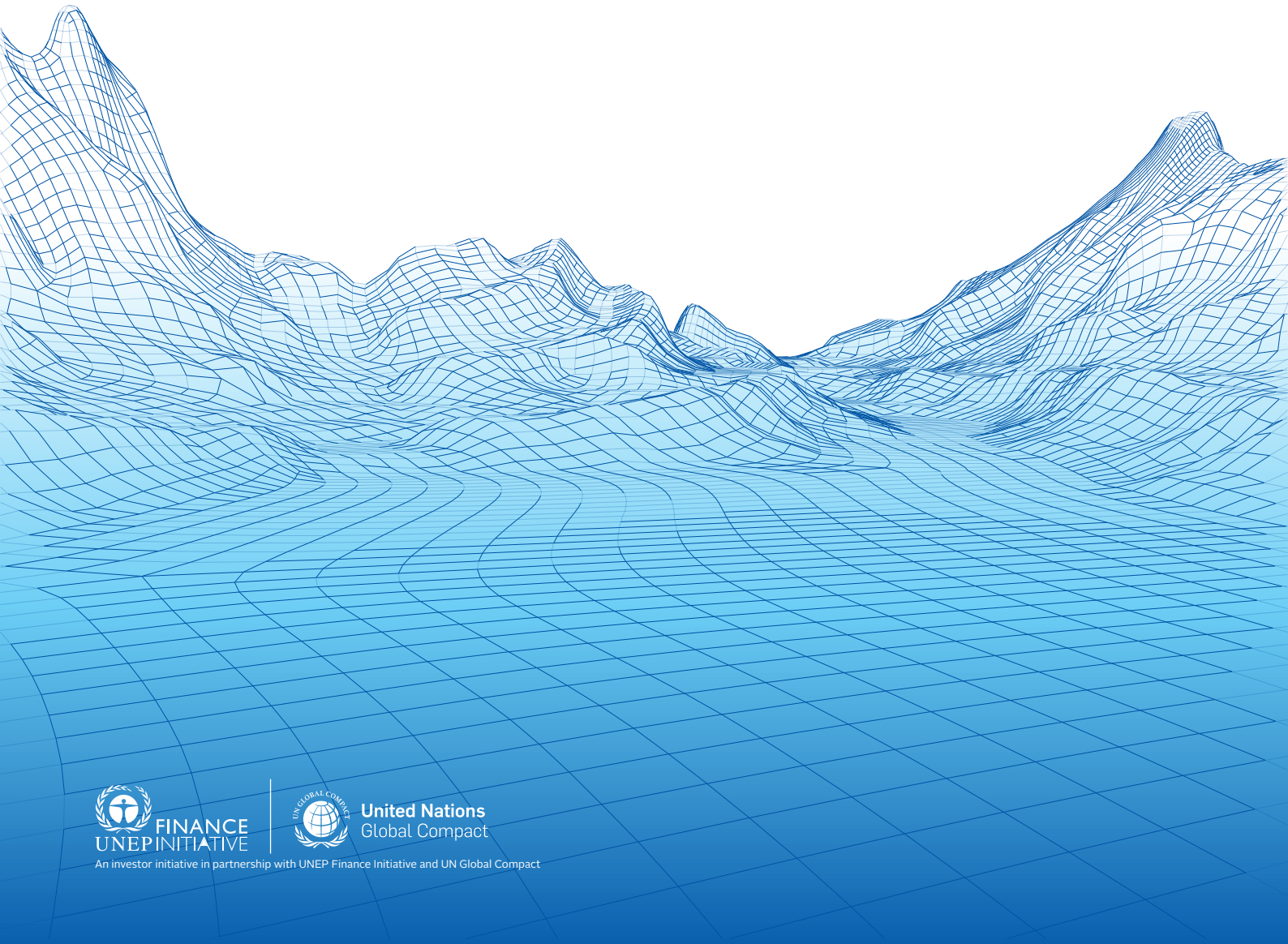
PRI Principles for Responsible Investment

CRAFTING AN INVESTMENT STRATEGY

A PROCESS GUIDANCE FOR ASSET OWNERS

Discussion Paper



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ACKNOWLEDGEMENTS

This document was prepared by the PRI with support from a number of PRI signatories who shared their expertise in its development. The recommendations of this document are those of the contributors and the PRI. They should not be interpreted as representing views of individual PRI signatories. The PRI would like to thank all contributors for their valuable input to this document. The PRI would like to thank the following signatories in particular for their support:

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Additionally, the PRI would like to thank the members of **PRI's Asset Owner Advisory Committee**, who advise **PRI's Asset Owner Insight** work, for their advice in the development of this discussion paper.

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This is an unedited section of content from a working paper on investment strategies. The PRI is seeking feedback on the content from PRI signatories and other stakeholders. **Please contact Don Gerritsen**, *Senior Manager, PRI at* **don.gerritsen@unpri.org** *by 30 October 2016 to comment.*

FOREWORD

INVESTMENT STRATEGY IS KEY TO LONG-TERM RETURNS

Mr. Mark Walker
Chair of PRI's Investment Strategies Working Group
Global Chief Investment Officer, Univest Company

Asset owners must commit to responsible investing early in the investment strategy process. Not only will this outline the direction of travel for the fund and the approach to maximising long-term investment returns, but stakeholders – including beneficiaries, NGOs, governments and regulators – are increasingly expecting asset owners to develop a comprehensive investment strategy that takes environmental, social and governance (ESG) issues into account.

Asset owners need to get on the front foot.

Many asset owners are already evolving their approach to investment strategy and beliefs, understanding how responsible investment principles should be incorporated and thinking through the practical (and any fiduciary) considerations – whether these are related to policies, asset classes or investment mandates. This is more than a tick-box exercise; it is an integrated part of investment decision-making that, in most cases, is expected to improve risk management and/or improve future returns.

Once set, an investment strategy cannot remain static; it should take account of new information, market developments and emerging thinking. The move towards a more long-term responsible approach to investment being one of these trends is self-evident. Ever more research is highlighting the benefits of a long-term perspective in investing and the financial impact of a more integrated approach to ESG factors, whether simply through managing risk in a more multi-dimensional way, or through expecting a positive impact on future investment returns.

Incorporating ESG considerations is not just about responding to specific issues that make headlines, such as divesting from fossil fuels, but about a more rounded approach to investing that considers both the short-term and the long-term, and a broader range of factors, such as climate change or human rights, that might impact individual companies or assets.

We hope this process overview will be an invaluable guide to what factors to take into account, as well as an exponent of the relevance of such factors and the vital enhancements that can be made to the investment strategy process.

EVOLVING INVESTMENT STRATEGY CONSIDERATIONS FOR BOARD MEMBERS AND EXECUTIVES

Mr. Michael Jongeneel
Project Member PRI Investment Strategies Work Stream
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Whether a pension fund, insurance company or other type of investor, asset owners' executives and board members often underestimate the effort involved in comprehensively thinking through all the decisions they will encounter in developing an investment strategy for their assets.

Asset owners that have already completed the journey of crafting a fully-fledged investment strategy are often confronted with new systemic developments that impact for instance markets in which they operate and the economy at large. This raises new questions to be considered, such as whether their current investment strategy incorporates the latest thinking and whether the investment strategy anticipates the opportunities of contemporary investment factors and trends – including responsible investing and sustainability. And, for those asset owners that have been traveling the responsible investing road for a while, the key question will be whether it is time to further deepen their investment strategy.

I wholeheartedly welcome this discussion paper, which provides asset owners guidance on developing and revising their investment strategy. It outlines key considerations for boards and executive management when deciding where and how to deploy both their capital and their attention and effort. The answers will vary between asset owners with a range of visions and goals, but in presenting the relevant questions this paper provides the crucial first step. The document offers additional support by describing a set of investment profiles, helping asset owners to determine their own profile, and by introducing a new dimension to the traditional risk-return matrix.

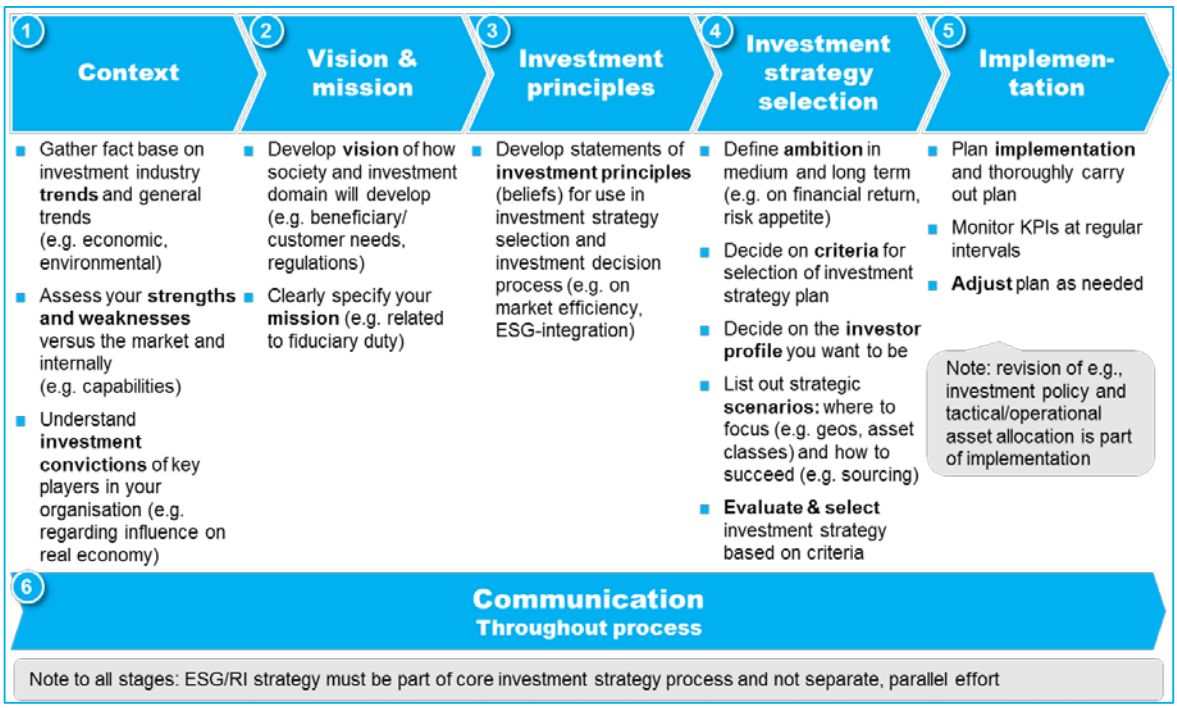
CONTENTS

EXECUTIVE SUMMARY

Asset owners should strive to craft a clear and explicit investment strategy to maximise investment returns. An investment strategy should embed comprehensive consideration of all long-term trends affecting their portfolios and how to perform as efficiently and effectively as possible for the benefit of their stakeholders.

However, many asset owners struggle with crafting such a strategy due to a lack of internal know-how on creating investment strategy plans and effective guidance. The PRI is committed to helping equip asset owners with the materials necessary to craft a clear and explicit investment strategy, one that is tailor-made. The steps outlined in figure A are a means to that end.

