in turn necessitated a heavier involvement of risk management teams who, as their name would suggest, have a vital role focusing on mitigating risk to the institution they represent. The raising and unpredictable risk profile and hard-dollar costs associated with continuing ESG activities in some jurisdictions accompanied by the often difficult to quantify benefits associated with maintaining ESG leadership likely informed many of these executives in decision-making. This dynamic plays directly into risk aversion biases which preference a certain outcome over an uncertain one.[28] While this trend was arguably more prominent in the asset manager community due to a higher exposure to risks such as loss of mandates, many of these risk-averse dynamics also manifested in AO institutions.

And so where do these observations lead us?

Accounting for where ESG succeeded and where it failed will be important for anyone seeking to advance investor efforts to address SLI. To help us in that, let's take stock of where the industry stands today:

ESG as a Verb/Practice is Ongoing:

Let's be clear- many firms are still active in using ESG integration as a process, especially in the asset owner community. **This is in part because of the underlying fiduciary duty of investors to consider financially material risks and opportunities, regardless of the acronym associated.**

ESG as a Noun/label is Being Walked Back:

However, because of the toxicity/politicised aspects of the ESG term, a significant number of asset managers and service providers are reluctant to be public about their efforts and many walked back public commitments to groups like Climate Action 100+.[29]

Because of the toxicity/politicised aspects of the ESG term, a significant number of asset managers and service providers are reluctant to be public about their efforts

[27] https://thehill.com/policy/equilibrium-sustainability/4010800-documents-fossil-fuel-anti-esg-campaign/

[28] https://insidebe.com/articles/risk-aversion/

[29] https://www.esgdive.com/news/house-judiciary-esg-probe-more-than-70-investors-have-left-climate-action-100/735805/

- Regardless of whether these investors are still practicing ESG in their underlying investment processes, this walk-back does have a meaningful negative chilling effect on public discourse and momentum around ESG issues. This chilling effect does matter.

AO's Haven't Sent a Clear Public Message To AMs:

Asset owner to asset manager engagement continues on many sustainability-related topics per the continuation of ESG as a verb/practice. However, this engagement is often private and thus does not raise to the level of influencing public discourse. Looking at one key lever, holding asset managers accountable to aligning with AO clients' interests, there have been some notable public shifts from AOs like People's Pension.[30] These changes have not been common or loud enough to-date to call it a large trend.

Allocation Decisions Move Slower Than Public Discourse:

The reality of AO portfolio allocation is that asset allocators need to look at multiple factors relating to performance and alignment with asset managers to make prudent decisions relating to selection, appointment, and monitoring (SAM) processes. These processes are typically designed to be deliberative and non-reactive. For many asset owners, SAM processes include but are by no means limited to ESG and/or SLI considerations. This means that changes to alignment on sustainable investment factors are only one consideration among many in AO SAM processes.

Asset allocators need to look at multiple factors relating to performance in order to make prudent decisions

- Now, contrast this methodical culture of AO allocation to the rapid rise of anti-ESG legislation in some states in the US which often prompted a legislative trigger for action leading to the public termination of mandates. The result is headlines dominated by discussion of withdrawn mandates. This is despite the AUM represented by these withdrawn mandates arguably representing a much smaller pool of AUM compared to global AOs that maintained ESG commitments.

Action Needs to Match Rhetoric:

Faced with a strong attack, some of the inconsistencies between the rhetorical strength of ESG statements and the strength of the underlying organisational commitment to advance those statements were laid bare. Many investors who made strong statements around social justice or climate action when those topics were in public favor were not willing to match the ferocity of the attacks levelled at them when the opposition to these ideas targeted the investor community. Part of what is happening today is the rhetoric shifting to embody a cautiousness in face of this attack, with an accompanying movement from ESG washing to ESG hushing.

Now, some in the sustainable investor community reasonably argue that investors have become too cautious, and that if anything asset owners need to be more outspoken on ESG issues given the pressing global economic/financial/societal risks the world is facing. **The authors would argue that this heightened rhetoric is only appropriate and effective if asset owners and other financial institutions can commit to clear pathways of action that will support their statements.**

[30] https://www.netzeroinvestor.net/news-and-views/the-peoples-pension-moves-28bn-out-of-state-street-citing-stewardship-misalignment

2 | Level-Setting

There are many nuances to how professionals in the sustainable investment field need to develop strategy on SLI. One of the foremost considerations should be the structural factors within AO institutions that limit or derail asset owner ambition on SLI. A foundational limitation that investors seeking to integrate SLI considerations into their practices today will face is how the investment sector relates to financial materiality.



