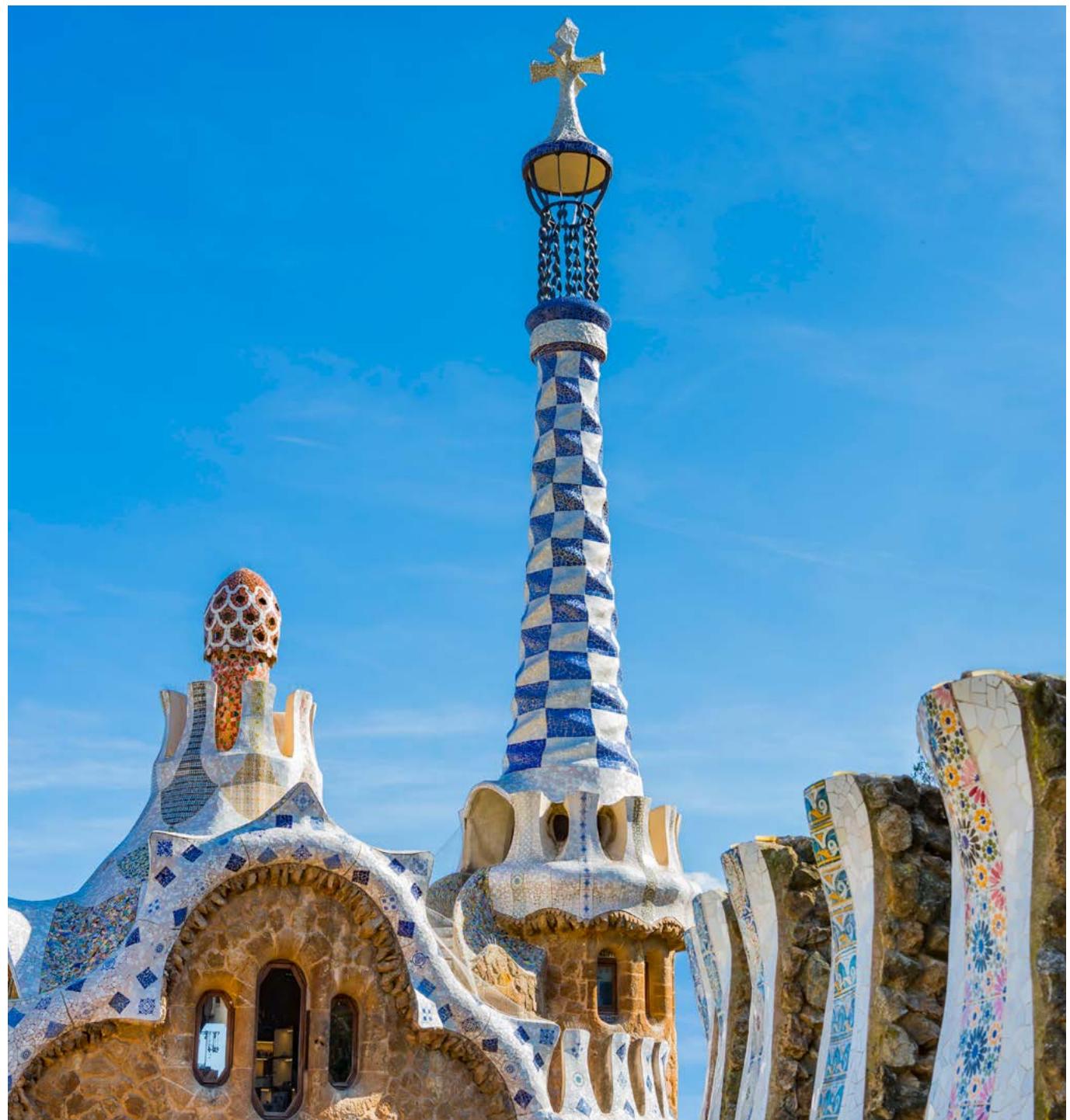


Thinking Ahead Institute

An agenda for change, Part II

December 2023





An agenda for change, Part II

December 2023

Contents

Executive summary	2
1. Introduction	4
2. The Systems Model – changing the mindset	6
3. The Business Model – broadening to a multi-stakeholder orientation.....	8
4. The Technology Model – developing the AI + HI combination	11
5. The People Model -- incorporating a future of work model	13
6. The 3D Investment Model – integrating risk-adjusted return and real-world impact.19	19
7. The Measurement Model	23
8. The Change Model.....	25
9. Conclusions on the Investment Organisation of Tomorrow	29
Limitations of reliance.....	30
About the Thinking Ahead Institute	31



Executive summary

This research paper – Agenda for Change part II – is authored by Roger Urwin, Anastassia Johnson and Marisa Hall following research and discussion by the Thinking Ahead Institute's (TAI) Investment Organisation of Tomorrow (IOOT) working group.

Agenda for Change Part I was completed in late 2022 and dealt with the *fundamentals of change*. Part II is dealing with the *model for change*.

We are grateful to the members of the group for their input and guidance as we continue to advocate for change in the investment industry to improve the value proposition for the end saver, wider society and the planet. The authors alone are responsible for any errors of omission or commission in this paper.