Figure A. Crafting an investment strategy in 6 steps



Questions are posed at each step to support the asset owner in thinking through the relevant choices. The questions include a range of topics from those that apply to most asset owners to items for asset owners looking to explore a next level.

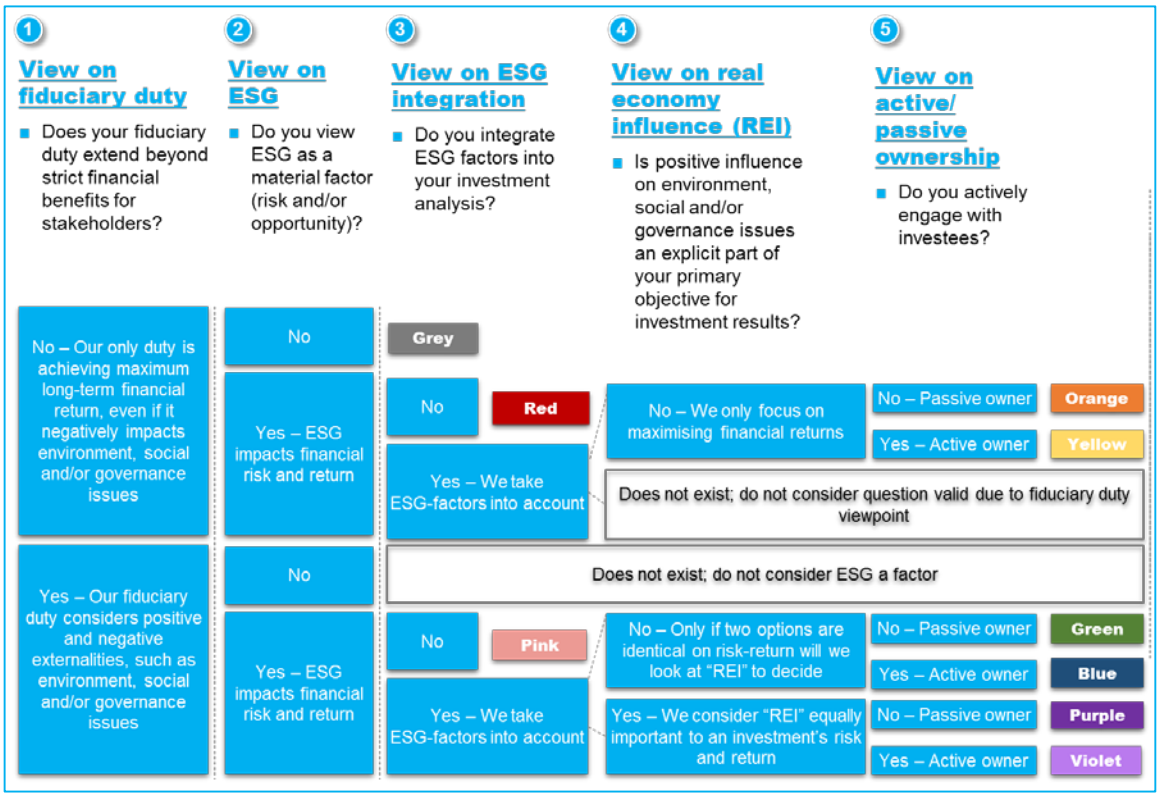
In reality, the process is not mechanistic or linear. The actual process will include moving back and forth between steps as required by the situation. This is especially the case in 'Step 4: Investment Strategy Selection' as investment strategy scenarios are created and evaluated to find the best fit with an asset owner's ambition and criteria.

Each step needs to be addressed – a common pitfall is skipping steps or deeming some as not essential. To ensure alignment throughout the process it is essential to have the right parties engaged, especially the Board. If done well, the process (excluding Step 5: Implementation) will

take between 9 months to well over a year, depending on the resources available and how comprehensive an asset owner's current investment strategy is.

In 'Step 4: Investment Strategy Selection' there is an almost infinite range of specific investment strategy options available to consider. This is where an asset owner's 'Investment Profile' becomes essential. Aligning all stakeholders on what investment strategy profile fits best, or which one is the ambition, not only helps communication about the strategy, but also helps limiting the range of investment strategy scenarios that need to be considered. Asset owners can determine their indicative profile by answering five key questions as shown in figure B.

Figure B. Determining your investment strategy profile



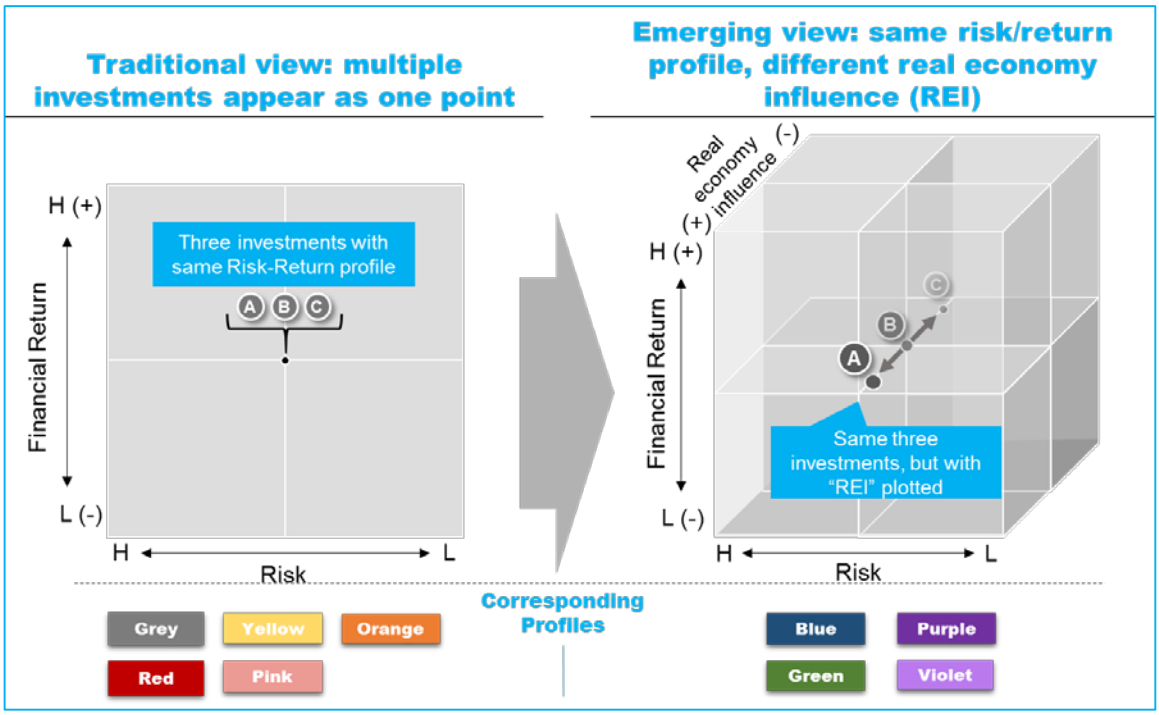
The answers are relatively black and white, as they are meant to differentiate asset owners from one another. The resulting profiles are therefore not always a perfect fit, but will still help guide asset owners' thinking in the process of investment strategy creation and evaluation. Throughout the strategy profiles section in chapter 4, recommendations can be found on ways to make the most of every profile, or consider the benefits of adjacent profiles.

Different profiles will have different ways of viewing investment decisions. Most investors view investments on a 2D chart of risk and (financial) return. A growing number of investors now integrate ESG factors with material impact to this 2D view, adjusting risk and return accordingly. However, there is a way to go yet further. An emerging perspective is taking this 2D view and adding a third axis which charts "real economy influence" *(REI – the extent to which an investment positively or negatively impacts the real economy, including environment, social, and governance impacts, additionally to financial return*). This allows differentiation of investments which happen to have the same financial risk-reward but different influence on the real economy as shown in Figure C.

Additionally it allows for an explicit discussion, if relevant, about balancing risk-return objectives with other real economy objectives.

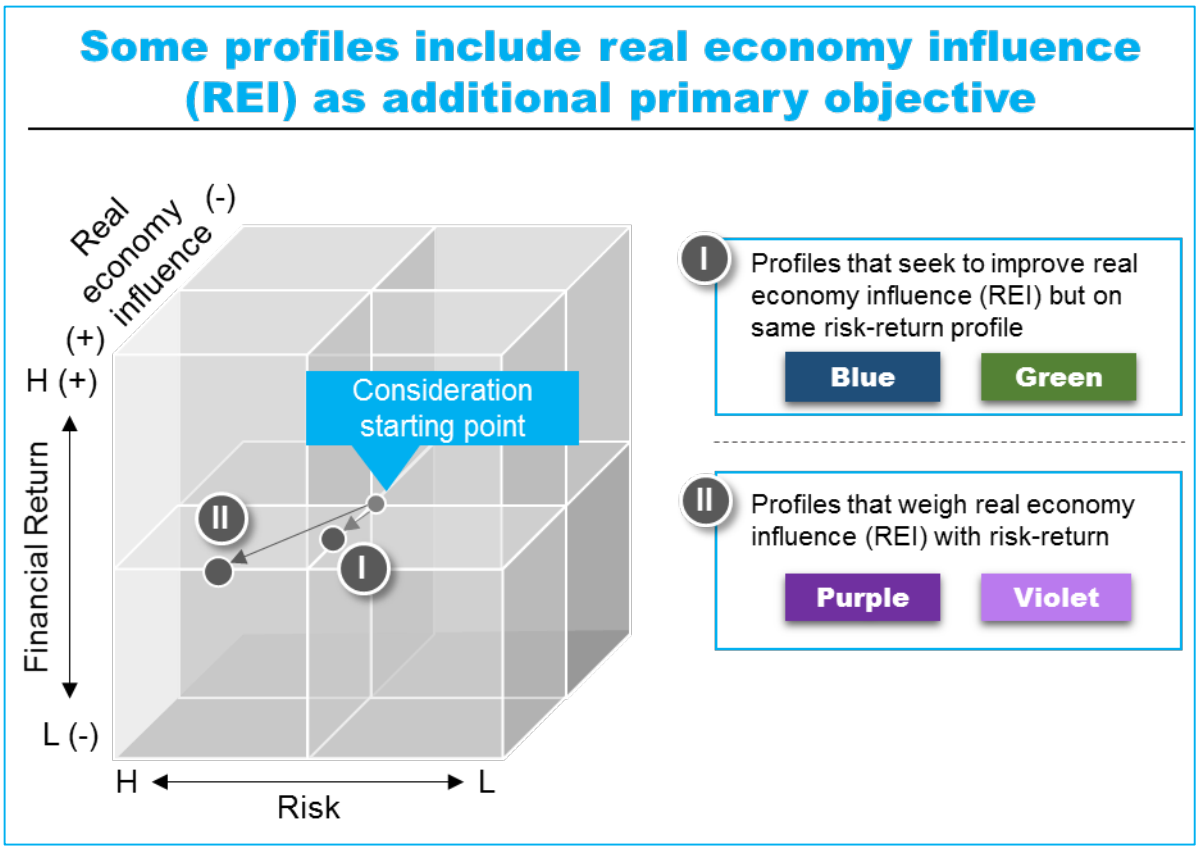
Real Economy Influence (REI)
Real Economy Influence is the extent to which an investment positively or negatively impacts the real economy, including environment, social, and governance impacts, additionally to financial return.

