

# Exclusions, passive approaches and ESG the Icelandic way

At the end of last year, **Tell Media Group**, in co-operation with **Baillie Gifford**, **Franklin Templeton** and **Pimco**, invited Icelandic investors to discuss ESG integration. Tell Media Group founder Niklas Tell and Nordic Fund Selection Journal editor Caroline Liinanki moderated the roundtable.

By: **Niklas Tell** Photo: **Jennie Nyström**



The discussion, which was held at Canopy by Hilton in Reykjavik, kicked off with Caroline Liinanki asking the Icelandic participants how their policies relating to ESG and responsible investing have changed over the years.

**SIGURBJÖRN SIGURBJÖRNSSON:** "I remember the time in the early 2000s when we had the first discussions about the PRI and at that time it was just starting. We saw a number of international funds focusing on responsibility but at the time, they were not able to compete on returns. Things have changed a lot. A few years ago, some clever politicians decided that it would be good to have one sentence in our pension fund guidelines that we should look at ethical issues. There were no additional explanation or guidance and nobody knew exactly what to do with that. It has been a really interesting journey since. For us, we've increased what we're saying about responsible investing every year and right now we're working to put our policy into practice and things are moving fast."

**HREGGVIÐUR INGASON:** "We had a policy in place some three years ago but as it's such a fast-moving area, we're constantly rethinking what we should do. To answer your question about what has changed over the past years, I would probably have to say 'everything'. Exclusions used to be a big thing for us but that has changed and today we only have a short list of exclusions."

**HREFNA ÖSP SIGFINNSDÓTTIR:** "We started in 2010 when we established an overall policy for Landsbankinn - to first

put pressure on ourselves and then others. In the beginning, it was all about our internal processes of how we lend money and how we invest. I represent the investment side at Landsbankinn and we established a policy on responsible investing in 2013 and since 2015 we've actively interviewed listed companies in Iceland and sent them questionnaires on ESG. Now we're co-operating with a local company in Iceland to get ratings on our assets, both of the mother company and of all the funds that we run in the subsidiary of Landsbankinn. We've come a long way but there are still a lot of things to be done."

**ARNE VAGN OLSEN:** "We signed the PRI in 2005 so it has been on the agenda for some time now. That said, I think we probably could have moved quicker in this area. Personally, I would also have liked to show more of what we've done. A lot of things have happened in the background. We still have a long way to go and we feel increased pressure from ourselves as well as from our peers, which is a good thing."

**NIKLAS TELL:** "WHAT ARE THE DYNAMICS THAT HAVE PUT ESG INTEGRATION HIGHER ON THE AGENDA IN ICELAND? IS IT PRIMARILY THE PENSION FUND LEGISLATION AROUND SUSTAINABILITY OR IS THERE OTHER CONTRIBUTING FACTORS AS WELL?"

**HREFNA ÖSP SIGFINNSDÓTTIR:** "I feel that the development in Europe has been driving the change and we're of course a part of Europe."

**HREGGVIÐUR INGASON:** "The legislation is actually fairly soft so I would agree with Hrefna that other factors are driving this change."

**ARNE VAGN OLSEN:** "The more you dig into this area, the more you realise that it's a tool to help you make better investment decisions. That's really why it's catching on so fast as it will help you identify risks that you weren't addressing to the same extent before."

**SIGURBJÖRN SIGURBJÖRNSSON:** "At the end of the day, we have an obligation to make our members better off and we do that by investing and receiving good returns. As I said earlier, when we started to look at this area, returns were not good enough. That has changed and today it's companies that are taking ESG into consideration that perform better and are more likely to perform better going forward."

**NIKLAS TELL:** "AS ANALYSTS IN THIS SPACE, DO YOU FOCUS MOSTLY ON HAVING ALL THE RISKS COVERED OR IS IT EQUALLY ABOUT ACHIEVING HIGHER RETURNS?"

**FIONNUALA O'GRADY:** "Traditionally, there has been more focus on the risk side and academic studies show that you can mitigate downside risks by incorporating ESG factors. We're, however, increasingly looking at these factors from an opportunity point of view as well. We're moving into a low-carbon economy and for us, it's important to understand and identify the companies that are adapting and will thrive going forward."