The members of the two IOOT working groups, chaired by Roger Urwin of TAI, were as follows:

West group (Europe/Americas)

- Carol Geremia (MFS)
- Frank Naylor (BTPS)
- Jaap van Dam (PGGM)
- James Davis (OPTrust)
- Luba Nikulina (WTW)
- Marisa Hall (TAI)
- Michael Pratten (CofE Pension Board)
- Nigel Cresswell (Quoniam)
- Onur Erzan (AllianceBernstein)
- Robert Brown (Univest)
- Russell Picot (HSBC & USS)
- Thomas Lee (NYSTRS)

East group (Australasia)

- Alison Tarditi (CSC)
- Alva Devoy (Fidelity International)
- Andrew Lill (Rest)
- David Neal (IFM Investors)
- George Crosby (NZ Super)
- Paul Deane-Williams (TAI)
- Philip Moffitt (Aware Super)
- Sonya Sawtell-Rickson (HESTA)
- Stewart Brentnall (TCorp)
- Tim Mitchell (WTW)

The two working groups (the 'Group') met (virtually) eight times between April and November 2022 and set out to accomplish the following:

- Help its working group participants move forward in their investment industry thinking
- Develop a set of principles and accompanying narrative through a peer co-creation process
- Transfer knowledge to colleagues, other TAI members and the wider industry
- Use convening, co-operation and cadence principles and build a participative group culture.

The Group worked with this developing thesis:

- There is a paradigm *shift* about to happen in the industry, brought about by a widening of organisational purpose within it. The working group developed a vision of what this *shift should look like*
- This shift will require organisations to adopt a much more agile, substantive and socialised *change model* than has been prior practice. The working group co-created a model of what this change should look like which is summarised below
- To do this requires a commitment to think through issues respecting all material *systemic factors* influencing investment industry outcomes. The thinking pursued by the working group made deeper and better connections between these systemic factors.



Shift chart summary

Shift	From present state	To future state
Systems model	Mindset works within narrower and more insular scope in which actions are largely solo	Mindset broadens to encompass a wider inter-connected scope in which collaborations are critical
Business model	Substantially focused on financial outcomes for shareholders and beneficiaries	Financial-first focus but with ancillary focus in which wider stakeholders are considered
Technology model	Technology misaligned to business need with more data producing less decision-usefulness	Technology channelling high-quality decision-useful information adaptably, cheaply, and efficiently
People model	People working in groups and teams with weak culture, governance and diversity	People work in Superteams that have an edge with culture, governance and diversity to the fore
Investment model	Investment built around asset level and portfolio level principles in which alpha pursuit is central	Investment combining traditional MPT principles with systems-level 3D investing principles
Measurement model	Measurement heavily focused on value-add outcomes (alpha) framework	Balanced scorecards consider the multiple facets of progress including total return outcomes vs goals
Change model	Incremental change mindset with light adaptation in response to issues as they arise	Transformational change mindset with issues seen and addressed systemically with holistic treatment

Principal conclusions

The Group's principal conclusions were these:

- **Multi-faceted change** – change is multi-faceted being much more than just shifting mindsets, but in addition defining and actualising the pathway in the face of considerable friction. It becomes critical for investment organisations to adapt in all major areas – in our thinking this is about the models for business, technology, people, measurement and investment – in order to fulfil their full potential. All organisational change is difficult because it involves giving up things you are attached to.

Decreasing the change 'frictions' is more important than increasing the 'fuel' in the argument for change

- **Change vision is crucial** – and this will major on a significant shift to consider wider stakeholders, modernise thinking and practice and incorporate sustainability issues, which are all critical to stay relevant and resilient. Investment organisations need to adapt internally at a speed and scale to match the accelerations taking place externally and in sync with the increasing uncertainty and complexity around them.

Communications need to be layered to meet stakeholder needs

- **Leadership of change** – To effect change on the scale suggested, the leadership needed is holistic and strategic and premised on building a leadership coalition of board and executive stakeholders. The leadership has the role to apply a disciplined change process that works in a transformational change setting that is more substantive, co-ordinated, agile and time-intensive than we have been accustomed to.

A step up in ambitions is needed

- **Collaboration** – AOs and AMs need to be collaborative organisations that value teamwork and inclusiveness and are effective and influential through various engagements and partnerships. There is a congruence in the need for AOs and AMs to change in similar ways given that AOs have heavy dependencies on AMs and strong philosophical and cultural alignment will act to create more effective arrangements.

Systems thinking is an essential feature of this shared philosophy

This paper

The paper is organised around seven main sections, which are the principal areas covered by the working group: the system-wide framing and change model are the bookends; the various models are the core sections: the business, technology, people, investment and measurement models.

The paper builds on seven years of TAI research, largely captured in the following research papers:

- [Smart leadership. Sound followership](#) | A peer group study of asset owners
- [The Asset Owner of Tomorrow](#) | Business model changes for the Great Acceleration
- [The Asset Manager of Tomorrow](#) | Critical requirements for asset manager success
- [It's about time](#) | Total portfolio thinking and practice
- [With great power comes great responsibility](#) | Duty of ownership, engagement and stewardship
- [The Asset Owner 100](#) | The most influential capital on the planet
- [A year needs a score, but a decade needs a purpose](#) | What makes purpose fit-for-purpose
- [Stronger Investment Theory and Practice](#) | Alternative investment principles to current practice.



1. Introduction

Truly sustainable investment organisations are sustainable in their organisational longevity and investment focus. For this to happen, there needs to be excellence in:

1. Systems Mindset and Model
2. Multi-Stakeholder Business Model
3. Technology Model
4. People and Future of Work Model
5. 3D Investment Model
6. Measurement Model
7. Change Model

This paper zooms in on these seven models in the next sections. Together these show what effective execution of transformational change can look like at asset owners and asset managers. And provides practical thinking and takeaways that we suggest are of value to group members, their organisations and the wider industry.

The place of models

- Models are important ways to simplify more complex elements of our world. We believe there are five models that cover the investors' activities and frame their unique situation. While we develop them singly it is important to tie them together, so they connect and consider the activities as a whole.
- Separating the asset owner (AO) enterprise into 'models' enables us to focus attention zooming in on important details and identifying distinct **best practice** principles
- This enables organisations to build successful **implementation** into each model
- And the principle is that all these models are **joined-up**, this is trying to ensure that these models are managed in an interconnected way and not in silos.