Figure C. Real economy influence (REI) as a third dimension allows investment differentiation



Investment strategy profiles that view their fiduciary duty as extending beyond monetary factors, will choose the investment which has the same financial risk-reward point, but with a more positive influence on the real economy (**A** as opposed to **B** or **C** in figure C). Further differences become evident when considering investment profiles that see real economy influence as a primary objective alongside financial objectives, or a secondary objective, as shown in Figure D.

Figure D. Real economy influence as additional investment objective



Investment decision '**I**' would be the preference of investment strategy profiles that view a positive real economy influence as a secondary objective: they will choose more positive real economy influence but not at the expense of risk or financial return. In contrast, investment decision '**I I**' will be considered by profiles that view real economy influence as a primary objective along with risk and financial return. The exact weight of real economy influence versus risk and financial return will vary significantly from asset owner to asset owner, resulting in different evaluations for any specific investment decision '**I I**'. Increased positive real economy influence can by all means go hand in hand with higher financial returns.

Momentum for responsible investing has grown significantly in the past decade with the number of institutional investors who have publicly declared their intention to investing responsibly by signing the six Principles for Responsible Investment rising from around 100 in 2006 to over 1,500 ten years since. Furthermore, institutional investors are now moving from responsible investment commitments to implementation, by integrating and embedding responsible investment into their investment strategy and decisions in a more comprehensive way – this is where asset owners play a pivotal role.

INTRODUCTION

Asset owners should strive to craft a clear and explicit investment strategy, which embeds comprehensive consideration of all long-term trends affecting their portfolios and how to operate as efficiently as possible for the benefit of their stakeholders.

The PRI has gathered current expertise and thought leadership to support asset owners in the development of a clear and explicit investment strategy.

This comprehensive asset owner strategy guidance is an 'advanced' form of responsible investment in two ways. Firstly, it constitutes the integration of all short-term and long-term trends, including ESG considerations, into the upper echelons of an asset owner's activity. Secondly, the process, when implemented in full, is quite technical. The outputs of the process and the clarity they provide, however, are worth the effort.

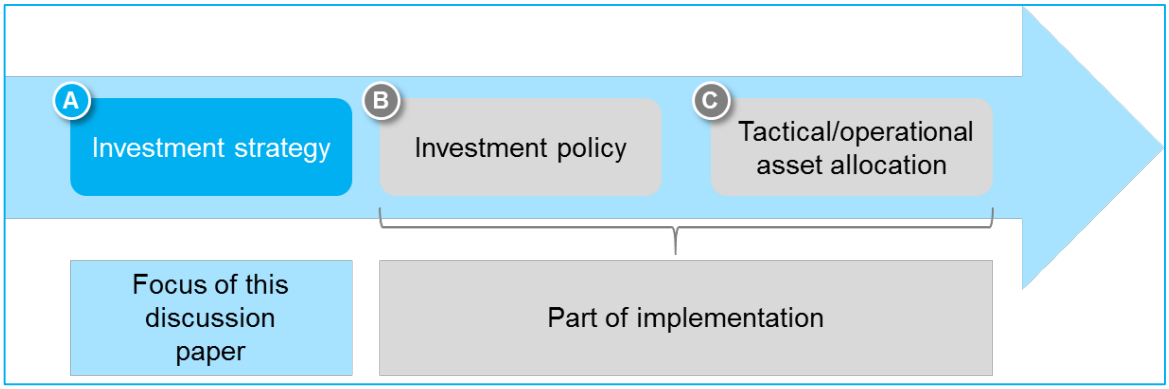
Some sections of this paper may not match perfectly with common practice today, even within the responsible investment community. In stage four's Asset Owner Strategy Profiles, quite a number of profiles entail a further level of ESG integration, where ESG factors are not only seen as material (and hence necessarily included in a strictly financial understanding of fiduciary duty), but are manifest explicitly in the aim of including influence on the real economy, including positive benefits to the natural environment and/or global societies, into fiduciary duty.

Representing thought leadership, the ideas and practices within '*Crafting an Investment Strategy - A Process Overview for Asset Owners'* see into the future of investment and provide today's leaders with the tools they need to form the vanguard of it.

INVESTMENT STRATEGY PROCESS

Crafting an investment strategy is the first step within the overall asset owner investment process as shown in Figure 1.

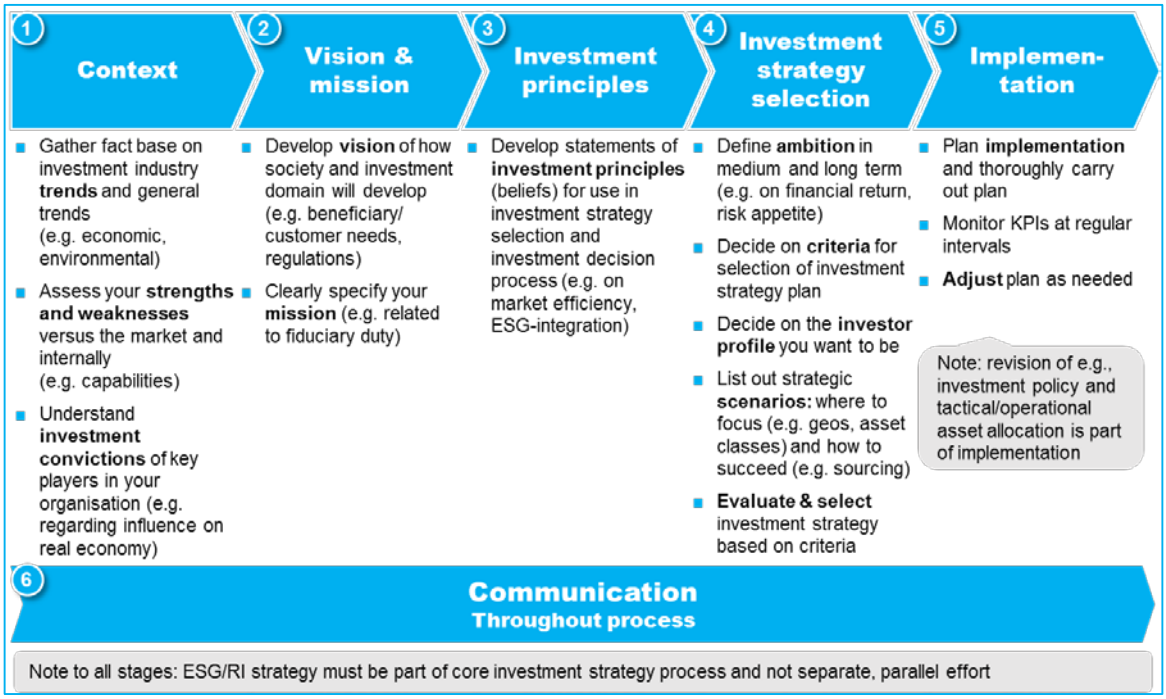
Figure 1. The asset owner investment process (simplified).



The Investment Strategy development process produces a high-level investment strategy plan including your organisation's vision for the future, mission, investment principles and the selected scenario for the investment strategy.[1] The investment strategy development process is displayed with key activities in each step in Figure 2.

[1] After you have crafted your investment strategy you will move to the second step (**B**) where you will create a more detailed investment policy. This policy will be used in the third step (**C**) to guide tactical and operational asset allocation. Steps B and C are part of the implementation of the investment strategy plan, stages which will be covered in further PRI guidance.

Figure 2. Crafting an investment strategy in 6 steps.



The process can start broadly with a wide survey of the context but then narrows down during subsequent steps. There may appear to be some seemingly repetitive actions between steps but each subsequent step asks a narrower question than its predecessor. It should be noted that iteration between different steps naturally occurs depending on the exact context of the asset owner. For example, it may be necessary to revisit Investment Principles after evaluation of some investment strategy scenarios if it becomes overly difficult to rank the various choices. The process is described mechanistically above, but it is a as much art as science and it is important that you and the appropriate stakeholders take ownership and embrace the process to make it work for your situation.

KEY PLAYERS

Crafting an investment strategy will require the involvement of many players at different points in the process. More details on roles and responsibilities are provided at each relevant stage. Common roles involved in the process are shown below.

- Board: it is critical that the board is involved in the process at all stages to ensure the investment strategy is both correct, acceptable and implementable. The board will ideally play a very active role in the process, e.g. in interaction with external experts, while keeping sufficient distance.
- CEO/CIO/CFO and direct reports: As critical as the board as they will need to be on side, and will eventually drive implementation.
- Project sponsor: Executive-level individual who is in charge of the process. It is commonly a Senior Director/Senior Vice President from the investment function or possibly the director of the strategy department.
- Project lead/team: Team tasked with executing investment strategy project. Reports to project sponsor.
- Investment committee: They should give feedback throughout the project, especially with regards to investment strategy scenarios. Possible heavy involvement depending on the organisation.
- Investment professionals: They will often be involved for perspective and to establish buy-in.
- Supporting departments: Where relevant, these departments will be engaged for input and consultation.

Investment strategy approach of resource constrained asset owners

This discussion paper is developed to provide insight and guidance to a wide variety of asset owners on the development and formulation of an investment strategy. Organisations with limited resources and/or capacity, can still use the outlined steps as a guidance, but may consider to focus on the aspects of the respective steps that are most relevant for the organisation, including which internal and external stakeholders should be involved. In situations where some or all activities may be outsourced, create clarity around roles and responsibilities of the strategy development process.

TIMING

The Investment Strategy process, excluding step 5, will take between nine months to more than a year depending on the prior status of the investment strategy, available resources, and desired rigor. The process will take longer if there is any misalignment among key players (e.g. within the board). The appropriate refresh cycle for an investment strategy will vary greatly depending on circumstances, best practice is every 2-5 years. A yearly review cycle should be instituted to monitor and tweak the existing investment strategy.

COMMON ISSUES

Investment strategy and the strategy plan process can easily suffer from process or thinking traps. However, such issues can easily be addressed, once you're aware of them. You may even consider mitigating them from the very beginning of the process as a preventative measure. The following list of common pitfalls is not exhaustive, so it is important to keep your eyes open as you go along.