**TINA ADATIA:** "I would agree with that and I do think that the financial community can play an important role in influencing companies to adapt to better practises in this area. In the past, it was mostly about governance as E and S were seen as longer term factors. That has changed and today all ESG factors are incorporated in our credit analysis. They could be material risks."

## PARTICIPANTS

- **ARNE VAGN OLSEN**  
*Chief investment officer of Lífeyrissjóður verzlunarmanna*
- **HREFNA ÖSP SIGFINNSDÓTTIR**  
*Managing director markets at Landsbankinn*
- **HREGGVIÐUR INGASON**  
*Chief investment officer of Lífsverk Lífeyrissjóður*
- **SIGURBJÖRN SIGURBJÖRNSSON**  
*Managing director of Söfnunarsjóður Lífeyrisréttinda*
- **ANDREW CAVE**  
*Head of governance and sustainability at Baillie Gifford*
- **FIONNUALA O'GRADY**  
*ESG analyst at Franklin Templeton*
- **TINA ADATIA**  
*Executive vice president and product strategist at Pimco*



**ARNE VAGN OLSEN**

*Lífeyrissjóður verzlunarmanna*

Chief investment officer at the pension fund Lífeyrissjóður verzlunarmanna since 2018. Prior to that, he spent six years as chief investment officer of Stapi pension fund and before that, he worked as head of marketing and sales at the asset manager Icelandic Securities.



**HREFNA ÖSP SIGFINNSDÓTTIR**

*Landsbankinn*

Managing director markets at the banking group Landsbankinn for almost a decade. Prior to that, she worked as a fund manager at Arev Securities as well as head of listing and issuer relations at Nasdaq OMX in Iceland. She was also the first chairman of Iceland SIF, the Icelandic Sustainable Investment Forum.

**ANDREW CAVE:** “We specialise in long-term growth management and ESG factors are important if you want to hold companies for the long term. We started doing deep dives into ESG factors specifically for our responsible investment funds but as soon as our fund managers received this information, they quickly said that everyone should have this. Insight on ESG factors are therefore now available to all our fund managers. Why wouldn’t you want access to this?”

**NIKLAS TELL:** “WHEN LOOKING AT COMPANIES, ARE YOU LOOKING FOR EXCELLENT COMPANIES FROM AN ESG STANDPOINT OR ARE YOU LOOKING FOR THE ONES THAT ARE IMPROVING? SO ARE YOU HAPPY TO OWN THEM EVEN IF THEY DON’T LOOK GOOD TODAY FROM AN ESG-RATING PERSPECTIVE?”

**FIONNUALA O’GRADY:** “We would certainly be happy to own companies transitioning towards an ESG-friendly status. Some ESG data and ESG ratings are very backwards looking and we’re more interested in how they’re evolving. It’s about identifying companies that are on the right trajectory.”

**TINA ADATIA:** “We have a similar approach and our analysts not only set an ESG score but also an ESG outlook. That lets us identify the rising stars in terms of ESG and it can also help us identify engagement candidates – companies that score low but seem willing to improve. It’s the same when you do traditional credit research. You don’t want all AAA. You also want to find companies that are improving as that’s how you make money.”

**ARNE VAGN OLSEN:** “So in essence you’re kind of inverting the ESG score. Maybe that’s the sweet-spot – to screen the companies that you need to take a closer look at.”

**TINA ADATIA:** “That’s probably where you would add more return.”

**SIGURBJÖRN SIGURBJÖRNSSON:** “I fully agree. Taking companies from being brown to becoming green or greener is what we should focus on.”

**CAROLINE LIINANKI:** “HOW DO YOU IDENTIFY THE WINNERS THROUGH AN ESG LENS? IS THERE A PROBLEM WITH DATA IN THIS AREA?”

**HREFNA ÖSP SIGFINNSDÓTTIR:** “This is what we’re lacking locally. When we invest internationally, we can always go to companies such as Sustainalytics or Bloomberg but we haven’t had that in Iceland. We’re now working with a local company that is developing a score and they’re getting more clients locally as well.”