2. The Systems Model – changing the mindset

Complexity is the enemy of change, but is also the opportunity to create an edge. Deal well with complexity and successful transformational change becomes possible.

As a first step, it is incumbent on organisations to understand the characteristics of complexity. Complexity is linked to growth in choices, flexibilities, freedoms and regulations.

Organisations face both structural complexity (mostly outside organisations) and operational complexity (inside organisations).

Modern organisational life is one of few absolutes and many relatives. So dealing with complexity is not about focusing on hard or soft data, but both. It's not about the short or long term, but both. It's not about stick or carrot, but both. It's not about productivity or creativity, but both.

How can we simplify complexity?

Systems thinking offers the potential to create a degree of simplicity from complexity and create an approach to change which is less piecemeal, and more likely to produce material improvements. In particular, this thinking emphasises a bigger vision, a stronger coalition of participants in the process of change and a more join

Systems leadership as defined by the World Economic Forum is a set of skills and capacities that any individual or organization can use to catalyse, enable and support the process of systems-level change. It combines collaborative leadership, coalition-building and systems insight to mobilize innovation and action.

In essence, systems leadership is collaborative leadership that finds joint solutions to common problems. The systems leader sees the larger system, produces reflection and more generative (=productive) conversations and shifts the collective focus from reactive problem solving in the short-term to co-creating the future in the long-term. And ultimately produces system-level solutions that produce collective gains and individual benefits.

Industry knowledge and application of systems thinking, and systems leadership is quite limited. To illustrate this, working group members currently don't rate their systems mindsets and systems leadership very highly and most believed they could substantially improve their skills in this area.



		How is your organisation positioned on the following attributes of sustainable organisations?			
		1 = very weak, 3 = moderate, 5 = very well			
		System thinker	Collaboration-minded	Systems leadership	System mindset score
AOs	A	3	2	2	7
	B	3	4	4	11
	C	3	3	3	9
	D	4	2	2	8
	E	4	4	3	11
	F	2	3	3	8
	G	4	4	4	12
	H	4	4	5	13
	I	3	2	3	8
AMs	Av.	3.3	3.1	3.2	9.7
	J	5	5	5	15
	K	2	2	2	6
	L	3	4	3	10
	M	3	4	4	11
	N	3	1	2	6
	O	1	2	1	4
	P	2	3	3	8
	Av.	2.7	3.0	2.9	8.6

Shift chart summary

	Shift from	Shift to
Systems model	Mindset works within narrower and more insular scope in which actions are largely solo	Mindset broadens to encompass a wider inter-connected scope in which collaborations are critical

3. The Business Model – broadening to a multi-stakeholder orientation

The purpose of investment organisations is shifting in the direction of a multi-stakeholder orientation in which wider stakeholder interests are factored into activities and decisions. This shift is deepening and maturing as civil society loses trust in governments.

The Edelman Trust Study (2023) expresses the force this way. Business is now the sole institution seen as competent and ethical; government is viewed as unethical and incompetent. And business is under pressure to step into the void left by government to support the societal values of rising well-being, falling inequality, a sustainable environment and a resilient system. This is producing that push towards multi-stakeholder thinking.

Data from the Edelman Trust Study validates the thesis. These were two critical survey results:

- i. I expect business to take a stand on climate change – 82% support;
- ii. Having societal impact is a strong expectation or deal breaker when considering a job – 69% support.

In practice, a combination of systemic forces – social, cultural and institutional – are creating this direction of travel. And with a wider range of stakeholders, the management of stakeholders becomes a higher priority for organisations.

At the same time, while more stakeholders may press concerns on asset owners, retaining a realistic focus on a legitimate purpose and influence is important; so realistic boundaries to your mission are necessary.

The aim is to 'rightsize' sustainability commitments to something 'Goldilocks' like – not too much in potentially compromising legitimacy (and returns); not too little in compromising fiduciary obligations (and risks).

Working Group Insight

"Our fiduciary duty is to generate superior risk-adjusted returns for our beneficiaries which has remained unchanged, but the way we go about it has been evolving due to the emergence of systemic risks. We have to think about the longer-term sustainability of the system that allows us to generate these returns. With the multi-stakeholder mindset, we care about the impact of our actions (or inaction) on the system and invest in our capabilities to take a proactive stance"

The multi-stakeholder mindset is not easy to implement, and organisations have to continue to improve the way they manage various trade-offs across multiple stakeholders, ensuring they deliver value on their needs, while acknowledging that these needs may diverge at times.

