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Sustainable Investing Research Initiative

SUMMARY REPORT

SIRI Pathways to Consensus:

Inaugural SIRI Decisionmakers Roundtable Discussion

Columbia University
June 6-7, 2024

INTRODUCTION

The world is currently facing unprecedented systemic ecological and economic challenges that are straining not only our resources but also the intellectual frameworks and financial theories on which we have relied for several generations. We continue to be burdened not only by a lack of political resolve but also by a market system that, in pursuing short-term profits, has directed trillions of dollars of global capital into economic activities that are now posing a danger not only to markets and economies, but also to our society and our planet.

These disconnects need urgent attention. To address them we must do more than tinker on the margins of our existing disciplines. We need to break through and create new understandings about the true systems of interdependence, correlation, and causality that link and drive our world. What we need, in effect, is a thoughtful rewiring of the source code of capitalism.

The recognition of this problem is widespread and has sparked pioneering thinking around the world. Innovation is both deepening and accelerating. The landscape around sustainability measurement and disclosure, for example, is full of new, exciting, and complicated theories and practices. In many ways we are witnessing the emergence of whole new "ecosystems of thought," within which innovators are:

- mapping and measuring the financial materiality of sustainability to firms and investors;
- chronicling the negative externalities of impact materiality, or how those same firms and investors affect our global biosphere and civilization;
- implementing promising new theories and practices of impact investing which seeks joint financial and sustainability gains;
- working on how to mitigate harm and improve outcomes within major specific domains such as climate change, water use, biodiversity, inequality, and many others.

Yet, the creative force that hurls people into new corners of thought must be matched by equally potent efforts to find common ground. To make progress, a blend of creation and consensus, innovation and standardization, vision and practicality is required. This takes time and can only be accomplished through careful discussions among the innovators.

To succeed, it is important to provide a platform for such discussions—a platform that brings together and fosters dialogue among the key players (from the private and public sectors, policymakers, and academia), that explores pathways to consensus and a shared vision, and that stimulates the co-creation of a more sustainable world. Moreover, it is important to drive forward scholarship and education in this field to inform practice and educate the next generation of leaders in business, investment, and policy.

The Sustainable Investing Research Initiative (SIRI) offers such a platform. SIRI's inaugural Decisionmakers Roundtable Discussion on Exploring Pathways to Consensus was held on June 6-7, 2024, at Columbia University. It brought together a carefully curated set of key leaders from around the world, including academics, industry experts, innovators, standard setters, philanthropies, and policymakers. The aim of this convening was to enhance dialogue amongst key players, identify challenges, build a shared vision, find common ground, and stimulate renewed commitments and collaborations. Besides fostering dialogue and actions, the convening also provided an opportunity to share insights of academic research and present new innovations and best practices.

The participants discussed the following key areas:

- Experiences and key insights from existing efforts: financial and impact materiality in disclosure as well as impact investing.
- Perspectives and approaches on emerging topics: system-level investing, fiduciary duty, and intergenerational equity.
- Next steps needed – Exploring pathways to a shared vision: building bridges between ecosystems of thought, engaging academic institutions, and creating avenues for future collaboration.

Since the roundtable discussion was under Chatham House rules, we have prepared this high-level summary of some of the key insights.

SUMMARY OF KEY INSIGHTS FROM EXISTING EFFORTS AND NEXT STEPS NEEDED

Financial and Impact Materiality in Disclosure and Impact Investing

Conversations around (financial and impact) materiality in disclosure, impact, and fiduciary duty can be difficult, complicated, and unproductive due to misunderstandings, measurement difficulties, a lack of commonly agreed definitions and terminology, and divergent perspectives, framings, and objectives across the different investment communities.

Participants of the Inaugural SIRI Pathways to Consensus Roundtable Discussions highlighted several needs that need to be addressed. They expressed a strong commitment to working together and a desire to explore new avenues for collaboration that would improve both the process and substance of conversation and help the field move forward. Specifically, the following areas for dialogue were identified:

1) **Need for improved measurement and design**. Better data (metrics and measurement) and coordination are needed to enable better decision-making, more effectively incentivize investment teams, and track progress toward the mitigation of system-level challenges and the building of an equitable, sustainable, and flourishing world.