Issues	Ways to mitigate issue during the process
Process Issues	
Skipping steps	■ Skipping direct to investment strategy plan selection without properly going through the earlier steps (Context, Vision & Mission, and Investment Principles). Likely to lead to incremental change from previous investment strategy ⟶ ***Mitigating action(s):*** *understand reason for skipping and remove possible barriers to go through all steps*
Insufficient quality in steps	■ Lack of robustness in steps or unwillingness to revisit previous steps if situation warrants ⟶ ***Mitigating action(s):*** *Provide right expertise and resources (especially time) for all steps*
Insufficient stakeholder buy-in	■ Board not aligned due to partial engagement in process or unaddressed differences ■ Lack of consensus on need for change ■ Lack of listening to beneficiaries/customers ■ Failure to include investment professionals perspectives ⟶ ***Mitigating action(s):*** *ensure a timely feedback loop is in place*
Outcome issues in investment strategy	
Solution not tailored	■ Desire for speed/ease of process leads to 'cut-and-paste' approach that does not account for asset owner situation ⟶ ***Mitigating action(s):*** *identify beforehand what makes the asset owner situation unique and emphasise this at the beginning of each process step*
Not specific	■ Resulting investment strategy so high level that it does not drive change. No strong direction on "where-to-focus" or "how-to-succeed" from the investment strategy ⟶ ***Mitigating action(s):*** *determine level of desired depth at the scoping phase of the project and monitor throughout the process*
Not adaptable	■ Investment strategy not sufficiently flexible as the environment changes. Too prescriptive in the formulation leading to no room for investment professionals to operate ⟶ ***Mitigating action(s):*** *include optionality, e.g., potential responses to certain (external) scenarios*
Not convincing	■ Supporting evidence and rationale for investment strategy is weak. Leads to issues on buy-in during implementation. ⟶ ***Mitigating action(s):*** *ensure financial and risk modelling is thorough with appropriate stress tests. Create documentation on analysis in shareable format as reference*

Not actionable	■ Investment strategy not formulated with view on how it will be implemented ⟶ ***Mitigating action(s):*** *involve sufficient investment professionals in process. Ask what will be the specific initiatives taken from each main point in investment strategy*

CONTEXT (STEP 1)

A solid set of materials is needed to provide a strong, common point-of-departure for your investment strategy. It is imperative to have a common point-of-departure so that all relevant parties (the Board and Executives in particular) can have fruitful discussion based on fundamentals and facts. Simultaneously, it is important to assess a variety of different scenarios on how the context may change in the short-, medium and long run. The questions of step one should all be seen in the light of a potentially changing contextual framework an asset owner operates in. Moreover, the context may vary widely for respective types of asset owners, such as defined benefit schemes, defined contribution schemes, insurance firms, foundations, endowments, et cetera. This relates to their type of liabilities, for example long versus short, the regulatory context, obligatory solvency/coverage ratios, asset and liability management, et cetera. The 'context' step aims to provide you with an overview of considerations that are of relevance to your organisation.

STEP 1 QUESTIONS

The following table provides an overview of trends. It is not exhaustive, but does help to guide asset owners through step 1.

Consider how these systemic developments will influence, among others, your portfolio in the short, medium, and long-run. Anticipate how stakeholders could possibly react to these developments (e.g. beneficiaries/customers, employees, competitors, society at large). Consider also how the impacts will vary by investment type e.g. asset class, geography, industry.

EXTERNAL FUNDAMENTALS

Social Trends

- Shifting demographics (e.g. aging, millennials)
- Demand for transparency (e.g. labour, tax, corruption, traceability)
- Shifting consumer preferences (e.g. digital, sustainable products and services like fair-trade)
- Individuality vs community (e.g. personalised vs standardised, sharing economy)
- Poverty / growing inequality
- Food security
- Human / labour rights
- Diversity
- Other…

Technological Trends

- Big Data
- Social media
- Computer power & cloud computing

- Connected world (e.g. mobile, internet of things)
- Cyber security
- Robotics (e.g. industrial, self-driving vehicles, drones)
- Renewable energy technology
- Biosciences
- Artificial intelligence
- Other…

Economic Trends

- GDP/productivity growth by nation, by industry
- Rise of emerging markets
- Capital flows
- Exchange rates
- Inflation/deflation
- Market performance/returns
- Market volatility over time
- Market efficiency
- Market risk and tail-risk
- Asset class availability
- Real-economy effects from environmental impacts (e.g. resource scarcity) / ESG concerns likely to become important in the markets
- Other…

Environmental Trends

- Global warming/climate change
- Resource scarcity/disruptions (energy, water, food, land)
- Deforestation
- Pollution (air, water, soil)
- Biodiversity
- Recycling/cradle-to-cradle (towards circular economy)
- Materiality of environmental risks and opportunities for markets
- Other…

Political Trends (including regulatory considerations)

- Geopolitical shifts (e.g. BRIC, terrorism)
- Increased regulations and soft law resulting from societal concerns (e.g. low-carbon goals, GMO concerns, health/safety, response to financial crisis)
- Changes in tax policies and tax transparency regulations
- Changes in governance regulations
- Central banks strategies and involvement
- Fragmentation and consolidation waves of politics and trade (e.g. TPP, EU expansion, Brexit, Grexit)
- Other…

External Fact Base

- What are more dramatic/disruptive shifts in trends that could occur broadly in the economy (e.g. dramatic lengthening in human lifespan, sentient AI)? What would be the impact?

- Where and how, measured in e.g. asset growth, is responsible investing manifesting most? And impact investing?
- How are the different themes developing from several perspectives including politically, consumer, NGO?
- What are in depth trends in themes like inequality within a country/region, globally? E.g. income, opportunity, justice. Or like social justice? E.g. rights of oppressed groups, indigenous groups. And so on.
- What trends are already being impacted by the investment community (e.g. asset owners, asset managers)?
- Are Sustainable Development Goals (SDGs) being 'considered' by companies? To what extent does it influence their actual behaviour versus being used as cover (e.g. greenwashing)?
- Other…

INTERNAL ASSESSMENT

In addition to gathering an external fact base it is important to understand the position you have in the market and your internal capabilities. This can be done through an asset owner assessment that may well consider the following questions.

Asset Owner Assessment

- Is there a clear investment strategy (including regarding RI?)
- What is the position relative to financial obligations, such as the asset and liability management profile? What liquidity requirements do you have? What other needs does the organisation have to maximise assets available to meet liabilities in the short-, medium- and long run?
- What is the general position in the Market (e.g. size relative to others, asset allocation)?
- What are capabilities and bandwidth to gather data and evaluate trends and investments within the organisation? (i.e. to what extent will you need to rely on the off-the-shelf analysis?)
- Is there sufficient in-house/available-to-hire investment/portfolio managers with deep understanding of the market and of sustainability in general?
- What is your operating and organisation model?
- What is your incentive structure? How is it aligned to your long-term goals?
- What is your expectation regarding potential new relationships and/or disruptions in the investment value chain?
- What is your process for transparency?
- What is your culture and how easy will it be to evolve it? What is your track record on implementation of transformation in the organisation?
- What is your market positions in impact investing generally? Per theme?
- Is there a clear position regarding impact investing?
- What is access/presence in relevant networks to source differentiating investment opportunities?
- Other…

To discover true investment convictions an in-depth dialogue is needed that cannot be pre-scripted. However the following questions could be addressed in the conversation:

Investment Convictions

- What do you consider the responsibility and the purpose of the asset owner you are working at?
- Do you hold a scientific or heuristic perspective to decision making?
- Do you expect a future more towards abundance, or more towards scarcity?
- What do you view as your potential legacy?
- Do you believe your industry is going through a secular disruptive change or a stagnated, placid future?
- What do you consider the main drivers in the investment marker? Is this 'satisfying' for you and aligned with your personal opinion?
- Do you consider it to be a responsibility of any business to contribute primarily to shareholder value or beyond, e.g. to stakeholder value?
- How do you see your own personal responsibility on this with the asset owner? (potentially ask if this deviates from the general opinion of other key players)
- Can you describe what success would look like for your asset owner 10-15 years from now?
- How do you view stewardship?
- Other…

Actions and roles

1. Project lead to ensure exhaustive list of:
    a) Trends to be examined / sources to be checked;
    b) Internal available assessments and gaps needed to be filled;
    c) Stakeholders for interview on investment convictions.
2. Project team will collect reports on macro trends, including all relevant factors such as climate change and regulation, and evaluate the historical impact of these trends on portfolios, and assess internal capabilities of your organisation to address these issues.
3. Hold an initial meeting with the board, Executives, and project lead to assess current strategy, discuss systemic developments outlined above and how they may influence your risk/return profile, and discuss direction for further/future considerations.
4. Project lead conducts interviews with board members/trustees and executives to clarify investment convictions.
5. Project lead/team will engage with further stakeholders (such as beneficiaries/customers) to further identify beliefs on all external factors (including ESG) which may influence investment outcomes. This can be done through means such as surveys or focus groups.
6. Board engages with further stakeholders to develop personal investment convictions further, and potentially even question them.
7. Hold additional workshops with the board/trustees, executives, and project lead to present and share initial findings, and educate on relevant issues (such as responsible investment) if required.

STEP 1 OUTPUTS

- **Compiled external fact base of materials, including a summary of key findings**. The fact base is a collection of general trends affecting society at large, the financial market and shifts in the investment industry. Trends should derive from a wide selection of different

sources, frameworks such as STEEP (i.e. Social, Technological, Economic, Environmental, and Political/regulatory) can help to ensure full coverage.

- **Internal assessment**. This includes an understanding of the investment convictions of relevant stakeholders such as individual members of the Board and Executives. This assessment includes the capabilities of your organisation and current position vis-à-vis others in the market. This will include internal skills and capacity, market position, relative size in the market and your organisation's culture.
    - **Investment convictions**: what are the investment convictions of key players in the organisation? These may demonstrate deeper motives that drive views on investment strategy.

VISION AND MISSION (STEP 2)

Taking into account all the trends uncovered in the Context (Step 1), you can begin to determine your Vision of the future. Additionally you should clearly define your Mission. Your Vision of the future is a view on how the world will develop and is dependent on the "Step 1: Context". The Mission is a statement on your organisation's purpose and will be used in selecting the investment strategy and for ongoing alignment of the organisation as investment decisions are made.

Board level involvement
Defining an organisation's mission may require significant time as it is critical to get full alignment at Board level.

Vision
Your Vision should encompass preferably a vision on (1) how society in general will develop, and (2) beneficiary/customer evolution, and (3) the future role of the asset owner industry within the financial market and global society.

1. **Vision on society**: This will include **an interpretation** of broad trends from "Step 1: Context" (e.g. demographics, big data, rise of emerging markets, climate change, tax transparency).
2. **Vision on beneficiaries/customers evolution**: This will include statements on how needs and preferences will change for your beneficiaries/customers. This may include: changing expectations on flexibility of pension schemes (especially for defined-contribution plans) or a shift from demanding solely financial returns.
3. **Vision on role of the asset owner industry**: A view on how the will evolve, what will be the role of asset owners. What will be the impact of changes to regulation across the globe, changing conceptions of fiduciary duty, long term vs short term focus.

Examples of vision statements

- *"We see the asset owner industry evolving to be both more concentrated into big players on one hand and more fragmented into small players on the other."*
- *"We see the population becoming older, richer, and more focused on the long-term social and environmental impact of their actions."*

- *"The economy will experience a long-term stagnation in growth as China slows leading to lower financial returns for extended periods."*
- *"We see regulations evolving to encourage the asset owner industry to hold both financial and other positive impacts for people and/or planet as dual-objectives."*

Mission

A mission statement puts the "raison d'être" of your organisation into words. It will indicate what role you want to play for which beneficiaries/customers. Depending on your situation, there might be more or less freedom to formulate a mission statement, e.g. some defined-benefit funds are tightly restricted with regards to their mission, whereas other funds are faced with a wide range of possible investment decisions. An asset owner's mission often includes how the organisation will serve its stakeholders (e.g. beneficiaries/customers, employees, society), as well as an explicit (or implicit) differentiation with regards to competition in the asset owner industry.