Let us once again be crystal clear here, the authors believe that SLI considerations are financially material and align well with the common precepts of fiduciary duty. The authors also believe that the sustainable investment community should continually ground our work on SLI in the core investment functions related to "long-term value creation in a changing world" as argued strongly in the Legal Framework for Impact.[31]

This next section is not about the theory or definition of financial materiality. It is about observations for how that theory turns into practice. It is also about how some of the gaps in that translation are limiting our ability as asset owners to adequately understand and address SLI-related risks and opportunities within our portfolios.

Financial Materiality Contextual and Dynamic

The authors recognise that considering financial materiality is one of the foremost duties of investors in decision-making and that there are important jurisdictional and regulatory factors for each investor to consider in their context. Given this varying jurisdictional context, we will not be giving a singular definition of financial materiality in this paper. However, we do think that what the CFA Institute wrote relating to the intersection of materiality and ESG also applies well to SLI considerations: "Materiality is contextual; that is, the materiality of ESG factors depends on the investor's objectives and time horizon and the specifics of the investment. Materiality is also dynamic: The materiality of a specific ESG factor may change over time."[32]

It is important for investors to do their best to appropriately consider all risks that are material to their portfolio. Thus, the authors propose SLI as a "both/and" not "either/or" proposition in relation to short-term and idiosyncratic considerations. Long-term view doesn't mean you ignore short-term developments, and an SLI-lens doesn't mean you disregard idiosyncratic risks and opportunities.

However, the authors would also argue that the balance of investor attention is overweighted towards short-term and idiosyncratic risks within portfolios and that there are structural reasons for that, which are discussed more below.

[31] https://www.unpri.org/a-legal-framework-for-impact/a-legal-framework-for-impact-summary-report/12520.article

[32] https://rpc.cfainstitute.org/sites/default/files/-/media/documents/article/industry-research/definitions-for-responsible-investment-approaches.pdf

Disconnect between Espoused and Enacted Values on Materiality

Many investors, especially asset owners, have spoken to the financial materiality of addressing long-term systemic risks for years.[33] However, speaking to these risks does not mean that institutional operations will change. This difference between the values that are in a vision statement and the values that influence an investment committee meeting can also be described as the difference between espoused and enacted values.[34]

- Within institutions, the enacted values are those that influence observable decision-making processes and behaviors while the espoused values are those that may be spoken to but aren't necessarily practiced. Consultants who work on the gaps between espoused and enacted values find that enacted values tend to overpower espoused values anytime there is dissonance between the two. This continues unless there is concerted effort throughout the institution to clarify alignment, foster accountability, and embrace a culture of continual evaluation and adaptation.[35]

ENACTED VALUES
are those that influence observable decision-making processes and behaviors

ESPOUSED VALUES
are those that may be spoken to but aren't necessarily practiced

Enacted Value of Materiality Within Investment Institutions Focuses on Short-Term Risks that Align with Existing Patterns

The issue of "short-termism" has long been derided in many investment circles as destructive to long-term value creation with a need for a paradigm shift towards more long-term principles. However, that espousal of the need for long-term perspective has not seemed to significantly decrease short-termism.[36] The CFA Institute in 2020 published a new research report on short-termism, finding that it costs investors tens of billions of dollars annually. The report found that ESG is a new frontier for investor advocacy for long-term alignment. Additionally, research shared in the *Harvard Law School Forum on Corporate Governance*[37] found that "the short-term focus of informed investors can lead firms and the stock market into a destructive cycle of short-termism."

The current materiality focus for investors tends to draw professionals' focus toward risks that are short-term, easily modeled, and have been experienced before

Within the AO community, few would choose to openly identify themselves as short-term investors. However, if short-termism is a prominent norm for the markets today (as the authors would argue) changing from this enacted value is difficult. This change is made more difficult by heuristic biases such as social proof and confirmation bias that drive investors towards herd behavior and disincentivises the search for alternative paths.[38]

This disconnect between the logic of a long-term focus and the reality of short-termism in the markets is highlighted in a Press Release from EY detailing the results of their 2024 Institutional Survey titled "Investors shun long-term ESG rewards in quest for short-term gains."[39] The survey results themselves are enlightening but many of the dynamics of short vs. long-termism as they relate to sustainability are summarised by Dr. Matthew Bell, EY Global Climate Change and Sustainability Services Leader:

[33] https://www.newprivatemarkets.com/three-investors-just-moved-the-esg-needle/

[34] https://medium.com/management-matters/nailing-down-the-meaning-of-values-personal-and-corporate-d424cb11300

[35] https://medium.com/@antonynizamoglou/espoused-vs-enacted-values-1fdd11de060c

[36] https://www.spglobal.com/spdji/jp/documents/research/research-long-termism-versus-short-termism.pdf