    - Metrics and measures need to be consistently defined and utilized across different areas. They should be applied using a common nomenclature and be compiled using the same or similar processes, which will make technical terms easier to understand. Even if there are differences, those differences will be better understood.
    - The goal of measurement goes beyond the sake of measurement; it should facilitate accountability. Accounting is necessary to, but not exactly the same thing as, accountability.
    - There are three types of accounting: financial, managerial, and tax accounting.
        - The key question is not what indicators measure but how they are used and by whom. What information is needed by executives to run the business? What information is needed by investors to decide whether to invest? And what information do different stakeholders seek. In short: for whom, by whom, and for what do we need the information?

- Sustainability accounting is not a fourth type of accounting; it is another lens for the existing three types of accounting. This might be a more helpful way to think about sustainability accounting.

- Role for transparency around both positive and negative externalities. It is important to account for both negative and positive externalities (impact[1]) of various market players, including investors and corporations. Yet, actors currently do not bear the full cost of actions. Most conventional accounting—whether by corporations or investors—tends to focus on the short-term performance of individual companies. Given the long-term and cumulative nature of sustainability challenges, a pivot towards system-level investing and intergenerational equity is needed. These concepts are still in their early stages, but they are gaining ground rapidly.

  - To design accounting that promotes and enables a systems and intergenerational view we must ask:
    - How do we design a better accounting system? And who would this information primarily be for–whose decisions will it inform?
    - Ideally, large mainstream investors and corporations would demand such information. (But they do not do so right now.)

  - If there is a business case, it might take advantage of the (positive/negative) externalities. In other words, there might be an opportunity to internalize some of the benefits/costs through markets. However, given that markets are far less efficient and able to solve problems than presented in stylized and idealistic economic and finance theories, there is a need for more accurate measurement, revised accounting theories, as well as well-designed government interventions, philanthropic efforts, and societal advocacy. Moreover, given the intrinsic and universal value of life, nature, and our planet, protecting them from the detrimental effects of short-term market logic is critical.

- The participants also identified that it is important:
  - To consider the temporal dimensions of decision-making both in terms of i) the time lag between decision-making, impact materiality, and financial materiality

[1] The Impact Management Platform, jointly sponsored by the UN and the OECD, defines impact management as "the process by which an organization understands, acts on and communicates its impacts on people and the natural environment, in order to reduce negative impacts, increase positive impacts, and ultimately to achieve sustainability and increase well-being."

(i.e., "dynamic materiality"), as well as ii) the urgency to act now as time is running out.

- To adopt a <u>systems-focused approach</u> (as opposed to merely a portfolio or enterprise-level perspective). The existing disclosure frameworks typically focus on the firm (i.e. the unit of disclosure is the enterprise), ignoring the firm's interrelationships with the broader environmental, social, and economic system.
- Relatedly, it is important to understand that the underlying issues are dynamic and involve powerful feedback loops.
- Focus more on the <u>health and resilience</u> of systems (as opposed to merely measures of financial performance).

- <u>Sustainability standard setting</u>: Participants also discussed whether to adopt a unitary vs. parallel design structure for sustainability standard setting. There was emerging agreement that, ideally, "double materiality" standard setting should take place under the custodianship of a single organization, but there was skepticism about when that could be achieved. (The International Financial Reporting Standards Foundation (IFRS) was doing important work but its exclusive focus on financial concerns limits its mission and expertise to the financial realm.) The global debate is highly fluid at the moment. Relationships between people and ideas are dynamic, feedback loops occur, and new threats are constantly appearing—the environment is one of "dynamic materiality". What is important is that impact and financial materiality are not seen as separate polarized concepts and disclosure exercises. They are deeply interconnected and dynamic. Accordingly, a <u>dynamic design</u> that includes a transition mechanism to move from one regime to another might be more fruitful in driving the field forward.