Examples of mission statements

- *"To build the leading pensions business in the UK, based on a modern approach to pension provision, where transparency, low costs and high quality are cornerstones in building a successful business"* (Now Pensions)
- *"Securing the financial future and sustaining the trust of California's educators"* (CALSTRS)
- *"We take our responsibility to Canadians very seriously and operate with a clear mandate – to maximise returns without undue risk of loss"* (Canada Pension Plan Investment Board)
- *"To serve those who serve others. Focusing primarily on institutions and individuals in the academic, medical, cultural, research and government communities, we offer solutions that help provide lifetime financial security and wellbeing on the best terms practicable, consistent with our non-profit heritage."* (TIAA)
- *"We empower entrepreneurs to build a better world."*(FMO)

STEP 2 QUESTIONS

Vision of the Future: Society

- What is your conclusion to how society is evolving? What will be different in the future and what will be the high level effect on your portfolio (potentially by asset class)?
- What changes will need to occur to get to that expected future? How will these changes affect e.g. different asset classes?
- What ESG factors do you expect will be materially important for which asset classes, assets, types of portfolios? Which will likely not be important? How will this vary by asset class? (note: depending on if you manage assets in-house or outsource you might focus on portfolio-level impact or on individual asset-classes)?
- What specific trends can be most positively impacted by the asset owner?
- What will be role of investments in the 'real economy'?
- Other…

Vision of the Future: Beneficiary/Customer

- How will the stakeholders' views and needs/desires evolve especially beneficiaries/customers, but also others like employees?
- What will beneficiaries/customers expect in terms of transparency?
- What will beneficiaries/customers expect in terms of integration of ESG-factors?
- What will beneficiaries/customers expect in terms of positive impact by the asset owner? What is the view of beneficiaries/customers in balancing several primary objectives?
- Other…

Vision of the Future: The Role of the Asset Owner industry

- Considering all inputs: what is your view on what changes will occur in the asset owner industry?
- What are the asset owner market dynamics overall?
- What are possible regulatory developments? What are likely developments?
- What is your definition of fiduciary duty?
- Do you expect policy makers to force movement on ESG in the Investment management industry?
- ESG: do you see a trend from risk-based approach of ESG to more opportunity based? If so, will this trend continue?
- How do your existing investments align with your current vision?
- Will automated systems displace asset owners or asset managers or significant parts of existing activities of asset managers or asset owners?
- What macro-trends can you influence?
- Will the asset owner be evaluated on ESG-focus?
- To what extent will the fiduciary duty in the future include responsibility for broad societal interests such as combating climate change, social inequality, et cetera
- Will artificial intelligence systems displace asset-managers or radically change their role?
- Other…

Mission

- How do your existing investments align with your current mission?
- Why does your organisation exist? What is the organisation's DNA?
- What role do you want to take? What is the asset owner's purpose? What do you want to be known for? How much room/space does your 'mandate' allow in crafting a mission statement?
- Does your mission distinguish you from your peers? Does your mission statement reflect this differentiation?
- Does your fiduciary duty extend beyond the strictly financial to include benefits for stakeholders other than monetary?
- Is positive impact on people and/or planet an explicit part of your primary objective for investment results?
- How do stakeholders perceive this mission (who will buy in and who will dissent)? Will the mission be endorsed by all stakeholders?
- What added/societal value do you offer now and in the future?
- In which impact domains do you want to play a leading role? In which way?
- Other…

Actions and roles

1. Hold planning session with project lead and board/trustees
2. Project lead collects views on existing Vision & Mission from board/trustees, C-level executives, stakeholders such as beneficiaries/customers, and outside experts/thought leaders through interviews and focus groups
3. Project team conducts a peer review of Vision and Mission statements
4. Hold a Vision and Mission workshop cycle with all key stakeholders; Project team should report on current Vision, Mission and input gathered
    - Workshops held as needed with board and executives to give opportunities to discuss key questions and give input. Typically several meetings held over a period of time to reach the final recommendation
5. Signoff meeting held with board/trustees where board is given opportunity to voice final input, questions, and thoughts regarding Vision and Mission, and finally approve new Vision and Mission

STEP 2 OUTPUTS

1. Approved Vision
2. Approved Mission
3. Materials for announcement of new Vision & Mission

INVESTMENT PRINCIPLES (STEP 3)

Once your organisation has a shared understanding of its Vision and Mission, it will need to define its investment principles. The principles should be a set of clear, impactful statements that will help to define your investment strategy and, later on, help to make investment decisions in line with that strategy. These principles need to be accepted across the organisation. Sometimes these are referred to as 'investment beliefs'.

The specificity and quantity of your chosen investment principles varies from asset owner to asset owner. Organisations can have as few as 3-4 high-level principles (e.g. "Diversification lowers risk and we will use diversification effectively to maximise return at the lowest possible risk") or a larger number of more specific principles.

Investment principles are used to drive the crafting of your asset owner investment strategy as well as the writing of your investment policy thereafter.

Examples of Investment Principles:

- *"There are unique opportunities for long-term investors"*
- *"Markets are efficient and it is difficult to beat the market. Therefore we focus on low-cost operation"*
- *"We seek the most attractive investment opportunities that have positive ESG effects that do not require a financial trade-off"*
- *"By staying liquid we are able to take advantage of periods of market dislocation where markets are least efficient"*

STEP 3 QUESTIONS

- Do you see the market as efficient or inefficient? What is your approach to market inefficiencies? Are you able to take advantage of inefficiencies or will you ignore them?
- What is your view on the value of diversification? What is your view on the impact that the screening out/excluding of certain investments has on diversification? Will you be able (and to what level) to screen out investments with net zero impact on your diversification strategy?
- What is your guiding investment approach?
- Is timing important to investing successfully? What is your view on timing?
- What types of risks do you incorporate (and to what level) in your investment strategy (e.g. liquidity, volatility, regulatory, stranded assets)?
- What is your belief in the importance of low-cost structure vs more active investing and ownership? Does active investing and ownership give returns exceeding the costs?
- What is your appetite for risk and volatility in relation to your liabilities?
- Do you view ESG factors as being material to investment returns (risk or opportunity)?
- Do you fully incorporate responsible investing into your investment analysis? Do you have the resources to do so?
- Are you willing to screen out or screen in certain investments regardless of financial attractiveness (e.g. tobacco companies, nuclear power)?
- Are there specific investment preferences driven by the nature of our beneficiaries/customers (e.g. specific region)? Do you use best-in-class methodology?

- What is your view on the benefit of a long-term investment outlook?
- What 'standards' do you want to adhere to or leverage elements from? E.g. UN Global Compact.
- To what extent are the principles applicable for the whole asset base? Or will you make an additional set of principles for a specific part of the assets?
- Will you use a thematic approach to ESG-focused investing? (e.g. low-carbon investing)
- Are there specific investment preferences as you consider impact on people/planet?
- How focused on the real-economy will you be in your investments?
- What are events that would lead you to change our investment principles?
- Other…

Actions and roles

1. The investment committee, CIO, and project lead will develop (or review) a set of Investment Principles based on the Vision and Mission the board has approved, through a series of workshops and discussions
2. Draft Investment Principles presented and discussed for approval at next board meeting
3. Upon board approval, investment principles are publicly shared.

STEP 3 OUTPUTS

1. List of organisation's Investment Principles with full agreement of the board
2. Materials to support roll-out of investment principles

INVESTMENT STRATEGY FORMULATION (STEP 4)

The Investment Strategy Formulation step consists of multiple sub-steps and is highly iterative. The sub-steps are:

- Setting ambition and criteria
- Selecting an investment strategy profile
- Creating and evaluating investment strategy scenarios to refine the final investment strategy

Following the mission and investment principles, you will set the 'ambitions' of your investment strategy. The ambitions, in combination with investment principles, will guide the setting of specific criteria that will be used for evaluating investment strategy scenarios later in the process.

After the setting of criteria, you should have an explicit conversation on what investment strategy profile you are and want to be. Five key questions will help you determining your profile. This conversation will be helpful when you come to look at investment strategy scenarios.

Finally you will go select an investment strategy selection by creating and then evaluating scenarios against your criteria. The combination of a specific option in "where to focus" (specific mix of e.g. asset classes, industries, geographies) and a specific option in "how to succeed" (e.g. sourcing, active/passive management) makes up an investment strategy scenario. Once the scenarios are laid out, they can be tested and ranked using the criteria to give a list of possible investment strategy scenarios. In many cases none of the initial scenarios will meet all criteria. This will lead to repetition and re-examination of earlier steps until a recommended investment strategy emerges.

Actions and roles

1. Hold one, or if needed multiple, workshop(s) with investment committee, CIO, and project lead to set your organisation ambition and criteria from the approved investment principles, as well as selecting your investment profile ("as-is", "to-be")
2. Project lead to present the recommended ambition, criteria, and investment strategy profile for board approval
3. After signoff, the working group will prepare different investment scenarios. This is an intensive period where assumptions are made, hypotheses on choices are set, multiple analyses are done and hypotheses are run through several models to test viability of outcomes
4. Working group to prepare investment strategy scenarios, evaluate, and come forward with recommendation
5. At next board meeting, project sponsor and project lead presents recommended scenarios for board discussion to gather reactions/input
6. Board approves/signoffs (or sends back to working group for further analysis)

STEP 4 OUTPUTS

1. List of investment strategy scenarios considered, alongside assumptions and evaluation results
2. Final Investment Strategy selected for policy writing and implementation

AMBITION AND CRITERIA (STEP 4A)

Ambition is derived from your Mission and Investment Principles. Ambitions will include terms that are financial (e.g. *"achieve a funding ratio of X", "outperform benchmark by X", "ensure growth of X"*) and, potentially, terms that lie beyond financial considerations (e.g. *"increase economic development in our country/region by X*", "*Our ambition is to become the leading impact investor in 2020 by doubling our impact and halving our footprint*", *"provide wide beneficiary well-being that satisfies their long term financial and societal aspirations"*, *"become the choice provider of pensions for the millennial generations"*, *"alignment of investment portfolio with the low carbon future to drive beneficiary financial sustainability"*, et cetera).

The ambition, in combination with investment principles, will direct the setting of specific criteria.

Criteria, in turn, are used to evaluate investment strategy scenarios, to rank how well they meet your goals. Many criteria sets will reference a financial benchmark, either met or exceeded. Selecting the right benchmark is essential for both steering performance as well as reporting to stakeholders.

Criteria should preferably be measurable, also if the criteria relates to ESG outcomes (e.g. "halving our carbon footprint").

Additionally, criteria may go beyond the direct outcome of the investments and could include elements like operational metrics and organisational capabilities (e.g. attractiveness of the investment strategy for talented professionals). Ideally criteria will have enough obtainable information to permit meaningful differentiation across strategic options.