[37] https://corpgov.law.harvard.edu/2024/08/13/the-short-termism-trap-catering-to-informed-investors-with-limited-horizons/

[38] https://www.alliancebernstein.com/us/en-us/investments/insights/practice-management/five-investing-biases-and-heuristics-to-watch-for.html

[39] https://www.ey.com/en_gl/newsroom/2024/12/investors-shun-long-term-esg-rewards-in-quest-for-short-term-gains

- "The global investor community should be front and center of the drive for sustainability, but instead what we're witnessing is worrying levels of apathy. Many investors do make the right noises on climate change but there's a real failure to walk the talk. In some ways, it's understandable that investors are being passive – they are rightly worried about the many holes in company reporting, but what's less forgivable is the apparent search for instant gratification when it comes to profitability. There's a pervasive view that immediate gains matter more than the valuable slow-burn rewards from ESG investments; and despite the latest UN assessment highlighting the lack of action on climate change, and that global warming could pass three degrees Celsius by 2100, with devastating impacts, investors seem to be focused on shorter term economic cycles and geo-politics."

Espoused Value of Addressing SLI Misaligned with Enacted Values on Materiality

Part of the difficulty that leads to the disconnect Dr. Bell is speaking to above is that the very nature of many SLI risks and opportunities are such that the impacts are diffuse throughout the system and will manifest over indeterminate periods of time. Also, they will often manifest in a manner that breaks pattern with existing historical records- an example here is climate change-related tipping points. These characteristics of SLI manifesting over an indeterminable time-period in unpredictable ways misalign with the norms of financial materiality described above. These characteristic are also part of what makes SLI-related financial risks and opportunities so difficult to measure using traditional methodologies in finance such as risk/return attribution, capital market assumptions, and scenario forecasting, as all of these means of analysis are often built using backwards-looking data as a foundation.

These attributes are part of what make SLI risks "wicked problems"[40] generally that global institutions and society are poorly equipped to address given the heuristic biases present in almost all decision-making. This difficulty is further compounded by other challenges specific to economics and finance:

- *A Focus on Alpha Over Beta:* Dave Zellner, former CIO of Wespath, would often argue that investors spend too much time thinking about alpha and not even enough time thinking about beta. To underline this point, he would share the following hypothetical- A CIO of a pension fund is walking down a beach and comes across a lamp that they rub, and a magic genie pops out. The genie offers the CIO two long-term scenarios- 1.) the broad market performs at 0% but the CIO's fund outperforms at 5% or 2.) the broad market performs at 10% but the CIO's fund underperforms at 8%. Which does the CIO chose?
  - Dave would point out how option 2 will better help the underlying beneficiaries of the pension reach their goals due to the higher absolute returns from the broad market. However, the CIO's incentives (and potentially ego/job security) would likely draw the eye towards option 1. Dave would go on to argue that it is important for investors to consider how to support the health of the broad market moving forward as represented by beta because of it's importance in driving absolute returns.

[40] https://www.interaction-design.org/literature/topics/wicked-problems#:~:text=Wicked%20problems%20are%20problems%20with,approach%20provided%20by%20design%20thinking

  - Moving outside the world of hypotheticals and genies, the authors would argue that a foundational reason why an absolute returns focus is not predominant in finance is that it is very difficult to understand and evaluate how individual AO actions influence the performance of the broad investment market. This is even more difficult to do in a form that can clearly attribute back to financial returns for a singular portfolio over a specified timeframe. Since there is no way to run double blind-tests of the global economy, investors currently have to rely largely on anecdotal evidence for any contributions to beta as compared to the more concrete and industry-accepted metric of relative alpha performance.

- *Free-Rider Risk:* Even if an investor is interested in taking actions to address broad-market returns, they risk other investors "free-riding" on their efforts since any value they create is diffusely distributed across all market participants.
  - The other side of this attribution and returns problem is the 'Tragedy of the Commons', which is prevalent in systems theory: As Aristotle said, "For that which is common to the greatest number has the least care bestowed upon it."[41]
- *Asset Owner Organisational Structure Not Aligned with Addressing Absolute Returns:* The incentives of the top decision makers at most financial institutions- Chief Investment Officers, Portfolio Managers, C-Suite Executives- will typically have some form of connection to performance of the funds. Rarely will one of these individuals have a distinct incentive to consider SLI because of many of the difficulties mentioned above.
  - If investors were examining a company's incentive structure with similar attributes, it would not be a surprise to hear that the lack of incentive alignment for the espoused values led to enacted values that reinforced an existing status quo.
- *Varying Ability for SLI Issues to Translate Into Current Materiality Context:* Not all SLI risks and opportunities are created equal. Some will be easier to translate to the current definitional context for financial materiality than others.
  - For example, the materiality argument for climate change is a more commonly accepted SLI factor due in part to the clear science, data, and macro-economic time-sensitivity of the forces at play.
  - Human rights risk in Conflict-Affected and High-Risk Areas (CAHRA) are less commonly embraced as financially material factors to consider within portfolio construction. This is not necessarily because investors think these factors are unimportant or immaterial. They are often spoken to through espoused values like a commitment to the UN Guiding Principles. Instead, it is in part because investors do not have the tools to track data and information around the risk in a way that easily integrates into existing investment processes and structures (although some such tools and frameworks are emerging).[42]
    - ➤ Put differently, investors do not have well-established tools available to foster sustainable peace. For example, we would argue that the three primary tools of sustainable investment- allocation, engagement, and disinvestment are all limited in the impact they will have as singular tactics in CAHRA regions. More impactful work would likely need to include thoughtful analysis and engagement with geopolitical and on the ground complexities, ideally combined with stakeholder partnership with impacted populations on the ground.