It is in this context that the participants of the inaugural SIRI Pathways to Consensus Roundtable Discussion highlighted the <u>need for unifying reporting</u>. The underlying issues are dynamic and involve feedback loops, making it difficult to solve them linearly. By taking into account the various positive/negative externalities, considering temporal dimensions, and adopting a systems-focused approach, <u>impact investing and systems dynamics can/should inform and advance existing efforts by SASB/ISSB, GRI, and others</u>. Doing so appears to provide a helpful road map.

2) **<u>Need for creating a common understanding of terminology</u>**. For example:

- The <u>concept of fiduciary duty</u> is commonly misunderstood and misused, and its interpretation needs to evolve to account for the unprecedented systemic ecological and economic challenges companies and investors are faced with. That is, fiduciary duty includes a responsibility to mitigate systemic risks in the portfolio (by addressing negative externalities), and not only a responsibility to mitigate enterprise risks. Moreover, pension funds and other universal owners have an obligation to both current beneficiaries and future generations, and hence need to consider intergenerational dimensions. In addition to clarifying/evolving its interpretation, legal reform to fiduciary duty could be pursued (such reform is likely more promising in the UK and EU than in the US given the current political climate). [See Appendix A on Fiduciary Duty and Intergenerational Equity for a deeper discussion on this topic.]

- Impact materiality and impact disclosure need to coexist and connect with financial materiality and disclosure as looking at financial materiality alone is no longer sufficient to address systemic challenges.

- Impact investing and investment impact should not be separately treated. Similarly, any investor (and company, respectively) has impact, not just the so-called impact investors. As for other market players (investors and companies), the attribution of positive/negative externalities is important.

In sum: creating a common understanding of terminology is important—and not just semantics—as it helps shape conversations and facilitate progress. Indeed, the participants of the inaugural SIRI Pathways to Consensus Roundtable Discussion seemed to agree that:

- Priority should be given on creating a shared understanding of "positive and negative externalities" and "fiduciary duty".
- To find consensus across key players and make progress, it might be best to move away from using the terms "impact" and "materiality".
- Impact investing has come a long way. Yet, to transform capital markets and trigger systemic change, all companies and investors (not just impact investors) should consider the financial risk, financial return, and positive/negative externalities of their decisions. This leads to the question: <u>How can we get the biggest investors moving as quickly as possible to system-level thinking?</u>

3) **<u>Need to engage and seek the support of a variety of investors</u>**. To make progress in system-level investing and sustainability reporting, it is essential to engage and enlist the support of a variety of investors, including the biggest investors such as sovereign wealth funds and pension funds. To gain their support, it is perceived to be important to:
   - Reduce barriers of adoption by being sensitive to the framing/language they use, i.e. by providing economic arguments to facilitate communication, by developing a handbook on system-level investing (including case studies), by offering good examples of systemic arguments, etc.
   - Validate leaders and find allies globally.
   - Recognize challenges such as the tragedies of common and free-riding.
   - Speak to people across the political spectrum to find common ground (on, e.g., social issues such as workforce issues and corporate power, making people feel economically secure and heard) and thus de-escalate tensions, reduce polarization, build bridges, and address systemic risks more effectively.
   - Educate investors that the systemic ecological, social, and economic crises the planet (and investors) is facing are unprecedented and existential. They are non-diversifiable and as such investors need to move beyond portfolio-level investing. Reducing systemic risk decreases non-diversifiable systematic risk, or beta, thereby increasing AUM. [See Appendix B on System-level Investing for a deeper discussion on system-level investing.]
   - Given that most investors hold diversified portfolios, it would be helpful to provide a platform (proxy advisor service) that adopts a market perspective and gives advice not only on what benefits the individual companies but also on what is best for the overall market. (<u>The Shareholder Commons</u> is working on this effort.)

4) **<u>Need for case studies and academic research.</u>** Participants emphasized the need for case studies and academic research on disclosure, fiduciary duty, and system-level investing.