**HREGGVIÐUR INGASON:** “It’s always good with standards and that’s what currently is lacking when it comes to ESG, especially here in Iceland. When we select funds to invest in internationally, we don’t invest with asset managers that don’t have a policy in place but comparing different policies can be difficult due to the lack of standards. When you look at financial data, everyone will know what different measures means but that’s not the case when it comes to ESG.”

**ANDREW CAVE:** “It’s such a fluid area and things change a lot. A company that was a leader a few years ago could quickly fall behind. A lot of our work is about helping good companies stay ahead. We try to talk about next year’s issue with them rather than focusing on last year’s problems. The only way to do that is to have in-house ESG analysts. Public information is typically backward looking.”

**TINA ADATIA:** “I’m convinced that disclosure and standardisation will improve over time. In the meantime, investors need to continue to ask companies for information but that also requires an investment in information technology. There’s data out there and instead of just asking for the data they’ve published, we also



need to ask companies what their targets are for 2030 and then hold them responsible.”

**NIKLAS TELL:** “I GUESS WHAT YOU NEED TO DO TO COMPANIES IS WHAT INVESTORS NEED TO DO TOWARDS YOU. WHAT KIND OF QUESTIONS SHOULD INVESTORS ASK TO LEARN IF AN ASSET MANAGER IS TRULY INTEGRATING ESG IN THEIR INVESTMENT PROCESSES?”

**FIONNUALA O’GRADY:** “Firstly, it’s about the culture of the firm. Has it created an environment where responsible investment is truly led from the top and embedded across investment teams or has it been a separate silo? Then you start to think about the three Ps – people, process and portfolio. A warning signal would typically be if there’s only one person focused on ESG during the due diligence process and it’s not mentioned anywhere else. Then it’s probably not that integrated across the firm.”

**TINA ADATIA:** “I think you hit the nail on the head and in addition, I think investors should be wary of expansive exclusion lists. It may help you sleep well at night but I don’t think it will help you find the best companies for your portfolios. Reporting is very important as well. How do you demonstrate what you’re doing?”

**ANDREW CAVE:** “We often get asked how we do this in practice. They’ve seen the policy but how do we integrate ESG in practice. One decision we’ve taken is to have members of the ESG team sit together with the investment teams. That way they’re not only part of the weekly meeting but part of the day-to-day discussions. I think that’s one practical way to make sure you integrate these questions into the running of portfolios. It has improved our ESG analysts in

terms of their investment understanding and our investment managers and ESG analysts now speak the same language, which is very helpful.”

**HREFNA ÖSP SIGFINNSDÓTTIR:** “For us, a lot happened a year and half ago when I made it mandatory for everyone working as a fund manager at our company to complete the PRI Academy. I should have done it earlier. You need everyone involved to make a difference. During the course, which is online, we had a lot of breakout sessions and it also allowed us to discuss local cases to see how we would handle different situations.”

**CAROLINE LIINANKI:** “AS PENSION FUNDS, HOW HAVE YOUR STRATEGIES CHANGED WHEN IT COMES TO EXTERNAL MANAGERS AND WHAT KIND OF REQUIREMENTS DO YOU HAVE WHEN IT COMES TO THE INTEGRATION OF ESG?”

**SIGURBJÖRN SIGURBJÖRNSSON:** “As I said before, we’re screening our managers more closely but the problem is the amount of data sources. It sometimes feels like it’s a bit of a gold rush as you have a lot of providers and it’s also very expensive and time consuming, which can be a problem for a small pension fund.”

**CAROLINE LIINANKI:** “IS THE PROBLEM THE MONITORING OF UNDERLYING ASSETS OR THE MONITORING OF THE ASSET MANAGERS?”

**SIGURBJÖRN SIGURBJÖRNSSON:** “It’s both, also the managers we meet. Everyone has an ESG policy and you need to dig deeper to understand. But it’s tricky for someone in Iceland – we’re a bit further away from the market.”



**HREGGVIÐUR INGASON**  
*Lífsværk lífeyrissjóður*

Chief investment officer of the pension fund Lifsværk lífeyrissjóður since the beginning of 2016. Before that, he worked as head of derivatives at Glitnir, head of treasury at VBS Investment Bank as well as a lecturer at Reykjavík University.