Investors do not have the tools to track data and information around the Human rights CAHRA risk (although some such tools are emerging)

[41] https://www.goodreads.com/quotes/10572146-for-that-which-is-common-to-the-greatest-number-has

[42] https://heartland-initiative.org/wp-content/uploads/2024/09/The-Saliency-Materiality-Nexus.pdf

Our Enacted Values Are Part of What is Making the Economy Sick

Applying the gap between espoused and enacted values to the health metaphor, many of us talk about getting healthier but find it hard to practice those ideals in our day to day lives. This struggle is somewhat dependent on personal choice, and it is also significantly influenced by how easy or hard it is to make our espoused choices in the system we operate. The person that has affordable access to healthy food, time to exercise, and strong healthcare options will find it easier to chose to be healthy than the person who does not have those resources.

This same system-level disconnect between what we say we want and what is easy and accessible is present for asset owners' relationship to SLI because of many of the structural elements named above. So, the question then becomes how do asset owners start influencing the system to make it easier to support the long-term health of their portfolios and the global economy their returns rely upon?

To Address SLI, Asset Owner Community Needs to Clarify Our Role

Case-Study on Changing "Rules of the Game"

Let's assume for a moment that an asset owner has seen enough evidence and has enough organisational buy-in to address SLI even with all the above considerations in mind. They will likely come up against the conclusion that engaging with individual companies or tweaking an allocation decision is not enough to address the risks they see.

- **Changing Rules of the Game:** As written about in the *Future of Investor Engagement*,[43] in order to effectively address systems-level risks the sustainable investor and asset owner community would need to support the reshaping of the economic "rules of the game" in ways that align with their long-term interests. In the aforementioned paper, the "rules of the game" are defined as "economic and policy incentives that companies must operate within." The paper goes on to argue that investors interested in understanding and addressing the impacts of the systems-level risk of climate change on their portfolio should consider the rules of the game because:
  - Allocation alone won't change the problem if the alignment of the economic system doesn't create a global market in which investment in solutions at the pace and scale needed to address the system-level problem is profitable.
  - Engagement alone won't address the underlying misalignment if it is only addressing idiosyncratic risks or surface-level aspects of SLI.
  - Disinvestment alone won't solve the problem so long as the company has a social license to operate, and other investors are willing to buy the divested capital.
  - The paper's main thesis is that, with these limitations in mind, it is important to reimagine the role of investor engagement in the financial system and not be constrained by "business as usual" stewardship.
- **Policy Engagement:** If AOs want to innovate and think differently about the future role they should play, one of the areas they may be interested in exploring is policy engagement. Policy engagement is logically a strongly aligned action for changing the rules of the game, because a change in policy or regulation can establish a new level playing field that better enables efficient and effective capital markets that support long-term value creation. Where this intuitive logic meets the barrier of practical reality is that investors have been historically reluctant to take on the political and reputational risks inherent in meaningful policy engagement. As a result, investors have not served as a meaningful counterbalance to other economic players actively operating in this arena. As of now, the authors would describe the high-level status quo of this imbalance as:

If AOs want to innovate and think differently about the future role we should play as asset owners, one of the areas they may be interested in exploring is policy engagement.