   - Such <u>case studies</u> can serve as a powerful tool to raise awareness of cutting-edge practices, to spotlight leaders, and to serve as a blueprint and hereby reduce barriers of adoption for investors and companies around the world. Moreover, such case studies could serve as a helpful illustration and hence as a valuable communication and training tool to inform and educate current and future generations of investors, boards of directors, policymakers, corporate leaders, and others.

For example, case studies may illustrate:

- The history of the field and evolution of thought.
- Impact pathways through which investors contribute to risks and opportunities.
- Effective engagement in stewardship and negotiation with peers across the investment system to form a common, persuasive position to present to a company.
- Global examples on how to successfully expand fiduciary duty to include non-financial value, intergenerational equity, and systems level.

- In addition to case studies, participants highlighted the need for rigorous academic research to gain a better understanding of what is working and what isn't. Areas of research include:
    - Need for research on system-level investing, including greater focus of research on systemic risks (beta) as opposed to portfolio returns (alpha).
    - Understanding how to facilitate decision-making (by whom and for whom). For example:
        - How information is consumed by different stakeholders (business, government, investors, etc.), whether those stakeholders act on this information, and if this behavioral change is sufficient to induce changes at the firm, industry, and societal levels.
        - Matching the right level of information complexity to different levels of consumers' sophistication and resources/time available for consuming and using information.
    - Conducting qualitative research that recognizes the limits of data and explores other ways of telling the story.

- To foster dialogue and exchange between academics and practitioner experts and hereby drive forward research and practice, there is a need for a platform that
    - facilitates direct interactions between researchers and real-world companies, asset managers, and asset owners, and
    - collects information on
        - thought leadership around system-level investing,
        - private efforts that provide information/data that is decision relevant, and
        - groups trying to grow relevant systems.

- For the best research, all parties must realize that data access is fundamental in academic research, and we should work together to overcome the many limitations in the available data. Collaborating with companies on specific topics and partnering with scholars who know how to develop surveys to understand decision-making would raise the bar of evidence significantly. Even having fine-grained data from one single company can be helpful.

5) **Need for training and education**. On the training and capacity-building side, there is a growing need for graduate education and training of professionals (for executives, boards of directors, and others) to stay current and understand all the standards and changes happening rapidly.

   Also, there is a need for correcting misunderstandings and misconceptions of fiduciary duty among professionals, for them to better understand system stewardship in capital markets, and to obtain training in negotiation and effective communication. Case studies and research will be critical tools to enhance such training and move practices forward.

NEXT STEPS: SIRI PATHWAYS TO CONSENSUS & AVENUES FOR COLLABORATION

We hope the above summary helps inform each participating organization about the critical bottlenecks and opportunities that exist in this vital field. At SIRI, we have already started undertaking steps to address the needs outlined above—driving forward unifying reporting efforts, exploring the evolution of fiduciary duty, developing case studies and conducting academic research, providing training and executive education, and engaging a variety of investors and other key players in dialogue and seeking their support—and carved out several avenues for collaboration.

SIRI Pathways to Consensus & Avenues for Collaboration

SIRI has brought on board Bob Massie—the former president of Ceres and co-founder of the Global Reporting Initiative—as Senior Research Scholar and Co-Director of SIRI's Pathways to Consensus effort to drive forward the identified projects alongside SIRI Director and SIPA Vice

Dean Caroline Flammer. Bob has been the co-convener of the Inaugural SIRI Pathways to Consensus Decisionmakers Roundtable Discussion and the driving force of the “Materiality Working Group” (MWG) that has been convening on a regular basis over the past months.