**SIGURBJÖRN SIGURBJÖRNSSON**  
*Söfnunarsjóður lífeyrisréttinda*

Managing director of the pension fund Söfnunarsjóður lífeyrisréttinda since 1997 but has worked at the pension fund since 1989 after graduating from the University of Iceland. Over the years, he has taken part in and chaired many boards and committees regarding the Icelandic pension system.

**HREFNA ÖSP SIGFINNSDÓTTIR:** "That's why the launch of Iceland SIF was so important – to empower us. It's expensive and we need to work together."

**NIKLAS TELL:** "WHAT HAS THE BIGGEST IMPACT BEEN FROM THE LAUNCH OF ICELAND SIF?"

**HREFNA ÖSP SIGFINNSDÓTTIR:** "That's easy to answer. There was an academic survey done in 2017 where the university asked institutional investors if they had an ESG policy in place and at the time, very few had that. We recently did a quick survey among Iceland SIF members, which include almost all big institutional asset owners in Iceland, and some 60 per cent now have a policy in place. Things are happening."

**NIKLAS TELL:** "IF YOU LOOK AT YOUR PORTFOLIOS, HAS YOUR ESG POLICY CHANGED YOUR ASSET ALLOCATION AT ALL?"

**SIGURBJÖRN SIGURBJÖRNSSON:** "Yes, and we have, as an example, moved into infrastructure in recent years. That's very much about ESG as that typically would be projects that are meaningful for societies. It could, for example, be about moving from coal to gas. We've invested with an ESG-focused manager and we're trying to do what we say in our policy. That's the biggest challenge. You can say a lot of things about ESG in your policy but you also have to act."

**ARNE VAGN OLSEN:** "ESG has become much more visible at our fund over the last 18 months. Before we make a commitment to a fund, there are much more discussions on ESG and that's a discussion that evolves all the time as you learn things in each meeting you have. We've had meetings with Icelandic asset managers looking to sell us something but if we're not happy with their ESG work, it's a no go. That's not something we would have done a few years ago."

**SIGURBJÖRN SIGURBJÖRNSSON:** "I would like to add one thing and that's about the huge reputational risk involved. If we invest with a fund with no ESG considerations, that could be very bad for the pension fund. Social media, of course, play an important role in that."

**ANDREW CAVE:** "We're seeing that as well and there are some interesting start-ups in this area trying to connect investors with their pensions. That makes it easy for the individual to see what the pension fund has invested in. It's still early days but social media will connect individuals with their money in a much more direct way. We will all feel the pressure from this."

**HREFNA ÖSP SIGFINNSDÓTTIR:** "I think we're seeing the same development at the PRI. At first, it was educational but now they're pressuring you. They want to see changes. Iceland SIF started out very friendly and we wanted everyone to join. I think now we need to consider if we should only allow those that really want to make a change."

**NIKLAS TELL:** "COMING BACK TO THIS QUESTION OF OPENNESS AND REPUTATIONAL RISK - IS THAT A PROBLEM AS INVESTORS WOULD LIKE TO INVEST IN COMPANIES THAT ARE IMPROVING? LOOKING AT A LIST OF HOLDINGS, THERE MIGHT BE 'BROWN' OR JUST 'LIGHT GREEN' COMPANIES BUT YOU KNOW THAT THEY ARE ON A PATH TO IMPROVE. IS THAT A REPUTATIONAL RISK OR ARE YOU HAPPY TO TAKE THAT DISCUSSION?"

**TINA ADATIA:** "For our ESG portfolios, we don't just start with a standard portfolio and take names out. There must be a reason for every single name in there. Even if there's a company in there that isn't as green as something else, we need a good reason for buying it and we should be able to stand by that decision. For every portfolio, these decisions are integrated in the team but we also have

a person who is even more of an expert on ESG to ensure that every holding is questioned. This is also why you need to continuously do your own internal research as we don't want to end up as in 2008 when we knew that rating agencies were behind the curve on financial risk."