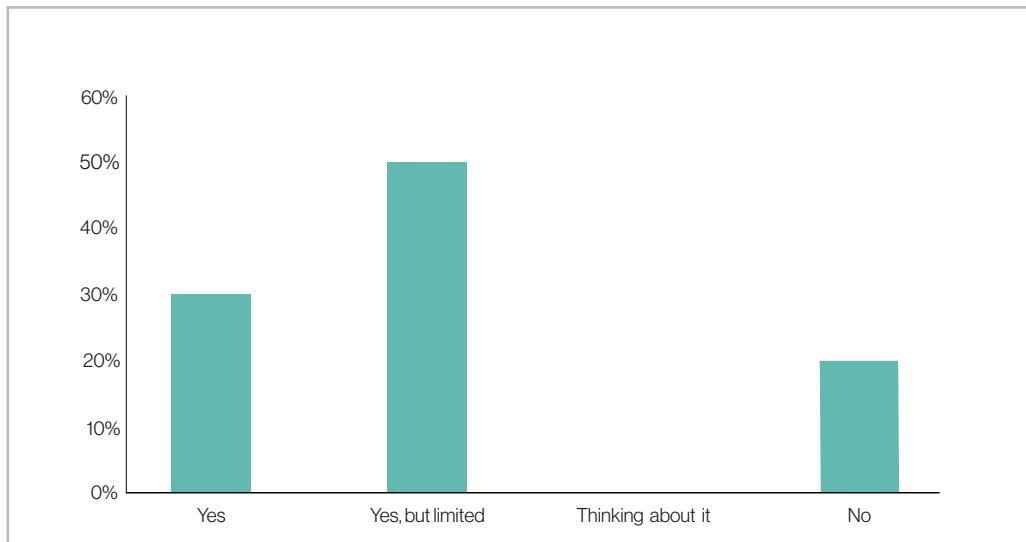
Working Group Insight

"Fund members seek an affordable, secure, sustainable member experience. These elements can be made more engaging. Our focus on financial sophistication has taken us down a path of not connecting well with members"

Organisations are clear that their engagement with stakeholders is not always optimal.

Feedback on satisfaction levels from pension scheme members, probably the clearest example of a key stakeholder, requires considerable improvement with many schemes neither measuring nor disclosing member experience and satisfaction.

Figure 1: Do you measure and disclose your fund's member experience and/or satisfaction?



Genuine multi-stakeholder mindset is only possible if organisations invest in achieving “real world” positive impact. The emphasis of engagement has to shift from individual assets towards an industry level and public policy engagement because this is where organisations can achieve sustainable “real world” outcomes.

How does purpose get expressed in investment organisations?

The concept of purpose mixes several elements beyond the pursuit of profit including why we exist, whom we serve, what outcomes we seek. Rebecca Henderson (2015) expressed it as “concrete goals for the organisation that reach beyond performance and profit maximization”.

Colin Mayer (2019) suggested “the purpose of business is to produce profitable solutions to the problems of people and planet. In the process it produces profits.”

The group found themselves identifying four overlapping sources of purpose – see right.

Contributing to the climate challenge ('Net Zero')

Producing the best investment performance/ business performance

Contributing positive impacts to members, sponsors and society ('Net Positive')

Producing the best employee and team experiences

Purpose is becoming more balanced

In discussing purpose, all group members agreed that there had been movement in recent times away from the top right performance quadrant to a spread across the quadrants.

Purpose increasingly reflected ambition and vision and spoke to the organisation's direction, motivations, reputation and relationships with the opportunity to inspire the workforce and build belonging.

In the thought experiment of putting measures against the categories of purpose, the importance of the employee experience was evident as was the reach of purpose across wider stakeholders in the net zero and net positive areas.

In describing your organisation's current purpose and vision, if you have 10 units of purpose and vision to allocate, how many would you give to...

	Producing the best investment performance		Producing the best employee and team experiences		Contributing positive impacts to members, sponsors and society (net positive)		Contributing positive impacts to the climate challenge (net zero)	
	AOs	AMs	AOs	AMs	AOs	AMs	AOs	AMs
0	0%	0%	0%	0%	0%	0%	0%	0%
1	0%	0%	11%	0%	56%	50%	22%	25%
2	0%	0%	56%	75%	22%	50%	56%	75%
3	22%	0%	33%	0%	22%	0%	22%	0%
4	44%	50%	0%	25%	0%	0%	0%	0%
5	33%	50%	0%	0%	0%	0%	0%	0%

As a rough guide we see 40% - 50% of the purpose weights being in performance, 20% - 30% being in employees and 10% - 20% being in stakeholders, both net zero and net positive.

Shift chart summary

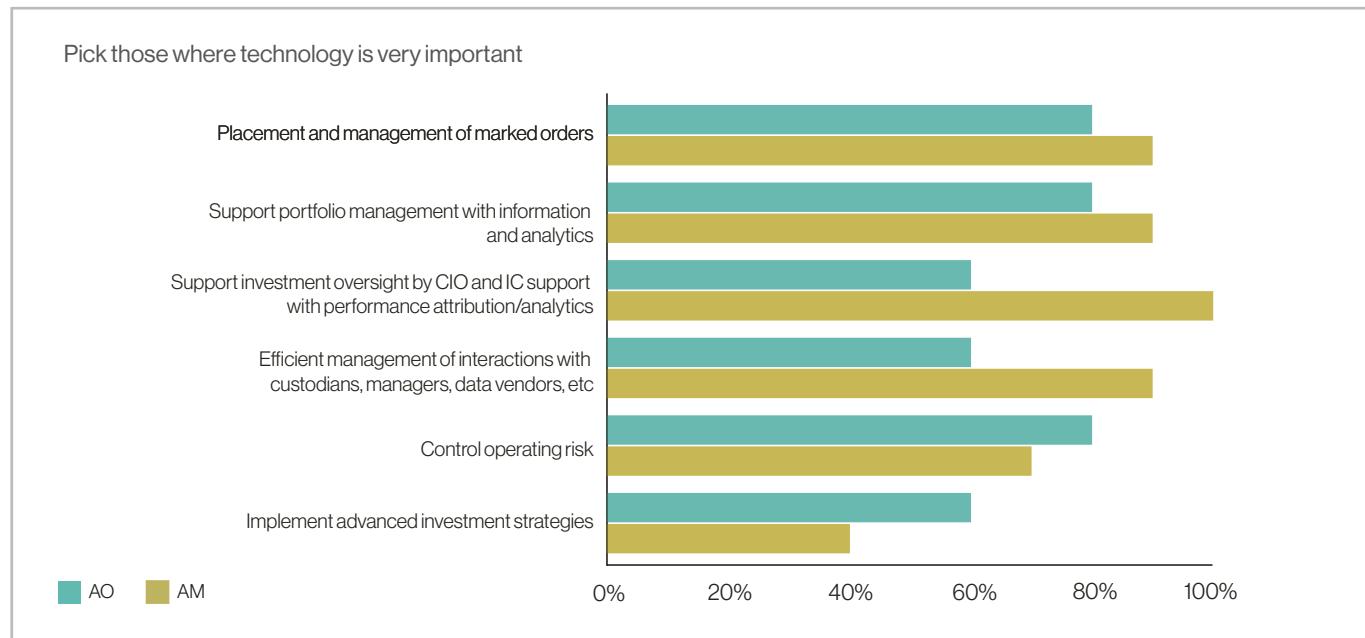
Shift	From present state	To future state
Business model	Substantially focused on financial outcomes for shareholders and beneficiaries	Financial-first focus but with ancillary focus in which wider stakeholders are considered