Moreover, SIRI will launch a series of convenings, educational programming, and research activities, including the following:

- **Sustainable Finance Seminars**: SIRI will lead monthly (online and in-person) working group sessions. These sessions will focus on the identified pathways to consensus (including unifying reporting, system-level investing, and fiduciary duty) to drive forward the rewiring of the source code of capitalism and foster ecosystem-building. In particular, participants will aim to make progress on the following pathways:
  - Unifying reporting: Building on impact investing and systems dynamics, SIRI will drive forward efforts to help unify reporting and to inform, support, and strengthen existing efforts by SASB/ISSB, GRI, and others in developing global standards and driving forward progress.
  - Evolution of fiduciary duty: SIRI will explore how beneficiary interests can help shape policy, practice, and education. This includes models of corporate purpose, shareholder primacy, multistakeholder, integrated thinking, and reporting.
  - Engage and seek support from a variety of investors: Throughout its activities, SIRI will aim to engage and enlist the support of a variety of investors, standard setters, and other key players from the public and private sectors.

To consolidate and advance the field of sustainability and finance, SIRI is now solidly anchoring the MWG at Columbia University, bringing it under the umbrella of the Sustainable Finance University Seminar to continue and elevate its work. By doing so, SIRI provides an important institutional platform that brings together and fosters dialogue among a variety of key players from the public and private sectors (including sovereign wealth funds, pension funds, and others), policy, and academia.

Following each seminar, a report summarizing the key insights and discussion points will be drafted and shared with participants. These reports will also be posted on SIRI’s website accessible to companies, investors, and educators around the world.

Please join us for these monthly discussions and participate in the Columbia University Sustainable Finance Seminars co-chaired by Bob Massie and Caroline Flammer: https://universityseminars.columbia.edu/seminar/sustainable-finance/.

- **SIRI Pathways to Consensus Decisionmakers Roundtable Convenings**: Following the success of the Inaugural SIRI Pathways to Consensus Decisionmakers Roundtable Discussion in Spring 2024, SIRI plans to hold future annual convenings bringing together a carefully curated set of leaders from the private and public sectors and academia. Following the convenings, a report summarizing the key insights and discussion points will be drafted and shared with participants.

- **Case Studies and Academic Research**: SIRI will develop case studies on disclosure, fiduciary duty, and system-level investing. These case studies will serve as blueprints for companies and for educational purposes around the world. These case studies will be shared on SIRI's website accessible to companies, investors, and educators around the world.

  Moreover, SIRI is engaged in nurturing academic research in system-level investing at Columbia and beyond. SIRI's website provides a glimpse of all the activities: https://siri.sipa.columbia.edu/content/research

- **Training and Education:** Critical to making progress is the training and education of the current and future generations of investors, standard setters, policymakers, business leaders, and other world leaders from around the globe. SIRI has developed several graduate courses around impact measurement, sustainability reporting, system-level investing, and fiduciary duty. Visit the following webpage to view the full list of SIRI-developed courses offered in SIPA's graduate degree programs: https://siri.sipa.columbia.edu/content/curriculum-and-careers. Also, read students' reflection blogs on their SIRI consulting project experience: https://siri.sipa.columbia.edu/news.

  In addition, SIRI plans to expand its current Executive Education offerings to educate the current generation of investors, boards of directors, standard setters, policymakers, business leaders, and others from around the globe. At this moment, SIRI offers the Sustainable Finance Stewardship Academy (SFSA) and the Sustainable Business Stewardship Academy (SBSA):

  - Participants of the SFSA learn how to engage in system-level investing—the new frontier in sustainable investing. They discuss the opportunities and challenges of implementing conventional tools and advanced techniques available to investors to trigger systemic change through their capital allocation, portfolio firm engagement, coalition building, policy engagement, and much more.
  - Participants of the SBSA learn how to integrate and align their corporate social, environmental, and policy engagements with their business strategies to sustain

their competitiveness and firm value. Moreover, they discuss whether and how corporations can act as stewards of systemic change by actively engaging with policymakers to improve industry-wide business practices that level the playing field and mitigate systemic challenges such as climate change, biodiversity loss, social inequality, poverty, and others.

Both of these programs are endorsed by the International Corporate Governance Network (ICGN) and the High Meadows Institute.

For more information on the current Executive Education offerings, visit the following webpage: https://siri.sipa.columbia.edu/content/executive-education.