[43] https://www.unepfi.org/industries/the-future-of-investor-engagement-a-call-for-systematic-stewardship-to-address-systemic-climate-risk/

CASE-STUDY

- Asset owners have limited resourcing and experience conducting direct policy engagement and limited institutional incentive to do so, in part due to barriers like free-rider risk. Additionally, they are not systematically signaling to asset managers that alignment on policy engagement is important enough to consistently and meaningfully influence allocation of mandates.[44]
- Asset managers share some similar constraints to those described above for AO's. Additionally, with some notable exceptions, asset managers have little appetite to get involved involvement in financial services regulations given their desire to be seen as neutral arbiters of capital that can serve the largest client base possible.
- Meanwhile, multinational corporations have well-established and well-resourced processes for influencing the rules of the game through donations, trade associations, and direct lobbying.[45] There is a strong economic incentive for these actors to advocate for their idiosyncratic interests, often in rent-seeking ways that largely preserve the status quo in the case of incumbent industries.[46] The resulting policy impacts of these rent-seeking behaviors can often be directly contrary to asset owner's long-term and broadly diversified interests as economic theory dictates that these rents are detrimental to the health and productivity of the broader economy.[47]

AOs are not using one of their most powerful levers (Policy Engagement) to influence behavior with one of their most strategic partners (asset managers).

The above is not a universal truth nor is there any guarantee that asset owners as a community would be successful at policy engagement to advance SLI. Even if they were, there is no guarantee such engagement would lead to positive outcomes for the overall economy. However, the alternative is the continuation of a status quo that does not appear to serve asset owner's long-term interests in fundamental ways. As such, the authors are encouraged by emerging examples of thoughtful and long-term policy engagement supportive of asset owner interests such as the Governance for Growth Investor Campaign in the UK.[48]



Click here

[44] To take the lack of capacity here one step further back, it is not even clear whether there is enough differentiation between asset manager policy engagement strategies to enable this to be a determining factor in an allocation.

[45] https://onlinelibrary.wiley.com/doi/full/10.1111/rego.12154

[46] https://hbr.org/2016/05/lobbyists-are-behind-the-rise-in-corporate-profits

[47] https://www.sciencedirect.com/science/article/pii/S0305750X18302432

[48] https://www.railpen.com/knowledge-hub/our-thinking/2025/governance-for-growth-investor-campaign-ggic/

3 | Moving Forward

Most experienced professionals in the field of sustainable investment would likely tell you that the industry is in a moment of disruption. However, disruption is not inherently a bad thing and is often welcomed in finance when associated with innovation. The authors would posit that this moment requires AOs to move beyond a recalibration of the same tools, and instead to take a fresh look at fundamental challenges and opportunities the asset owner community is being called to grapple with.

This moment requires us to take a fresh look at fundamental challenges and opportunities of the SLI community

The authors would also name that it can be exhausting and risky to do things differently, and it is often much safer to maintain the status quo in the short-term. However, for professionals excited about contributing to impactfully advancing their institution's long-term financial interests while generating real-world impact, it is our experience that it is more exhausting over the long-term to get stuck in the status quo.

So, What Does Leadership Look Like?

The first and foremost intention of the ideas below is to offer potential next-steps that help asset owners better fulfill their core fiduciary responsibilities. The authors believe that fulfilling these duties in a changing world requires asset owners to get smarter and skill up on SLI and that the below are prospective next-steps on that journey.

These ideas are not presented as an exhaustive or prescriptive list. While some of these steps are inter-related, the suggestion of the authors would be that each interested asset owner and related stakeholders explore whichever idea(s) they feel most relevant to their institutional and jurisdictional context.

Lastly, the authors would strongly recommend that the community of practitioners interested in SLI focus more on refining the actions and processes described below rather than debating definitions or, even worse, trying to market SLI as a product. The authors believe that the below represents a good menu of options for areas where interested practitioners can get involved in practical and value-add ways that evolve over time. In summary, let's have more verb and less noun this time around.

Sharpen Investment Case for SLI

- *Build out Firmer Investment Case for Understanding and Addressing Systemic Risk:* There are already strong papers on the financial case for SLI written by asset owner peers, asset managers, and academics. However, there is much more that needs to be done in the space to develop the sophistication and relevance of research that would allow asset owners to adequately address and understand SLI. As such, the authors actively call on interested academics and other institutional stakeholders to continue to further build-out the investment case.
  - Rigorous and quantitative-based research is pivotal for developing bridge language that will allow sustainable investment professionals to move the materiality of SLI from an espoused to an enacted value-set within AO institutions. In practice, SLI arguments need to be able to translate to analysts, asset allocation leads, risk management teams, and C-suite executives in order to be fully embraced and integrated at AO institutions. It is also important for finding bridge language that will allow sustainable investment professionals to create common understanding and cohesive strategy for addressing and understanding SLI throughout their organization. Potential areas for initial research include how to better communicate and capture the financial materiality of SLI in the face of the challenges described on pages 16-18.

