The session focused on the risks and opportunities in green investing from the perspectives of both academics and practitioners. The session concluded that a few pioneering funds are beginning to incorporate environmental and sustainability factors into their investment decisions, but that the field is not fully developed and many green investment strategies remain unexplored.

Mats Anderson, CEO of Fourth Swedish National Pension Fund (AP4), presented AP4’s view of ESG (environment, society, governance) investments. He noted that AP4’s objective is high return over the long-term and that the fund considers ESG factors in their investment process. The inclusion of ESG is not simply for public relations reasons. Rather the fund believes such factors improve returns over the long-term. Mr. Anderson noted, moreover, that socially responsible investment doesn’t have to be complicated: “Keep it simple, and act now.” One example he pointed to was the S&P US carbon efficient index, which weights the carbon footprint of its constituent companies. Because there is not much tilt compared to the original index, shifting investments from the S&P 500 index to the S&P 500 carbon efficient index is a feasible choice for many SWFs. Switching indices will, moreover, reduce carbon risk and generate higher returns in the long run. Another strategy employed by the AP4 and other Swedish AP funds, is an ethical council they created to provide recommendations on ESG issues.

Pascal Blanque, Deputy CEO and CIO of Amundi Asset Management, presented Amundi’s vision of socially responsible investment. Amundi uses a best-in-class approach. This consists of identifying leading companies, in regards to ESG criteria, from each individual sector or industry. By shifting investments toward best-in-class performers on ESG factors, Amundi can help companies in which it invests evolve toward best practices, without shifting sector weights or concentrating risk. He also pointed out that incorporating extra-financial criteria into financial analysis could allow for more accurate valuations.

Paul Dickinson of the Carbon Disclosure Project discussed the risks and opportunities in green investing. In regards to the feasibility and profitability of ESG investments, Mr. Dickenson drew on the words of Alan Brown, Chairman of the Board of Trustees of Carbon Disclosure Project. Mr. Brown dubbed the shift toward a low-carbon economy a predictable industrial revolution. Investment opportunities thus abound. Towards this end, the Carbon Disclosure Project provides data for rational responses to climate change and cooperates with index providers to create green investment products. One new project they are currently undertaking is the climate bond initiative which aims to create new instruments that allow investment capital to make truly long-term investments.

Harrison Hong, Professor of Economics at Princeton University, presented two research projects exploring quasi-experiments in green rating and investments. The first analyzed the impact of financial constraints on “corporate goodness” or firm performance on ESG measures. Hong, Kubik and Scheinkman (2010) found that financially constrained firms have a lower “goodness” score compared to their unconstrained peers. The one exception was the dot-com bubble period when financial constraints on all firms were temporarily loosened. Their analysis also revealed that goodness doesn’t come free. Rather it is costly and firms only invest in “goodness” with financial surplus. The second research project studied the role of the “principle-agent problem” in corporate goodness by measuring the response of Kinder, Lydenberg, and Domini scores to 2003 dividend tax. They find that firms with low insider ownership (presumably with larger agency problems) tend to have lower goodness scores than firms with high insider ownership.

Augustin Landier, Professor at the Toulouse School of Economics, pointed to the positive role SWFs can play in socially responsible investing (SRI). He noted that green investing has the potential to produce huge network externalities and that the optimal standard for the individual investor depends on the equilibrium standard. Given this situation, game theory suggests that if most investors have a green investment standard, it would be best for each individual investor to adopt similar standards. If others do business as usual, however, it is most profitable for the individual not go green. Thus the best response for each individual investor depends on which equilibrium standard of the entire network. Also, investment size is an important factor in
determining SRI standards. They could become fragmented and inefficient if a large investor consensus with significant market power fails to emerge to identify a common, efficient standard. The size and objectives of SWFs give them a unique advantage, with significant positive externalities in green investments: first, SWFs have the sophistication and incentives to establish good, efficient standards in these investments; and more importantly, SWFs present a critical mass because of their large size – SRI can have an impact only when it becomes widely adopted. A common green investment platform led by SWFs could thus play a catalytic role.