Engage with SIRI

To stay engaged with SIRI and informed about its various activities, please join the mailing list and visit the dedicated webpage: https://siri.sipa.columbia.edu/content/pathways-consensus.

SIRI would be delighted to engage you and/or your organization in its various activities across education, research, and dialogue. Collaborations can take on many different forms:

1) co-hosting SIRI Pathways to Consensus convenings and other activities to foster dialogue among leaders from academia, public policy, and the private sector around the rewiring of the source code of capitalism;
2) fostering academic research on investment and systems-level challenges;
3) developing better measures to track progress on addressing those challenges;
4) supporting curriculum development and extra-curricular activities for graduate students (including case studies, consulting projects, internships, job opportunities, etc.) to educate the future leaders in finance, business, and policy; and
5) developing corporate training and executive education around sustainability reporting and system-level investing to educate the current leaders in finance, business, and policy.

If you or/and your organization is interested to explore potential avenues of collaboration with SIRI, please reach out to SIRI Director and SIPA Vice Dean Professor Caroline Flammer (caroline.flammer@columbia.edu) and Associate Dean Katherine Benvenuto (kad57@columbia.edu).

Thank Yous

A big thank you to everyone for joining the inaugural SIRI Pathways to Consensus Decisionmakers Roundtable Discussion. Your insights were invaluable to the conversation (and to this summary report) and to making progress in rewiring the sources code of capitalism! A special thank you goes to our co-conveners John Balbach (Director, Impact Investments, John. D and Catherine T. MacArthur Foundation), Margot Brandenburg (Senior Program Officer, Ford Foundation), Jessie Duncan (Senior Program Officer, The Tipping Point Fund on Impact Investing), Eelco van der Enden (CEO, Global Reporting Initiative (GRI)), Jeffrey Hales (Charles T. Zlatkovich Centennial Professorship in Accounting, UT Austin; former chair of SASB, Board member of ISSB), Stephen Heintz (President, Rockefeller Brothers Fund), and Mindy Lubber (President and CEO, Ceres) for supporting the inaugural SIRI Pathways to Consensus Decisionmakers Roundtable Discussion. Moreover, we express our deep gratitude to co-organizer Bob Massie, SIRI Managing Director Chandana Yelkur, the Columbia graduate students Mariana Judice de Mello and Meha Sadasivam for their diligent notetaking during the convening, as well as SIPA's Development and Alumni Relations Team (Eduardo Ayala Fuentes, Katherine Benvenuto, and Niessence Pope) for their tremendous help in organizing and bringing you all together.

Appendix

Appendix A. Fiduciary Duty and Intergenerational Equity

The perceptions and interpretations of fiduciary duty are evolving. In particular, 12 years ago a new pension scheme (NEST) was introduced in the UK. NEST automatically enrolls every employee into a DC pension scheme. It was gradually rolled out (by now it has around 13mio members and 39bn AUM) and transformed the demographics of people investing in capital markets in the UK, including more women, younger people, and people with low incomes. This demographic shift is driving new questions about what the duty of loyalty looks like and what kind of outcomes these investors might want and deserve from the companies they invest in. NEST undertook a process quite different from typical pension schemes. They analyzed their membership base, including their attitudes to investment risk. They concluded that the most important thing for their members' long-term outcomes was to remain invested in their pension scheme, as members can opt out. Therefore, they prioritized stability over maximizing returns to retain members, which is not a typical way of thinking about fiduciary duty. NEST also surveyed their members' attitudes on sustainability issues. They found a high commitment to sustainable investing among their members, who have significantly lower average earnings than the general economy. This has led NEST to adopt a more ambitious approach to sustainability. For example, NEST has become a committed steward of living wage standards in the UK economy, filing shareholder resolutions on the living wage in the retail sector. NEST also decided to go tobacco-free, with the justification that it is a risky investment. As the NEST case illustrates, the thinking about beneficiaries and what's important to them is evolving. If fiduciary duty reform occurs, it could send new signals to bodies like the ISSB. There is growing interest in reforming fiduciary duty to better align with members' best interests, despite current legal ambiguities.