**ANDREW CAVE:** "There's a systemic risk that we are all facing here, especially as social media is very black or white – it's good or bad. There's a danger that it pushes everyone to more and more exclusions as it can be complex to explain the ESG considerations for a specific holding and you can't really have that debate online. There's a place for exclusions but it needs to be confined to some obvious categories. Another thing to look out for is the mushrooming of engagement. Companies are facing more and more investor meetings on ESG and as an industry, we need to be careful of how we use company time. Today, we try to focus on a narrower list of high-quality and research-led engagements where we have a specific issue that we think a company can move forward with. We would rather do 20 of them per year than 300 box-ticking compliance engagements."

**FIONNUALA O'GRADY:** "I think that focus on quality over quantity is important. With more disclosure requirement, we must be careful that we're not doing ESG engagement for the sake of it and to generate figures, which is not value additive for the corporates or our end investors. There must be authenticity around what you're doing in order to have meaningful results."

**ANDREW CAVE:** "One example on a specific engagement that we worked on for a long time was Ryanair. At one point, we had an analyst who worked more or less full time on that case for some five months and we, of course, have to figure out how you pay for that. One question around this

topic is if engagement can be part of the future for active management and I very much think that's the case. You pay a little bit more for active and for that, you get a team that works on issues like these."

**NIKLAS TELL:** "AS INVESTORS, DO YOU THINK ESG WORKS IN A PASSIVE FORMAT AS WELL?"

**ARNE VAGN OLSEN:** "This is a very interesting question – but I would like the asset managers around the table to answer this first."

**SIGURBJÖRN SIGURBJÖRNSSON:** "I have the courage to say both yes and no. A passive vehicle will, of course, buy all the companies in the index and can therefore not select companies from an ESG perspective. That said, a large passive asset manager can still use their influence and engage with companies."

**FIONNUALA O'GRADY:** "I think ESG is inherently part of active management and strengthens the case for it because you're actively looking for those opportunities. We're also offering passive products in the ETF space and ESG absolutely has a role to play here as well. We're currently looking at how to integrate ESG in our passive ETF range but you're, of course, limited in what you can do. We're exploring how big data can play a role to close data gaps as well as the pressure that index investors can apply to companies to improve practises and disclosure – or risk missing out on greater access to capital. On the active side, we're focusing on applying ESG in alternative assets, such as real estate, and that's an area where you can be so active given ownership levels and access that you move into impact investing."





**ANDREW CAVE**

*Baillie Gifford*

Head of governance and sustainability at Baillie Gifford since 2015 and a member of the global stewardship portfolio construction group. Previously chief sustainability officer for RBS, responsible for helping to rebuild its approach to corporate responsibility after the financial crisis.



**FIONNUALA O'GRADY**

*Franklin Templeton*

ESG analyst at Franklin Templeton since 2015 focused on equities, fixed income and alternatives. Before that, she held a stewardship role at Threadneedle Investments. She is also a member of CFA UK's certificate in ESG investing panel.



**TINA ADATIA**

*Pimco*

Executive vice president and product strategist in the London office, focusing on multi-sector fixed income and ESG strategy. Prior to joining PIMCO in 2004, she was on the consultant relationship team at Henderson Global Investors.

**SIGURBJÖRN SIGURBJÖRNSSON:** "We were talking about brown and light-green companies earlier and I think that private markets are a much better place to work on these issues. We ask a lot of questions around this when we invest in private equity funds."

**TINA ADATIA:** "Private markets can absolutely allow you to have an impact but you need to be careful to make sure you get compensated for the illiquidity risk that you're taking. We still need to balance the ESG risks and opportunities with investment risk and opportunities and we must deliver on both of those goals. When it comes to passive, most have taken the exclusion route and I think it depends on their incentives whether they can use their votes and engage with companies. They're charging very low fees and ESG and engagement are resource intensive so it's more difficult. In fixed income, I think you need to be active to do ESG and you can be very effective as companies need to come back to the market again and again to refinance. As a large fixed income investor, you can influence companies very quickly when they approach you with a new bond."

**HREGGVIÐUR INGASON:** "I actually agree with most views. I think you can do both but to me, ESG investing is a subset of active investing."