4. The Technology Model

Technology will be a major ingredient in producing desired levels of risk-adjusted performance and delivering value to stakeholders.

It is seen as most useful for client interactions, management of interaction with suppliers and stakeholders, and to support portfolio management.

Figure 2: How important is technology in support of the following objectives?



We can characterise the technology and data challenge generally for investment firms as creating a technology system (data platform and management infrastructure) that aims to process and channel relevant high-quality information adaptably, cheaply, and efficiently into the investment process, with various reporting handled efficiently alongside.

Most data quality will be gauged through a combination of materiality and validity which will reflect soft and hard and other considerations. The costs and benefits of data quality need to be assessed on joined-up terms by adopting a complete picture on data quality, thinking about it in terms of fundamental organisational resources and incentives in the context of all stakeholders and the value chain.

Most data users evaluate benefits of a given level of data quality too narrowly – they over-emphasise the simple facets of data quality like objectivity and accuracy; and do not sufficiently consider materiality and the natural scarcity of good quality data in complex systems where simple causality is not present.

Working Group Insight

“In our tech transformation, the most value was added by change managers who joined from outside the investment industry. The process is slow – but it has been time well spent”

Hiring will play a part in technology success. Organisations will often value programming capabilities and understanding of technology in new hires. Also, within the investment research process, it has become part of standard training at some organisations.

We are experiencing a rapid rise in technology opportunities in the fields of machine learning (ML) and artificial intelligence (AI). These are in their early days as portfolio and analysis tools. But they can be expected to play a big part in managing the data challenge allowing the current paradox of ever more data without more decision-usefulness to gradually give way to a more effective data environment where big data sets provide decision-useful intelligence.

Figure 3: How would you characterize your use of Artificial Intelligence or Machine Learning as a portfolio analysis and management tool?

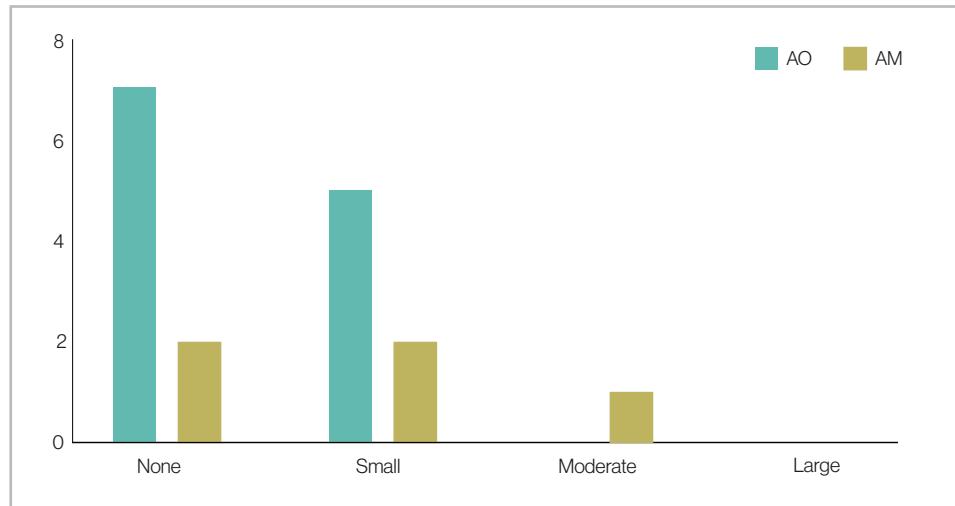
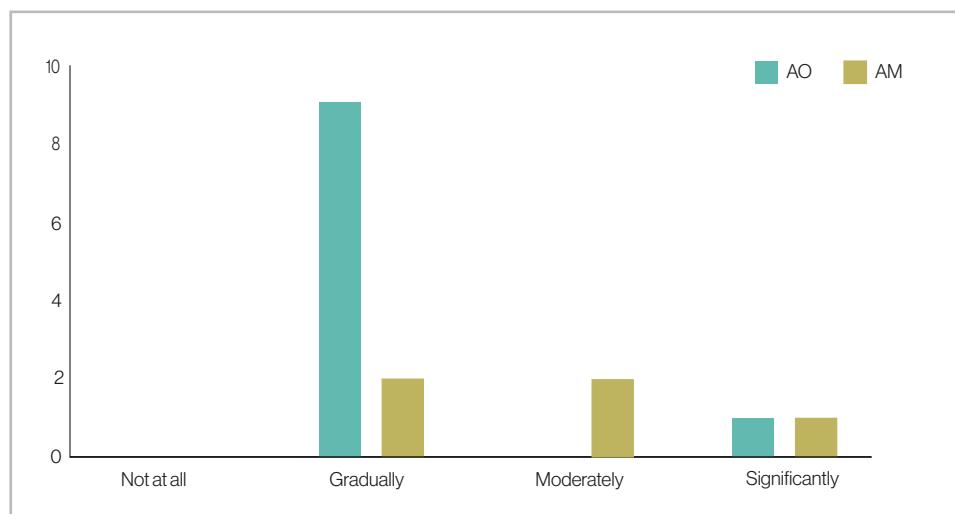


Figure 4: How would you expect your use of Artificial Intelligence or Machine Learning as a portfolio analysis and management tool to grow?