STEP 4A QUESTIONS

Ambition

- What is your target for the combination of risk and financial return? Absolute or relative to a certain benchmark?
- What level do you want to outperform your competitors?
- Where do you want to excel?
- Is positive impact on people and/or planet an explicit part of your primary objective for investment results?
- Do you want to be a leader? In what mainstream domains? How/where related to ESG/impact investing?
- What [quantifiable] benefits will you create for your beneficiaries/customers other than financial returns? (e.g. regional development, CO_2 emission reduction) In terms of 'output' or 'outcome'?
- What level of investment in specific impact themes do you want to have?
- What is the timeframe of your impact?
- Other…

Examples of Criteria

- Level of agreement with the mission statement (qualitative)
- Acceptable risk/return profile
- Investment horizon
- Cost position required to execute investment strategy (e.g. active management might be impossible given cost envelope)
- In-line with beneficiaries/customers views (e.g. a healthcare pension screening out tobacco investments)
- Addressing needs of relevant stakeholders (e.g. attractive for talented professionals)
- Ability to execute (e.g., fitting DNA of your organisation)
- Robust in relation to future compliance and upcoming regulations
- Timeframe of investment impact (financial, additional impacts)
- Size of economic impact on a certain county/region or industry
- ESG-impact, potentially monetised (e.g. CO_2 emission abatement value)
- Catalysis of certain multiple in co-investment dollars in an impact-theme
- Other…

INVESTMENT STRATEGY PROFILES (STEP 4B)

Your investment strategy profile arises from your answers to a few key questions. The answers to the questions should flow naturally from your Vision, Mission Statement and Investment Principles. If they do not, it will be necessary to revisit those earlier steps.

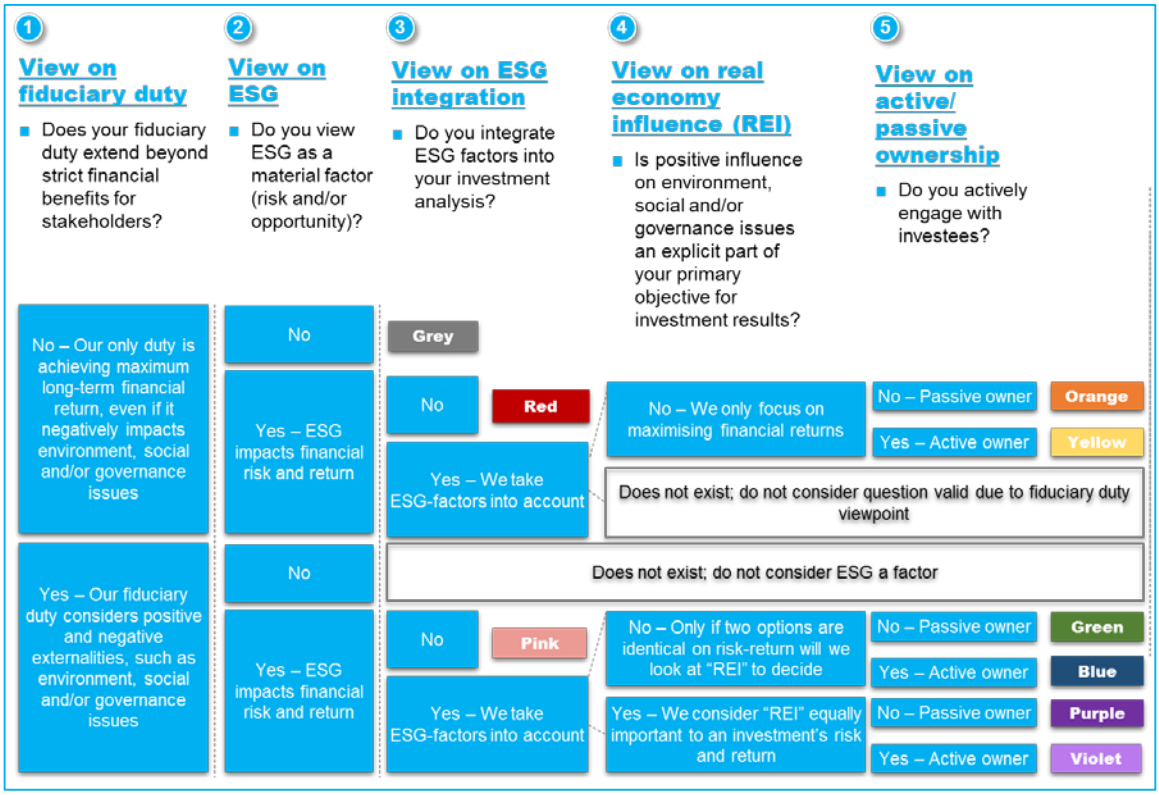
Key questions for profiles:

1. Does your fiduciary duty extend beyond the strictly financial view to include benefits for stakeholders beyond monetary?
2. Do you view ESG as a material factor (risk and/or opportunity)?
3. Do you integrate ESG-factors into your investment analysis?
   Note: There is range to which asset owners presently integrate ESG factors, starting from basic performance and norm-based screening to integrating ownership activities and ESG factors within traditional investment decision making criteria. Hence, ESG-integration is not black and white. Regardless of where an asset owner falls on how comprehensively they partake in ESG integration, they have been grouped together to reflect the perception of added value to the investment decision making process.
4. Is positive real economy influence (REI) an explicit part of your primary objective for investment results?
5. Do you actively engage with your invested companies? (Note: This is engaging once an investment is made (e.g. voting at Annual General Meetings, or meetings with management to influence company strategy) and not actively selecting investments).

Other questions are also of high-interest but do not lead to different profiles for this document's purpose. Other high-importance items are, for instance, having a long-term or short-term horizon and a focus on investing in the real-economy. However, a long-term focus is shared by all asset owner (or at least stated as a focus). Additionally, the level of focus on the real economy is often a question raised. However, this is more often a further description of the profiles from the five questions above.

Referring to Figure 7, asset owners may assess which profile they are in (an "as-is" state) and be comfortable in that current profile. Others may assess their "as-is" state and aspire to move into another profile (a "to-be" state). In either case, the tips in this section provide food for thought, and are labelled with profiles that could benefit from considering them.

Figure 7. Investment strategy profiles



The answers are relatively black and white, as they are meant to differentiate asset owners from one another. There are, of course, nuances to the answers (for example, the degree to which you integrate ESG factors into your investment analysis), however the yes/no answer format will steer you to the most appropriate profile. The resulting profiles are therefore not always a perfect fit, and it may be that some aspects of the profile description are more relevant than others.

Fiduciary Duty in the 21st Century

Note: Investor understanding of fiduciary duty continues to evolve between and within countries. A full discussion of the issues at hand, and current projects, can be found on the PRI's ***Fiduciary Duty in the 21st Century*** *website.*

INVESTMENT STRATEGY PROFILE: GREY

- View of fiduciary duty: Only duty is achieving the maximum long-term financial return, even if it negatively impacts environmental, social, and/or governance issues.
- View on ESG: ESG is not a material factor, and does not impact financial risk and return.

INVESTMENT STRATEGY PROFILE: RED

- View of fiduciary duty: Only duty is achieving the maximum long-term financial return, even if it negatively impacts environmental, social, and/or governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are not integrated into investment analysis.

INVESTMENT STRATEGY PROFILE: PINK

- View of fiduciary duty: Fiduciary duty considers positive and negative externalities, including environmental, social, and governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are not integrated into investment analysis.

INVESTMENT STRATEGY PROFILE: ORANGE

- View on fiduciary duty: Only duty is achieving the maximum long-term financial return, even if it negatively impacts environmental, social, and/or governance issues..
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: positive influence on environment, social and/or governance issues is not an explicit part of the primary objective for investment results.
- View on active/passive ownership: does not actively engage with investees.

INVESTMENT STRATEGY PROFILE: YELLOW

- View of fiduciary duty: Only duty is achieving the maximum long-term financial return, even if it negatively impacts environmental, social, and/or governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: positive influence on environment, social and/or governance issues is not an explicit part of the primary objective for investment results.
- View on active/passive ownership: does actively engage with investees.

INVESTMENT STRATEGY PROFILE: GREEN

- View of fiduciary duty: Fiduciary duty considers positive and negative externalities, including environmental, social, and governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: positive influence on environment, social and/or governance issues will only be considered if two options are identical on risk-return.
- View on active/passive ownership: does not actively engage with investees.

INVESTMENT STRATEGY PROFILE: BLUE

- View of fiduciary duty: Fiduciary duty considers positive and negative externalities, including environmental, social, and governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: positive influence on environment, social and/or governance issues will only be considered if two options are identical on risk-return.
- View on active/passive ownership: does actively engage with investees.

INVESTMENT STRATEGY PROFILE: PURPLE

- View of fiduciary duty: Fiduciary duty considers positive and negative externalities, including environmental, social, and governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: "REI" is equally important to an investment's risk and return.
- View on active/passive ownership: does not actively engage with investees.

INVESTMENT STRATEGY PROFILE: VIOLET

- View of fiduciary duty: Fiduciary duty considers positive and negative externalities, including environmental, social, and governance issues.
- View on ESG: ESG is a material factor, and does impact financial risk and return.
- View on ESG integration: ESG factors are integrated into investment analysis.
- View on real economy influence: "REI" is equally important to an investment's risk and return.
- View on active/passive ownership: does actively engage with investees.

OPPORTUNITIES FOR EACH PROFILE

ESG Evidence
■ Review and asses empirical evidence related to ESG impact on financial performance
Further Reading
Deutsche Asset ■ **Management/University of Hamburg: ESG and financial performance: aggregated evidence from more than 2000 empirical studies** **Most relevant to profiles**: Grey

Fact Check

Review and assess legislative environment regarding issues such as:

- Your Fiduciary Duty
- Stewardship
- ESG transparency and reporting requirements
- Environmental regulations

Further Reading

- **Fiduciary Duty in the 21st Century**
- **The PRI Policy team's webpage account for recent regulatory shifts, globally**

Most relevant to profiles:
Grey
Red

Check up on Competition

- Conduct a peer review to gain an understanding of current practices incorporating ESG factors into the investment process. A consultant can provide an external point of view, and considerations your organisation might have missed.

Further Reading

- **Ceres' Blueprint for Sustainable Investing**
- **The PRI Policy team's webpage account for recent regulatory shifts, globally**

This is relevant to all strategy profiles.

Improving Real Economy Influence

- Discuss impact goals for your organisation with beneficiaries and other stakeholders to gain further perspective.
- Evaluate how to best consider these perspectives. How do they relate to organisational risk and return objectives?
- How will your organisation look to create, measure, and report impact performance in the future?

Further Reading

- **PRI - Understand the impact of your investments**

Most relevant to profiles:
Orange
Yellow
Green
Blue

Enhancing Ownership

- For insight regarding current practices regarding active ownership and engagement, contact your local Responsible Investment Association (RIA)
- The **PRI's collaboration platform** allows institutional investors to approach investee companies in coalition.

Further Reading

- PRI - Why be an active owner?