- *Sharpen Engagement with Key Partners – Fund Managers:* One area of profound opportunity for asset owners is in engaging their asset managers to independently encourage and incentivise managers to better align and represent what asset owners believe is in their best long-term interests. In turn, asset managers have institutional resourcing, macro-economic sectoral insights, and breadth of engagement experience that could benefit asset owners in grounding development of SLI strategy in practical economic realities.
  - Ultimately, within the structure of finance and the owner-manager relationship, the flow of capital as dictated by mandates still reigns supreme when it comes to influencing behavior. Further engagement of asset managers by AO's will thus only be fully effective if it is:
    a) Based on clear and independently executed expectations related to SLI topics that align with AO interests that in turn lead to,
    b) Material influences on allocation based on manager performance against these expectations.
      - ➤ This work of a.) and b.) can include leveraging new datasets and platforms that are emerging to help investors wrestle with SLI, such as the Systems Aware Investing Launchpad by The Investment Integration Project.[49]
      - ➤ It can also be customised for different asset classes like private equity, as written about by PRI and the Predistribution Initiative.[50]
- *Advocate for Up-Skilling Teams:* If asset owners decide they want to meaningfully improve their ability to understand and address SLI, they will likely need to build out different capabilities. One of the most impactful places to encourage this increased knowledge on SLI is on the investment teams responsible for allocation within asset owners- whether that allocation is executed via in-house capabilities or through oversight of external third-party managers.
- *Continue and accelerate investment in solutions:* Flows of capital can be powerful supporters of positive change and there are a multitude of examples of prominent institutions deploying capital in SLI-related areas like climate change with a focus on achieving strong financial returns and generating positive impact. This can include meaningful and robust allocation commitments as in the case of La Caisse on page 6. It can also include organisational structures that help facilitate collaboration on SLI issues as with the recent elevation of Kirsty Jenkinson of CalSTRS to oversee all of that Fund's Private Market activities as well as its dedicated Sustainable Investment and Stewardship Strategies department.[51]
- *Investing in Sustainable Development in Emerging Markets:* Investing in sustainable development in emerging markets is an important aspect of how AO's as a community should be thinking about understanding and addressing SLI. However, the mechanisms for doing so are not always clear. For example, the economic case for a strong ROI on investments in areas like climate adaptation including in emerging markets are clear,[52] even if the finance system has not yet innovated an efficient market-wide mechanism for reflecting the value of that ROI within investment incentives. Additionally, raising conflict in fragile states is shown to have a highly negative impact on a country's economic growth with a chance to spillover into other countries.[53] This negative impact does not only impact the regions where the conflict is taking place. A study from the *Journal of Peace* Research found that global GDP would have been on average 12% higher in 2014 in the absence of violent conflict since 1970.[54]

Up-Skill Teams made up of:
1) sustainable investment professionals
2) asset owners and
3) strategists within the institutions

[49] https://tiiproject.com/sail/
[50] https://www.unpri.org/pri-blog/aligning-private-equity-investment-practices-and-structures-with-esg-goals/6718.article
[51] https://www.calstrs.com/calstrs-announces-kirsty-jenkinson-as-new-senior-investment-director
[52] https://www.wri.org/research/climate-adaptation-investment-case
[53] https://www.theigc.org/sites/default/files/2016/12/IGCJ5023_Economic_Cost_of_Conflict_Brief_2211_v7_WEB.pdf
[54] https://www.researchgate.net/publication/366153870_The_global_economic_burden_of_violent_conflict

Both of these findings support the logical prudence of investing in peace, even if it is unclear today how the value generated by said investments could be accounted for within existing financial mechanisms.

  - Many AOs understand and embrace the intuitive case for such investments and are already supporting the exploration of new means of financing sustainable development in emerging markets. An example of this is the multi-stakeholder SCALED initiative.[55] SCALED seeks to make blended finance vehicles simpler and more efficient for interested private market investors in order to catalyse sustainable development capital flows.

- *Nascent Idea for Exploration – When do Asset Owners Need to Bring Investments In-House?* At the heart of the disconnect between asset owners and asset managers when it comes to SLI is a principal-agent problem. With managers often compelled to react to a variety of client interests over a relatively short time-frame, there is no immediately clear pathway to ensuring alignment between the interests of asset owners seeking a long-term SLI view and the underlying activities of asset managers. As noted above, this work of alignment is in part an asset owner responsibility to make their long-term SLI interests clearer and more explicit in investment mandates. However, following such attempts at engagement, should an asset owner eventually decide that this misalignment is a significant and intractable problem and has the scale and resources necessary to bring significant portions of asset management in-house, the costs and impacts of doing so may be worth further exploration.[56]