Shift	From present state	To future state
Technology model	Technology misaligned to business need with more data producing less decision-usefulness	Technology channelling high-quality decision-useful information adaptably, cheaply, and efficiently

The likely impacts of these applications will be very significant. It is hard not to see a considerable rebalancing in the AI + HI combination (artificial plus human intelligence). The principles to be applied here are:

- Get technology playing a part in replacing the drudgery parts of work functions
- This will open up big data to become more useful through better data handling
- Make sure tech comes with its explainers, not allowing it to be too opaque or black box
- Apply the human touch through those functions that can't be automated like creativity, empathy, judgement, inspiring others and critical thinking.



5. The People Model

Investment organisations rightly attach significant importance to the people model and producing the best possible employee and team experiences. The group emphasised this area as commanding priority attention in the future.

In your personal view, which of these areas would you wish to give particular emphasis to in the future (choose one)	AOs	AMs
Producing the best investment performance/business performance	33%	25%
Producing the best employee and team experiences	22%	75%
Contributing positive impacts to members, sponsors and society (net positive)	22%	0%
Contributing positive impacts to the climate challenge (net zero)	22%	0%

And while the future of work is a challenging problem it can be broken down and tackled in its major themes: hybrid work, organisational design, social capital, and managing talent.

1 Hybrid	The hybrid work journey we are in is extremely messy
2 Organisational design	Organisations should reset their operating model
3 Social capital	This has retreated, so has collaboration and these need a reset
4 Work more personal	Individuals get personal and organisations get human
5 Talent	While talent is everywhere, in practice it is unnecessarily scarce

Hybrid work

Put simply, employees like hybrid working. It is seen by employees as providing work flexibility, personal growth, wellbeing, and generally supports a good workplace existence.

But the organisation goals are not necessarily so well served by hybrid working, at least not as hybrid work is currently set up. Hybrid is not that well regarded by investment organisations in terms of productivity, collaboration, creativity and innovation. In particular hybrid working is not seen as supporting social capital with consequences for organisational effectiveness.

Figure 4: How are our hybrid arrangements viewed by our employees - reflecting work flexibility, personal growth, well-being, employee experience? Score on a 0-10 scale

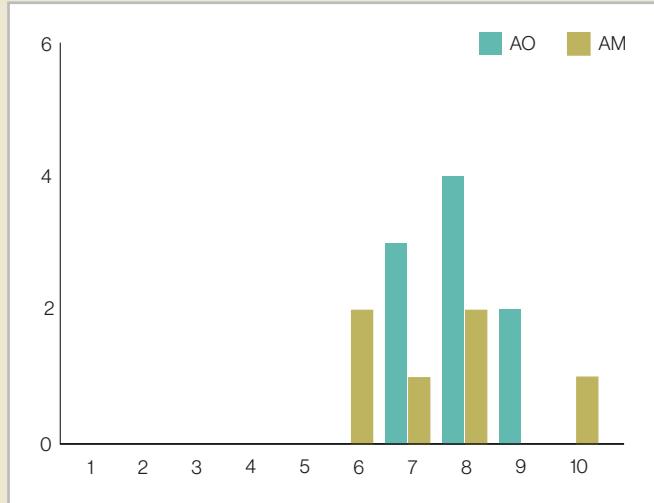


Figure 5: How are our hybrid arrangements viewed by our organisation - reflecting productivity, collaboration, creativity, innovation? Score on a 0-10 scale

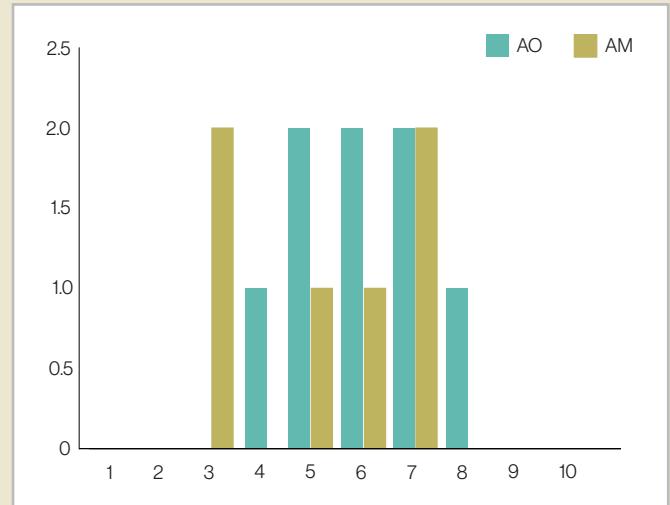


Figure 6: How are our hybrid arrangements contributing to productivity in inputs and outputs - reflecting effective space utilisation, time optimisation and social interaction? Score on a 0-10 scale