Most relevant to profiles:
Orange
Green
Purple
Grey
Red
Pink

More On Real Economy Influence

- Are your methods for measuring 'real economy influence' in your portfolio clear and consistent?
- How are these measured and reported?
- Could they benefit from being publicly available?

The Impact of Equity Engagement from IE2 is a research worth reading.

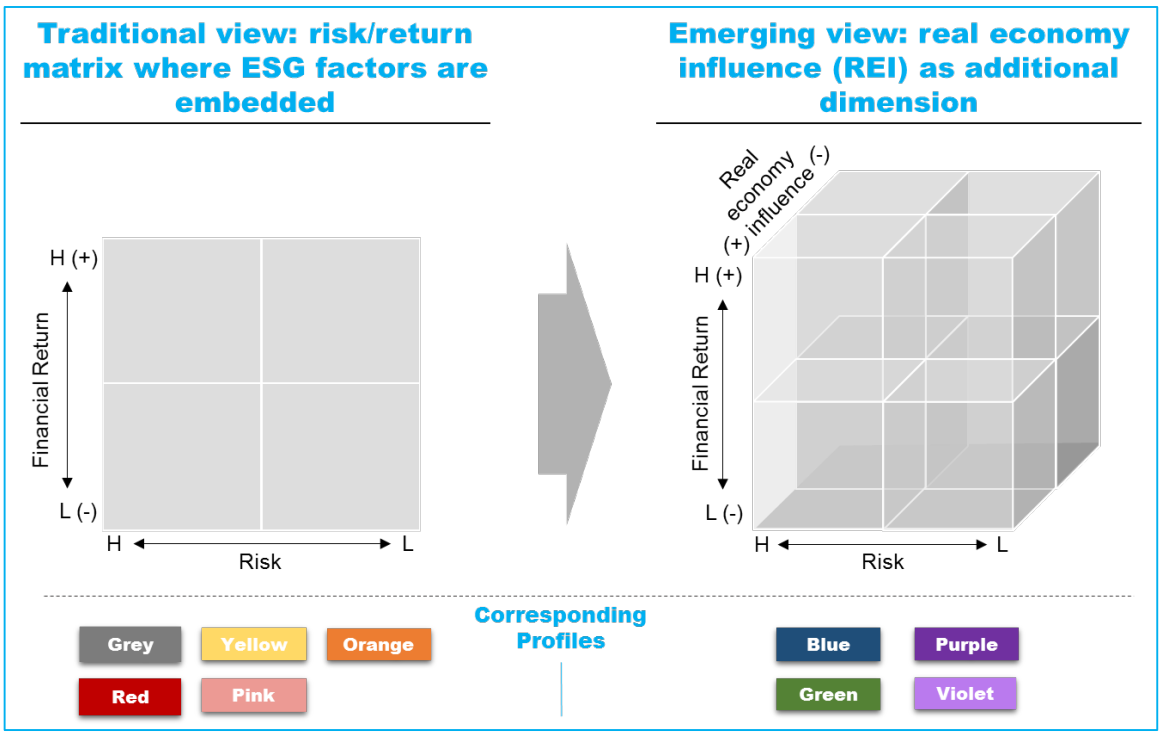
Most relevant to profiles:
Violet
Green
Blue
Purple

TRADITIONAL VIEW OF RISK-REWARD AND AN EMERGING 3D VIEW

A key split, related to the above profiles, emerges when asset owners answer the question: "Does your fiduciary duty extend beyond strict financial benefits for stakeholders?", the first question when deliberating which investor profile is the best fit, in combination with "Is positive influence on environment, social and/or governance issues an explicit part of your primary objective for investment results?" (the fourth question). Answering either of these positively places an asset owner in agreement with an emerging view: investors worldwide need to extend the traditional 2D view of risk versus with a third dimension that charts the real economy influence that investments can have on the natural environment and/or society.

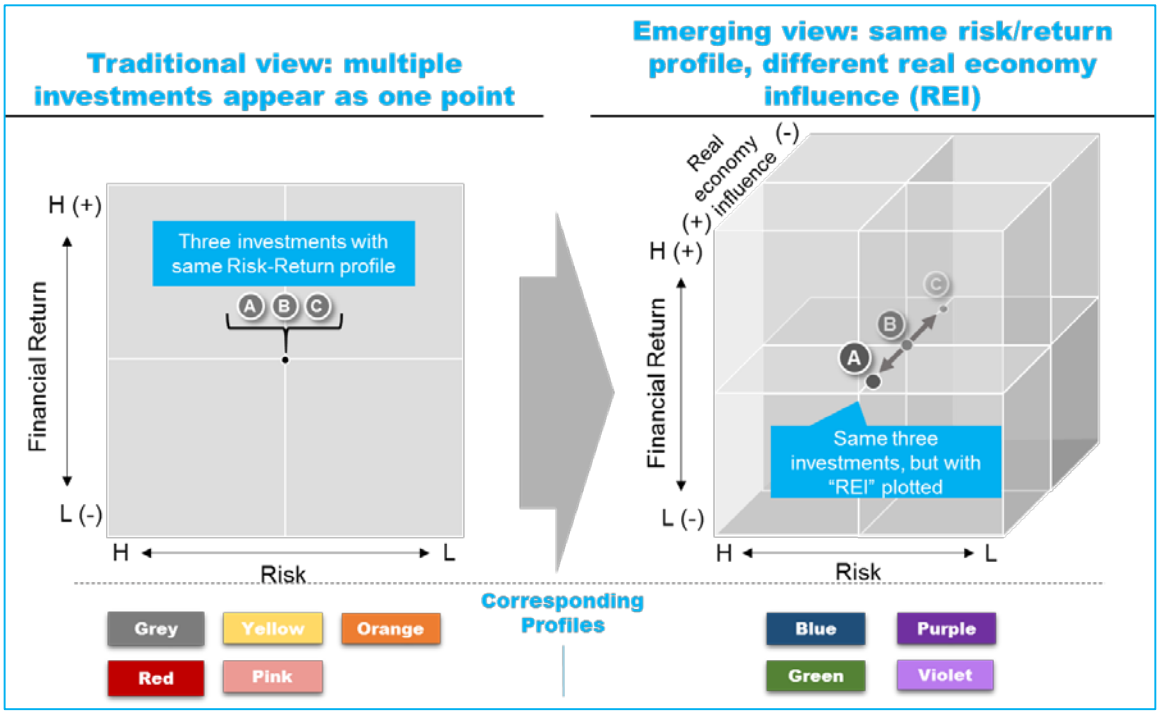
This transition is as important for the 21st century as the addition of risk to return was half a century ago. It takes ESG incorporation to the next level, as it explicitly creates a macroeconomic environment where long term returns, as well as a sustainable financial system, is enabled.

Figure 4. Shift from traditional 2D to 3D view with 'real economy influence'



The grey, red, yellow, orange and pink profiles see their investment universe in the traditional 2D frame, which doesn't explicitly take real economy influence into account. In contrast, the blue, purple, orange, green and violet profiles have adopted the emerging perspective, viewing an investment space in a way that that accounts for real economy influence. We can see this difference illustrated below in Figure 5.

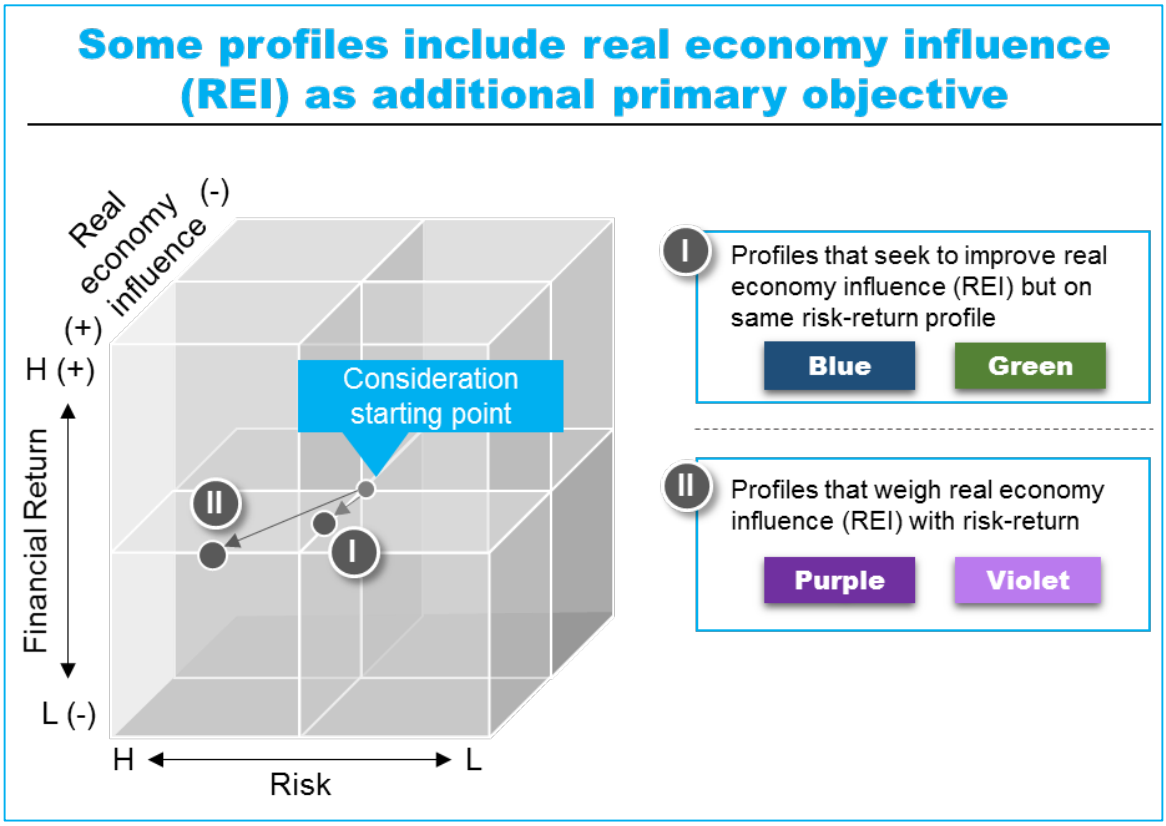
Figure 5. Plotting investments strategies onto 3rd, real economy influence dimension



On the left these investments appear at the same point because they are not differentiated on risk or financial return. However, on the right, the three investments appear at separate real economy influence levels (though at the same risk/return profile). The profiles who prefer this 3D view will choose investment **A** over **B** or **C** to increase their positive influence on the real economy.

Some profiles will include 'real economy influence' as a primary objective of their investment results along with financial returns. These profiles go beyond having influence as a secondary objective (i.e. only moving along the same risk-return line in search of a better real economy influence). They will weigh the difference in real economy influence along with differences in financial return and risk when selecting between two investments or investment strategies. This difference between having real economy influence as a primary objective (along with financial returns) and having real economy influence as a secondary objective is illustrated in the next graph.