Simplify and sharpen language around stakeholder messaging for SLI

Get Better at Engaging in Public Discourse on SLI

- *Simplify and Sharpen Language Around Stakeholder Messaging for SLI:* Asset owners seeking to work on SLI have an imperative to get better at engaging with their stakeholders on the actions they are taking on said stakeholder's behalf. Institutional asset owners represent hundreds of millions if not billions of individuals worldwide. That fact alone presents an incredible engagement opportunity in sharing the "why" for AO work on SLI in accessible and compelling ways. However, this will not be successful if communication efforts are carried out through the wonky language or aspirational claims that surrounded ESG as a noun. Instead, public communications efforts intended to engage broad audiences should focus wherever possible on plain-talk messaging that emphasises how addressing specific SLI issues seeks to concretely benefit stakeholders over a timeframe said stakeholders find relevant.
- *Build up capacity to engage in public policy:* Efforts to engage in public policy can differ to fit the jurisdiction and institutional appetite of the asset owner. Many sustainable investors already engage in financial regulatory matters that they find directly relevant to their institution. This format is often reactive to posed regulation, as in the case of comments on proposed disclosure frameworks on topics relevant to SLI. Some asset owners have also begun to explore what it means to take a more proactive role in policy[57] although initial findings indicate that there is still relatively light proactive engagement on regulation and policy by asset owners.[58]

  - This is another area where, if asset owners decide they would like to build out capabilities, it will be most effective if accompanied by relevant up-skilling internally and/or development of new external partnerships.

[55] https://www.oecd.org/en/publications/blended-finance-case-studies_2fb90b9a-en/scaling-capital-for-sustainable-development-scaled_7e8698e1-en.html

[56] However, even in this case the asset owner institution still needs to ensure adequate cohesion and clarity of strategy on how they wish to address SLI internally with these in-house asset management teams. Otherwise, they will simply replicate a similar principal-agent problem within their institution.

[57] https://www.businessgreen.com/news/4372264/cop16-investors-worth-usd-5tr-urge-governments-bold-action-biodiversity-loss

[58] https://influencemap.org/report/Untapped-Potential-Asset-Owners-and-Climate-Policy-Influence-30206

  - For asset owners who may not have a capacity or interest in direct engagement in public policy, there is still an opportunity to build it into engagement with asset manager partners. One reference for this work is the set of best-practices from the Net-Zero Asset Owner Alliance on *Aligning Climate Policy Engagement with Net-Zero Commitments*.[59]

- *Take the Countervailing Forces More Seriously:* An important lesson of any effort to address SLI moving forward is also to understand that there will be strategic and well-resourced entities seeking to disrupt and derail these efforts. The motivations of these entities may vary- some are likely trying to preserve incumbent industry's profitable market position while others may see ESG as detrimental to the efficient functioning of capital markets. Regardless of motivation, it is naïve for sustainable investors to not incorporate consideration for some form of organised opposition as a baseline for strategic planning. Taking these forces seriously will allow asset owners and other investors to be more proactive in structuring efforts in a manner that seeks to address flaws in logic before they are pointed out by opponents.

Strategically Directing Efforts:

- *Level-Set What Has and Hasn't Worked:* The asset owner community needs to be courageous in naming and deprioritising those areas that have not worked to-date or areas where claims have been overstated. Such an accounting is difficult to do in time of attack. However, looking at weak points in approach is helpful for mounting a stronger strategy moving forward.
  - One key step for asset owners and investors more broadly would be disregarding the need to defend ESG as a noun or product in favor of more ferociously defending the aspects of ESG as a practice that AOs have conviction add value to investment process and align with long-term interests. This same posture also applies to how to position in relation to emerging aspects of SLI.
- *Actively pursue globally diverse peer to peer asset owner relationships:* There are distinct advantages to maintaining strong relationships with local peers, including shared challenges and opportunities within your jurisdictional and regulatory context. However, if seeking to work on global issues, asset owners should more actively pursue relationships with peers beyond their immediate geography. This type of direct relational connectivity becomes only more important as geographically diverse regions increasingly build up their institutional asset owner size, capacity, and influence.
- *Do less, do it better, and trust each other:* There are countless efforts in the broader work on SLI-related issues that are worthwhile and if each asset owner individually tries to contribute to all of them, then we move none of them forward. The AO community would benefit from AO's focusing energy on a few strategic areas, developing legitimate expertise and diverse stakeholder relationships in said areas, and trusting that other leaders will take up other necessary responses to SLI issues. This holds true for individual bilateral strategies and collaborative ones.
  - This more intentional organising of efforts would still be undertaken by individual and independent asset owners who are each operating in the best-interests of their underlying clients and participants. However, it could be facilitated by existing institutions like the PRI or through the development of new coalitions and structures that are explicitly designed to facilitate collaboration on SLI to serve AO interests.
- *Deepen Focus on Most Influential Leverage Points within Financial System:* One of the skillsets of community organising and policy advocacy is power analysis- seeking to understand where different actors have access and influence on points of leverage within the system. This is something the sustainable investor community can significantly improve on.

The AO community would benefit from each member focusing energy on a few strategic areas, developing legitimate expertise and relationships in said areas, and trusting that other leaders will take up other worthy causes

[59] https://www.unepfi.org/industries/aligning-climate-policy-engagement-with-net-zero-commitments/

- For example, if seeking to influence the strategy or perspective of a publicly-held corporation, it could be argued that analysts at the major global brokers have very high access and influence with the leadership of the companies they cover. These analysts have distinct influence over broad market sentiment on the company's economic prospects and often build credibility and relational trust with company C-suite representatives if in place over an extended period. Yet these individuals are rarely integrated into conversations on ESG or SLI even as they relate to corporate engagement.
  - ➤ Almost all investors have some business with a major global broker, with these being especially important partners for larger asset owners that have brought management in-house. In this context, building relationships with these analysts could become an impactful strategic consideration for corporate or sector engagement that appears largely underutilised today.

Increase Institutional Capacity

- *Thinking differently about partnerships:* Some of the more creative projects looking to address systemic risks involve many different stakeholders- as with the earlier mentioned Mining 2030 initiative. These initiatives can bring many different stakeholders to the table and, in that process, create insights and tools that are useful across the broader economic system.
  - Academic institutions, civil society organisations, industry associations and multilateral institutions each bring different insights influence to bear (along with their own unique challenges). For example, community representatives directly impacted by economic activity can present powerful and insightful contributions to a corporate or sectoral dialogue, even if there are important challenges investors should consider when seeking to engage with these groups.[60] Partnerships with non-investor groups and institutions will be pivotal for effective work on SLI and investors should work to become familiar with these challenges and opportunities (if they are not already).
- *Take the long-view:* Another important lesson from the Mining 2030 has been the need to set strategy for SLI work over an extended period of time. Rather than structuring engagement around objectives that can be achieved easily within 12 months, the more ambitious project of creating new norms in the market takes time. That work can be highly impactful- for example new disclosures covering waste facilities were first requested in 2019 . These disclosures now cover a significant proportion of the market, have been built into industry standards and will soon be subject to audit and assurance.
- *Invest in Systemic-Risk Leadership Institutionally:* Finally, to make all of this real, institutions need to make meaningful long-term commitments to build up their capacity. A good north star for these actions is the clarification of alignment, fostering of accountability, and embrace of a culture of continual evaluation and adaptation that were referenced earlier in the paper in moving from espoused to enacted values on long-term SLI. None of this will happen overnight, and much of it will require disruption of existing cultures. Resilient commitment with explicitly outlined expectations from the leaderships of institutions is thus fundamental to this type of change.

Institutions need to make meaningful long-term commitments to build up their SLI capacity.

There is still potential heightened risk for leadership on SLI as the fallout from pushback against ESG-related efforts continues to wax and wane. Thus, institutions need to decide whether they are truly willing to commit to this for the long-term, or whether they would like to maintain their programs closer to the status quo. **Institutions can make either decision with integrity, but this integrity is strongest if paired with transparency.**

[60] In particular, noting that affected communities may be vulnerable, victims of trauma or historic injustice, and that expectations of the role of investors in for example, remedy, will need to be subject to careful communication.

Conclusion

This paper is not intended to be a rallying cry for the asset owner community. Instead, it was written more as a 'health check'. The diagnosis of the authors is that there is an opportunity for AOs to meaningfully advance investor's ability to understand and address SLI-related issues if we start thinking more strategically, creatively, and courageously.

We need to start thinking more strategically, innovatively, and courageously

When it comes to both ESG and SLI, we as an asset owner community need to check where our blind spots are, where our weaknesses lie, and where perhaps we were taking a placebo, hoping it to be effective. It is only through this candid accounting that AOs can find the root cause of the illnesses impacting our institutions, our portfolios, and the broad economy. In service of that, let us end with two simple beliefs held by the authors of this paper- taking SLI seriously is a vital imperative for asset owners seeking to achieve strong resilient long-term returns, and it is one that requires more from AOs than some institutions will be willing or able to give.

However, the authors would suggest that the impact we are talking about is not contingent on 100% participation. In fact, the premise of this paper is about leadership and leadership only requires the asset owner institutions that are suited and excited for this moment to step forward. What can emerge from an opting-in of AO's interested in leading on SLI is collaborative work between independent and engaged asset owners who focus on areas of strength and alignment while respecting limitations and divergence. Such a grouping has the potential to help advance the long-term financial interests of the portfolios individual AO's manage, strengthen the health of the global economy on which our portfolios rely, and make the world a more sustainable, just, and equitable place in the process. The authors believe that is an opportunity worth risking for - and we invite others to join us who feel the same.

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