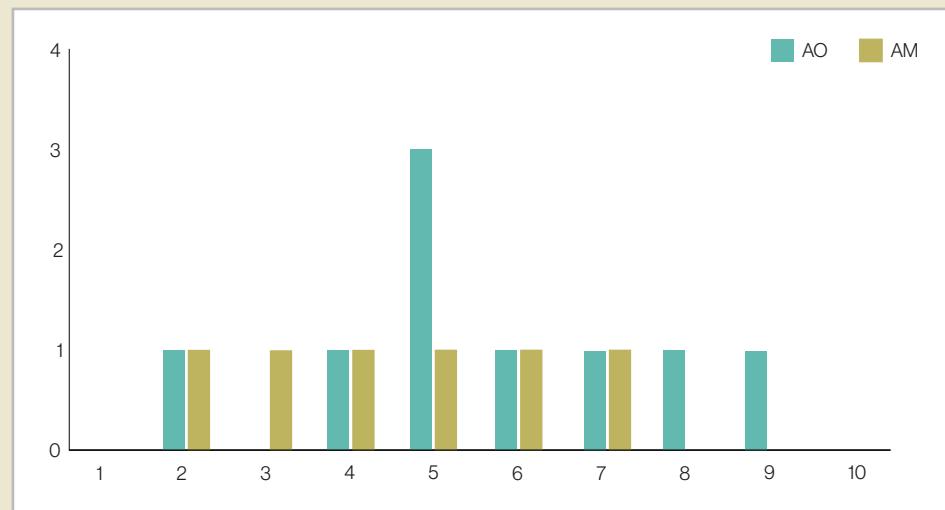
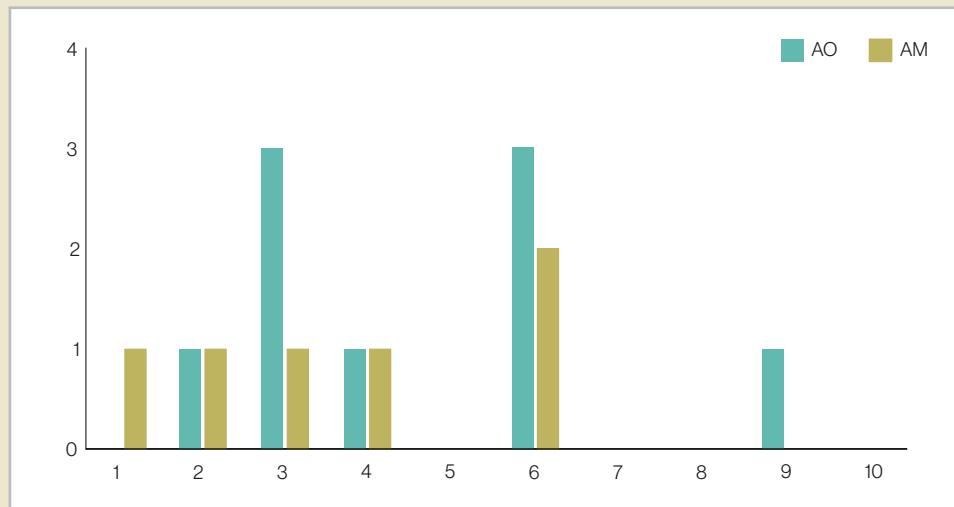


Figure 7: How are our hybrid arrangements contributing to social capital - reflecting abilities and incentives to build relationships, networks, norms and trust levels? Score on a 0-10 scale



The group had optimism that the hybrid model can be turned into efficient practice by further evolution in design and practice.

Working Group Insight

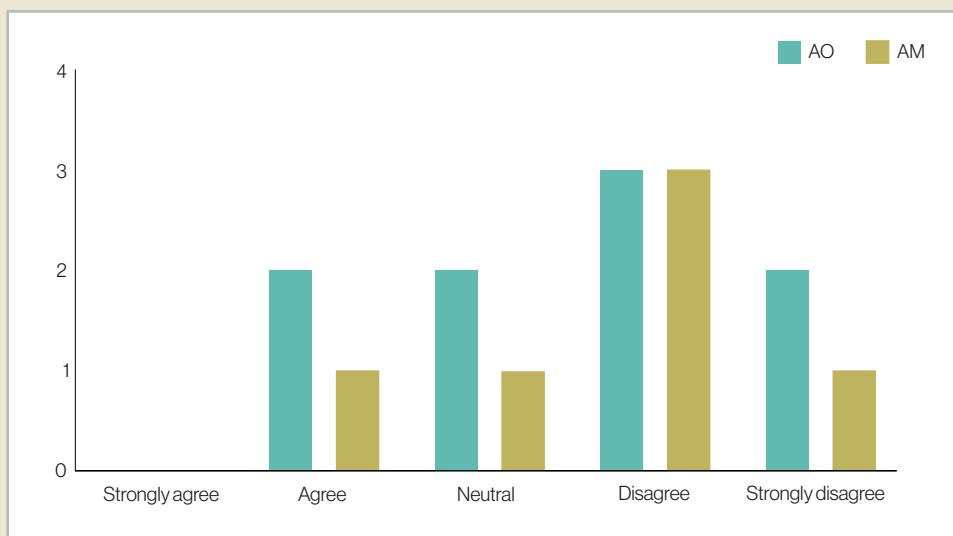
“Our experience is that junior staff and their training is where hybrid model of work is lacking and where most of long-term impact is. We are edging towards understanding how to solve these issues, but it is not completely clear yet”

But to do this requires better data and information on how effectively hybrid models are working in practice. For example, organisations should conduct regular pulse surveys to extract data on how hybrid is working for different parts of the business.

Working Group Insight

“We get feedback that our leadership is lacking in explicitly setting the rules of our hybrid model, but we are aware that engagement level of our employees has been lifted by the flexibility that they have now and we are reluctant to change that”

Figure 8: We have a significant supply of data about how our hybrid model works



In terms of assessment, hybrid should be assessed according to:

- The value to the individual in flexibility and other benefits
- The value to the organisation, particularly in terms of productivity
- The impact on different teams with different functions. Some functions are more relationship-oriented and require a strong social capital base.