Figure 6. Real economy influence as additional investment objective



Profiles which have real economy influence as a secondary objective would choose investment **I** over the initial investment a, but not **I I** as it would have higher risk. Profiles who have real economy influence as a primary objective would choose investment I and also II over the initial investment. Investment **I I** would lead to greater influence but at higher financial risk. A concrete illustration of **I I** would be the consideration of a (thematic) investment strategy that targets double-bottom line companies. By limiting the universe of investments the asset owner will consequently limit diversification and increase risk at the same financial return level. Each specific asset owner will decide what weight to give real economy influence in their choice of investment strategies and investment decisions.

Combined investment profiles

In the overall portfolio of an asset owner, there can be a mix of profile selections.

SELECTION OF INVESTMENT STRATEGY (STEP 4C)

After you've set your criteria and selected the most appropriate investment profile, it is necessary to define the range of investment scenarios for evaluation. Each scenario combines an option in "where-to-focus" and "how-to-succeed". The total number of scenarios is almost infinite. To illustrate the complexity it is helpful to consider that the universe of options for "where-to-focus" is the full range of investment allocations across the following factors: asset classes, sectors, geographies, type of funds, fund strategies, time horizon, size of investment, size of stake relative to others, time horizon, and more. Your investment strategy profile should be used to help guide your thinking to a manageable number of scenarios to consider.

Each scenario will be run through an evaluation that will include a financial model, risk model, and, possibly, an real economy influence model. The depth and complexity of these models is an additional, important choice. The result will be a final investment strategy that can be approved.

Note that many scenarios will be immediately unsuitable due to your investment principles or ambitions (e.g. an ambition to avoid carbon-intensive investments will most likely disqualify any choice that has a significant asset allocation in the oil and gas sector; an ambition to avoid large volatility will disqualify any choice with significant VC-investment).

SELECTING OPTIONS FOR INVESTMENT ALLOCATIONS ("WHERE-TO-FOCUS")

After you have determined your investor strategy profile, which will help guide your thinking on which investment strategy options to consider, you will step through key questions to get to a set of allocation options to consider ("Where-to-focus").

Below we've listed a suggested range of options to consider. Your criteria may restrict the choices under consideration, leading to some of the possibilities being immediately unsuitable. Using your investment profile will help you focus on the best possible options for the scenario at hand.

"Where-to-focus" Questions

- What is the full range of investment opportunities to consider?
- What are the right attributes/characteristics to each relevant investment opportunity? In terms of return, types of risks, et cetera.
- What are favoured options in the overall portfolio of various investment opportunities to be considered? Which choices will contribute most to achieving your ambition? How are portfolio characteristics being valued, e.g., risk diversification?
- Which elements to consider of the following list (not exhaustive):
- Asset classes (e.g. debt, equity, ETFs, currencies, alternatives like real-estate, infrastructure, commodities, private debt/loans)
- Sectors (e.g. consumer goods, financial services, healthcare, energy, utilities, basic materials, industrials, tech, telecom) and sub-sector – which to overweigh, which to blacklist?
- Geographies (region, country)
- PE & VC funds (e.g. growth, early-stage, real-estate, mezzanine, LBOs, distressed, ...)

- Hedge funds & fund strategies (e.g. quant, arbitrage, event driven, global macro, directional, …)
- Type of investment (fund of funds, multi-asset funds, targeted funds, individual equities, individual debt offerings, co-investment, strategic, direct ownership, etc.)
- Time horizon (<5 years, 5-10 years, 10-20 years, >20 years)
- Individual investment size ($M, % of portfolio)
- Ownership stake (<1%, 1-5%, 5-20%, 20-50%, 50-100%)
- Where are the largest capital needs from economic point of view and impact point of view?
- Are there new vehicles that could be explored to expand the range of options? (ESG related examples: green bonds, equity linked to success on an impact-theme)
- Other…

After answering the above you may start choosing specific options of "where-to-focus". Each option is a combination of several asset allocations specified along the dimensions listed under the questions above. The level of granularity will vary based on your situation and should be at a level sufficient for you to evaluate the investment strategy scenarios.

SELECTING OPTIONS FOR "HOW TO SUCCEED"

After selecting a set of strategic investment allocation options to consider ("Where-to-focus") it is necessary for the asset owner to explore "How to succeed". The appropriate operating model is critical and the internal capabilities need to be reviewed (referring back to "Step 1: Context") before deciding what operational models to assess.

"How-to-succeed" Questions

- Insource or outsource of investment function? To what level? (See Figure 7 for guidance)
- Active or passive management (investment selection)? (See Figure 7 for guidance)
- Active vs passive investment ownership, level of engagement? (Use investment strategy profile to answer)
- What partnerships could be created to maximise returns?
- Which approach to scale and cost?
- What are your objectives on transparency and / or reporting?
- How much innovation do you want to finance? How patient is your capital?
- Which innovative alliances or joint venture options are possible to create new synergies?
- What partnerships could be created to maximise the positive impact of an investment? (e.g. other asset owners/investors, public/private groups)
- What types of engagement are most suitable for you? In which situation will engagement be used for improvement of financial returns or for improving positive impact?
- Is the future asset owner professional one that combines both financial analysis and ESG analysis or are these separate skills? What level of insourcing / outsourcing? (some questions are more investment manager questions)
- Other…

Figure 7. Decision on how to operate regarding in- vs. outsource and active vs. passive management (selection)

	In-source	Outsource
Active management	▪ *In the long run, active management outperforms passive management returns* ▪ *I have the volume / expertise / capabilities to manage the required investments at a better cost than through a 3rd party, for a comparable return*	▪ *In the long run, active management outperforms passive management returns* ▪ *An experienced 3rd party will provide me with the right performance at a better cost*
Passive management	▪ *In the long run, passive management outperforms active management returns* ▪ *I have the volume / expertise / capabilities to manage the required investments at a better cost than through a 3rd party, for a comparable return*	▪ *In the long run, passive management outperforms active management returns* ▪ *An experienced 3rd party will provide me with the right performance at a better cost*

Combined operating selections

There can be a mix of operating selections. E.g. you could perform part of the investment function in-house outsource the rest. You could choose to be active owner in a few investments but passive owners for the rest of the portfolio.

EVALUATION OF INVESTMENT STRATEGY SCENARIOS

Following selection of a set of strategic investment allocation options to focus on as well as your most appropriate operating model, you can now create investment strategy scenarios to evaluate.

A) Select combinations of investment allocations options ("where should we focus?") and how you will operate ("how do we succeed?") to make up a strategy scenario
B) What metrics / KPIs are essential in this scenario?

The last step is to evaluate the preferred investment strategy scenarios against the set of criteria. Often one or more criterion will not be met by a given scenario and it will be necessary to move back a step, either creating a new set of scenarios to evaluate, or adjust your ambitions or criteria. Each constructed scenario will be run through a financial model, a risk model and possibly an ESG-impact model. The features, depth and complexity of the models will depend on your specific situation and will be derived from the ambition and criteria. The scenarios will be ranked and the top investment strategy scenarios will be selected. These investment strategy scenarios will be further evaluated using a series of more advanced tests including stress tests that include deviations from expectations in the market, general economy, ESG trends and internal factors (e.g. capabilities for internal active ownership). If this leads to unacceptable outcome, it will lead to another set of iterations, until finally an investment strategy plan is established that fits mission, investment principles, ambition and criteria.

IMPLEMENTATION (STEP 5)

The investment strategy will then be translated into initiatives for implementation, e.g. an investment policy, tactical and operational asset allocation, potentially (revised) RfP for a new Investment Manager or renegotiating IM's mandate. Additionally, an implementation monitoring plan needs to be made.

This document is focused on the investment strategy plan process. As such it does not in include "Step 5: Implementation". Step 5 will be addressed in further work by the PRI on asset owner investment policy.

Most strategic failures occur in the implementation phase. Typically, strong steering occurs on 'hard' elements like KPIs, incentives, organisation structures, and too little attention for elements like, for instance, convincing the respective audiences, role modelling by senior management, changing individual behaviour, clear responsibility for implementation of initiatives, and capability building among employees. It is essential to hold these elements in mind during the investment strategy process instead of only at the end of the process.

COMMUNICATION (STEP 6)

A communication plan is needed to cover all previous 5 steps. The plan needs to include the right stakeholders at the right point in time. Although communicating clearly about the progress made

during the process is important, what may be even more crucial is insuring that the right opinions are included at each step of the process, and that there is a clear pathway for them to be included.

Experience shows that communication is almost always underestimated, and not communicating enough is a real risk during the course of a strategic change project.

The communication plan will need to include both internal and external communications. In particular it is very important to communicate with stakeholders outside the organisation (e.g. beneficiaries/customers, shareholders, outsourced asset managers). The topic of responsible investment can be a powerful tool for stakeholder engagement.

An initial plan for communication should be agreed at the beginning of the process. Revisiting the plan frequently, at least once per step, will help ensure the plan is aligned with the strides that are made. It is helpful, while revisiting the communication plan, to review any feedback on the process from both internal and external parties (e.g. confusion from investment professionals, concern from beneficiaries/customers). The communication plan should be flexible, and adapt to changing circumstances.

STEP 6 QUESTIONS

- Who will be responsible for communicating about the process? Who else will be involved in planning and then executing the communications?
- What is the current channel and process for communicating with stakeholders (internal and external)?
- How is the internal audience segmented? E.g. Board, executive team, several groups of employees, workers council
- How is the external audience segmented? E.g. beneficiaries/customers, external asset managers, management teams at investments, shareholders
- What are the key communication plan objectives and key themes at each step? For each audience group? What is the process for determining the content/message for each communication moment (what is forum for decision, who is consulted, who recommends, who decides)? When can an early draft of messages be created?
- For each audience segment:
  - What are the key messages? What is right frequency and length?
  - Who is sending out the message(s)?
  - What communication channels should be used? And for which purposes?
  - What types of communication should occur early in the process? What should occur once an investment strategy is selected?
- What is likely to cause anxiety among stakeholders (which ones)? How will you relieve this anxiety?
- How will you collect feedback on the execution of communication? From which groups? What type of feedback will be focused on?
- Other…

Actions and roles

1. Executive Committee and Board decide on who will lead the communication team and who will be on the team (e.g. communication team, project team)

2. Communication team to create an initial proposed communication plan for discussion with the Executive Committee and Board, project team, and other relevant parties (e.g. communications department)
3. Create and deliver tailored messages (as appropriate) at each step to internal (e.g. employees) and external stakeholders (e.g. beneficiaries, shareholders, investment management teams). Creation coordinated by communication team and delivery by appropriate party
4. Monitor delivery of messages (planned discussions, executed discussions, feedback gathered)
5. Collect feedback on communications as needed (e.g. email box, quick web survey, focus groups, one-on-one discussions)
6. Project lead to setup recurring agenda item to revisit communication plan at project meetings and at Board meetings. Includes discussion of any collected feedback on communication

STEP 6 OUTPUTS

1. Integral communication plan
2. Communication messages and message materials
3. Monitoring report on communication execution (including feedback channels established)
4. Monitoring reports on ongoing feedback on investment strategy process (plan and implementation)

This is an unedited section of content from a working paper on investment strategies. The PRI is seeking feedback on the content from PRI signatories and other stakeholders. **Please contact Don Gerritsen**, Senior Manager, PRI at **don.gerritsen@unpri.org** by 30 October 2016 to comment.

The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact