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State Street – passive investor active owner

State Street Global Advisors is the world's third largest asset manager with over $ 2.5 trillion in managed capital, equivalent to about 23,000 billion SEK. AP7 has been collaborating with State Street for the past 18 years. State Street Global Advisors CEO Cyrus Taraporevala describes their perspective on ESG issues and active ownership out of the perspective that they are a giant in index management.

1. **You are big within index funds which is often associated with passive ownership. What's your perspective on being an active owner within index management?**

Cyrus: We manage both active and index-based strategies. In our index-based strategies we cannot make the S&P 500 the S&P 499. Because we cannot sell a stock if it is in the index we are especially interested in how a company articulates its long-term strategy and whether its board demonstrates the kind of effective, independent leadership necessary to hold management accountable for executing on that strategy.

We focus on issues that are material to a company's ability to generate long-term value, including a range of environmental, social and governance areas. We stress active and constructive engagement rather than passive inaction or adversarial confrontation. We also issue regular thought leadership that details our views on important ESG topics. We believe this kind of active ownership, characterized by transparent and consistent engagement, helps improve the long-term quality of companies, the overall quality of the indexes and the broader economy by promoting good governance and sustainability practices.

2. **What are the most common prejudices of index management and accountability regarding ESG?**

Cyrus: The biggest misperception we frequently encounter is the mistaken notion that index management is a passive exercise. First from an operational standpoint, it is not a trivial undertaking to track an index closely and accurately over time. We also find that many investors are unaware of our active stewardship program and the systematic way we engage with our portfolio companies on ESG issues. For example, climate is a risk we think all companies need to address, and it has been an engagement topic for our stewardship team for a while.

In 2016 we were the largest investment manager to vote in favour of shareholder proposals asking companies to report on climate-change risks. The following year some of our peers followed suit with their voting, and those climate-related shareholder proposals passed.

Even some regulators underappreciate our level of engagement and mistakenly believe we outsource our voting to proxy advisors. We often need to educate them on how we use data and analytics from proxy advisors, but hasten to remind them that the voting decision itself remains ours. We also need to remind the market of the unique advantage we have as large, global investors invested in nearly every public company in the world in terms of the perspective that gives us on the good, the bad and the ugly when it comes to ESG practices.

3. **Have you experienced increased expectations from your investors, such as other pension managers, about ESG responsibility?**

Cyrus: Yes, we have definitely seen an increase in interest in ESG from our clients over the last few years. There are, of course, regional variations in the degree of uptake. Large public pension plans in northern Europe, Australia, Canada, and Japan and in the US have expressed the greatest interest.

We are definitely experiencing the mainstreaming of ESG. We have managed ESG strategies since 1985. Initially these were niche products for mission-based investors who wanted to screen out certain types of industries or companies. Now we are seeing a greater demand for a holistic integration of ESG across our entire investment platform, as there is a recognition that ESG intangibles are driving a greater share of a company's value. These are issues we cannot ignore as long-term investors.

4. **Have you encountered any resistance to your increased ESG focus?**

Cyrus: Yes, we have been criticized by some business groups for "politicizing" the boardroom by focusing on ESG issues. They complain that we are misusing our rights as shareholders to enforce arbitrary political or social "values" on companies. But as I wrote in a commentary for the *Financial Times* in July 2018, this completely misrepresents our mission.

We seek long-term value for millions of ordinary investors in a world that has become increasingly obsessed with short-term results. That goal, not some political agenda, is why we have developed our rigorous, research-based engagement program. Far from injecting politics into boardrooms, we believe our focus on active stewardship in a rapidly changing and complex world is more important than ever for ensuring healthy public markets, resilient economic growth and shared prosperity.

5. **What is your view of disinvestment as an ESG-tool?**

Cyrus: As I mentioned, the reality is that in our index strategies, we don't have the choice of divesting or selling in the way that our active managers do. However, given the success of our active stewardship program, we also believe in the power of engagement and having a seat at the table.

For example, in addition to our own conversations with oil and coal companies, we believe industry efforts like the Taskforce on Climate-Related Financial Disclosure (TCFD) can be an effective way for fossil fuel companies to be more transparent about their climate-related risks and can help them to begin thinking about the sustainability of their business models.

6. **Regarding your ownership in broad indexes, do you work with all ESG issues at the same time and in all companies, or do you focus on topics?**

Cyrus: Each year our stewardship team takes a risk-based approach and prioritizes ESG issues, such as board quality, gender diversity, climate risk, water management, etc., as well as particular sectors that bear careful scrutiny. We do this in order to scale our impact across multiple companies while at the same time limiting the ESG risk in our portfolio. Finally, we believe that transparency is fundamental to an effective stewardship program. Each year we publish a detailed stewardship report that describes our engagements and our proxy voting decisions.

7. **Which ESG issues do you think will be in focus the coming years?**

Cyrus: Good governance will be a mainstay of our focus, as so many other risks are related to the quality of governance oversight and to what extent boards are working with management to track those risks. Climate risk will also continue to be an important focus, as companies are just beginning to do the hard work to understand the longer-term impacts on their business models.

As investors evolve their understanding of how the entire range of E, S and G factors impact long-term value, they are likely to expand the lens to include more topics, especially with regard to social issues such as diversity, culture, human capital and the social and environmental impact of a company's supply chains. At State Street Global Advisors we have been engaging with companies on these topics for many years and will seek to leverage that knowledge to advance the dialogue on how they impact long-term value.

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