**NIKLAS TELL:** "GOING FORWARD, DO YOU THINK THERE WILL BE SPECIFIC ESG THEMES THAT WILL BE MORE IMPORTANT THAN OTHERS FOR INVESTORS IN ICELAND?"

**HREFNA ÖSP SIGFINNSDÓTTIR:** "I think themes related to the environment will be at the forefront."

**HREGGVIÐUR INGASON:** "I agree that the environment is top of mind right now. Exactly which themes will be important is, of course, influenced by the views of our board of directors. They're currently looking at the SDGs when looking ahead for what to focus on going forward."

**ARNE VAGN OLSEN:** "I think governance has been a big issue so far and it continues to be important. This is a small country and governance issues are therefore extra important. I agree, however, that environmental issues will sit high on the agenda going forward."

**SIGURBJÖRN SIGURBJÖRNSSON:** "I agree. If we look at Iceland as a country, I think we've come a long way in terms of E, S and G. Especially when it comes to environmental issues, I think we can do even more considering the natural resources we have. As a country, we can be at the forefront and I think we should do more. As a pension fund, it can be challenging as the board of directors typically are very much focused on local issues. I think we should open up and find balance on how we could have an impact, both domestically and in an international context."

**FIONNUALA O'GRADY:** "It was mentioned earlier that there hasn't been much of a regulatory push in Iceland so far. It will be interesting to see whether there will be regulation on capital markets locally as countries are confirming their commitments to the Paris agreement."

**HREFNA ÖSP SIGFINNSDÓTTIR:** "I think it's vital for us to approach this in a way to make sure that we don't get too much legislation in this area."

**ANDREW CAVE:** "Looking at the different letters of ESG in isolation, I think it's clear that it very much started with governance and that's for good reason. When it comes to environmental issues, we know fairly well what needs to be done. There's a known pathway to follow. "S" is the big unknown, maybe apart from labour rights, but it's a very interesting area and some of our more progressive

asset owners are now pushing us hard on these issues, especially social issues in the tech sector. These are questions, such as content stewardship in social media: how to handle the Instagram culture and the effect that has on young people. Gaming addiction is another topical issue, at least in the UK. It's tricky because it's not an area where you can use exclusions and we need to work our way through this."

**CAROLINE LIINANKI:** "HOW ARE YOU WORKING WITH EXCLUSIONS AND ACTIVE OWNERSHIP?"

**HREGGVIÐUR INGASON:** "When we first started working on our ESG policy three years ago, we were walking around in the dark. We therefore decided that we needed to put something down on paper that we could easily implement and exclusions were part of that. It was not a long list but simply things we didn't want to be associated with. We still have three or four items on the list that we exclude but we're moving towards active ownership."

**SIGURBJÖRN SIGURBJÖRNSSON:** "We don't use exclusions because one of the most difficult things about all of this is where you draw the line. What do you do if you own equity in a company and that company in turn owns another company where a small part of the activity is something you don't agree with? How do you find the balance and where do you stop?"

**HREFNA ÖSP SIGFINNSDÓTTIR:** "Our policy is not based on exclusions but we will exclude if you violate the laws. The difficulty is, of course, when we do that. Is it when the courts say a company has violated a law or is it when we think they have violated a law?"

**ARNE VAGN OLSEN:** "You can also ask yourself about investing in US treasuries. There are so many grey areas that you have to have an opinion on and I don't think there are any wrong or right answers. We haven't used exclusions so far but we're looking into it. Maybe if engagement fails, it could be the last resort."

**ANDREW CAVE:** "Looking back, exclusions used to cost you a lot but that's not the case any longer. At Baillie Gifford, we do have some responsible investing funds where we apply exclusions but if I look across our full range of funds, the holdings would change very little if we had applied those exclusions. We have very few fossil fuel investments, for example. Not because of any restrictions but because our managers don't see the long-term value in oil and gas."

**HREFNA ÖSP SIGFINNSDÓTTIR:** "The strategy when we started was very soft. We didn't have any exclusions. If we look five years ahead, I think we will do it differently. I think we need to make some exclusions and we need to be more aggressive and more vocal on different topics." ●

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