More generally, universal owners (such as pension funds, insurance companies, and sovereign wealth funds) start interpreting their fiduciary duty as intergenerational. For example, pension funds have an obligation to current beneficiaries and to future generations. They should not prioritize one over the other. Yet, based on observations in the markets, this is not always implemented in practice.

There are several potential reasons for the lack of implementation:

- Misalignment of incentives. Investment teams are often incentivized to meet financial benchmarks that do not account for externalities, underpricing human, social, and natural capital. There is a need to align the incentives of the investment teams with stewardship teams, moving toward a multi-capital approach, recognizing that financial capital depends on human, social, and natural capital.
- Data availability and quality. Better data (metrics and measurement) is needed to understand the value of these capitals, to map the impact pathways, and to more effectively incentivize investment teams to align their interests with stewardship efforts.
- Limited pool of members and investors. To address system-level risks like inequality, it is important to increase the pool of members and investors to co-create improvements to investment structures and practices. (For example, see NEST Pensions and the Predistribution Initiative.)

Appendix B. System-level Investing

The world is currently facing unprecedented systemic ecological, social, and economic challenges. These challenges are global, not local, and cannot be diversified away. Systemic issues are increasing in magnitude, complexity, and number. There is a feedback loop between these systems, and they are affecting financial performance and risks. Ultimately, it comes down to a single question: Do we believe that the crises and challenges we are facing nowadays are fundamentally different from those that portfolio managers have been trained to invest in and cope with based on 20th-century theory, specifically modern portfolio theory? We are asking investors to go beyond mere portfolio-level investing because there are challenges out there unlike anything they have seen before. It is critical to convince the financial community that these issues and crises are fundamentally different. Otherwise, there is no reason for them to behave in a fundamentally different way.

Investors need to manage and influence the health of these overarching systems beyond the portfolio level. A comprehensive approach is needed to reframe how we set goals, evaluate progress, and define materiality. To be effective, one needs to be thoughtful about what investors can (and cannot) do to address systemic issues and identify leverage points at which they can operate. For those leverage points, investors can use specific kinds of tools, which may vary from industry to industry, but the principle remains the same. (See The Investment Integration Project (TIIP) for details on those tools.)

It is important to be clear that there is something different about what we are asking investors to do at a system level compared to the portfolio level. Specifically, we are asking the financial community to operate on two levels:

- They have a strong arm for managing portfolios effectively, which has created significant wealth. Portfolio managers need to manage their portfolios with due care, loyalty, and attention to returns. Well-managed portfolios that return competitive profits are essential.
- They have a weak arm for managing impact and recognizing their role in systemic risks. If they can impact these systemic risks, they can be part of the solution. Asking them to take responsibility for their impact on systemic risks and building portfolios to mitigate these risks is a significant challenge. To make progress, providing performance benchmarks might be helpful.

A hybrid model of portfolio and system-level attention is needed. This means balancing financial efficiency with resilience and the health of the system. Each aspect comes at a cost to the other, requiring a balancing act. Previously, the assumption was that efficient portfolio management and asset allocation, measured by profits and returns, would create the best possible world. This is no longer sufficient. Finance needs to take responsibility for its impact on systemic challenges.

Also, it is important to note that idiosyncratic risk only impacts around 25% of the variability of returns. The book "Moving Beyond Modern Portfolio Theory" (by James Hawley and Jon Lukomnik) explains how 75% of returns for those asset owners come from the beta—the return of the market—not from alpha produced by any particular asset owner. In other words, investors who do not deal with systems-level issues are addressing the tail of the dog rather than the main body. A stronger focus should be given to the 75% of returns, namely systemic risks (beta).

In addition, there is a need for investors to do things they haven't done before, such as collaborating on data sharing and standard setting. They will need to engage appropriately with policymakers in ways that tie back to their portfolios. Their focus is not solely on their portfolios, but also on the policymakers and other relevant stakeholders.

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