Hybrid is a big part of the future of work and will take some time to develop into an efficient model. Up to now, dimensions of culture and productivity haven't been represented enough in the hybrid discussions.

Hybrid also represents an opportunity for middle management roles to step up and create successful hybrid approaches for their teams. Teams can represent role models for better hybrid practice to be rolled out more widely.

Working Group Insight

“We feel that making hybrid explicitly defined potentially risks missing an opportunity to really explore the idea of flexibility and what it might mean for each department. We also see this as an opportunity of our middle leaders to step up and lead their teams instead of adopting a traditional hierarchical mandate”

Effective team practice has to work around the particular mix of types of work that makes up the team's functions and goals. The work design matrix idea below may help in assessing the impact of hybrid working on various functions and deciding how to organise employees in these functions.

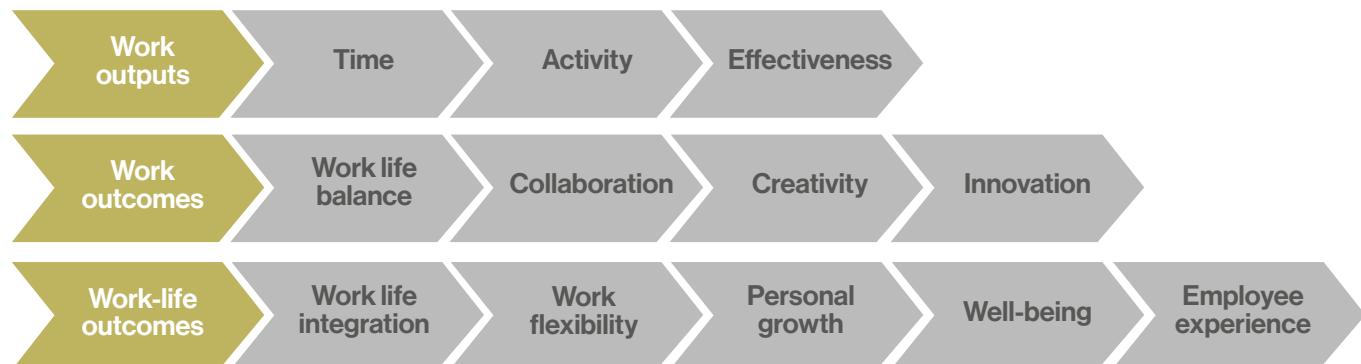
Work design matrix			The work category that the majority of this task works best with		
Task	Examples	Social capital	Remote	Hybrid	Office
Focused	Work within role and on projects on personal tasks	Small	x		
Oversight	Sharing information and knowledge about work situations and progress	Moderate	x		
Coordinating	Work with others identifying priorities and workflows	Small		x	
Co-creation	Work conducted in groups aimed at arriving at group answers	Moderate		x	
Upskilling	Study that helps individuals build knowledge, skills and abilities	Small		x	
Influencing	Communication that attempts to persuade and influence	High			x
Water-cooler	Accidental engagements 1-2-1 and in small groups with high serendipity	High			x
Coaching	Work with colleagues to help them with tacit knowledge, skills and abilities	High			x

Effective team practice is generally assessed according to measures of productivity. The challenge is in measuring productivity in the most meaningful and relevant way. Three facets of productivity are illustrated in table below.

Productivity is most often thought of as work outputs like time and activity and to a limited extent effectiveness. Time spent can be tracked as can activity and effectiveness although there is more subjectivity involved and effectiveness is most likely a matter of judgement where opinion differs.

More issues of subjectivity arise if we widen our perspective to work outcomes. Here there is more attention to critical enablers of successful teams and organisations. The outcomes will only arise with significant contributions from collaboration, creativity and innovation. These are all under-represented in a work output assessment. The full spectrum of contributors to work outcomes must also consider work life balance – with respect for the idea that with poor work life balance outcomes become unsustainable – the professional becomes burnt out or simply leaves the workforce.

The productivity lens can be widened further. In a more holistic appraisal of productive outcomes areas the full employee experience is considered along with work-life integration, work flexibility, personal growth and well-being. All these are critical enablers to productivity and are valuable areas to think about more deeply and assess more extensively.



Social capital as value creator

Social capital is generally not well understood – it is thus not often prioritised.

Social capital comprises the relationships, norms of behaviour and the trust that exists in organisations between colleagues. All these are required for innovation and creativity.

In people businesses such as investment organisations, social capital lies alongside human capital, intellectual capital and financial capital as a principal enabler of value creation.

But social capital suffers from hard-to-measure and slow-to-emerge properties and as a result it's easy to under-weight or even to ignore.

Remote ways of working have had a detrimental effect on social capital. The challenge is to rebuild it through coherent actions within the hybrid model. These actions can take place in both in-office and off-site settings.

With time in-person being reduced, individual T-shaped qualities of people and teams become more valuable as builders of social capital. The T-shaped person connects dots well through their ties in the inner ring of their relationships and their networks and bonds in the outer rings.

T-shaped people have natural advantages as contributors to building social capital and cognitive diversity. Their mix of subject depth (the vertical bar of the T) and subject breadth (the horizontal bar of the T) suits the profile of cognitively-diverse teams through their wider perspectives across many fields and disciplines. T-shaped people will contribute positively to cognitive diversity through their natural growth mindset and integrated thinking.

With time spent in relationship-building reduced, relationships need other ways to build trust via better intelligence on trustworthiness using cognitive rather than affective sources of trust.

Work is getting more personal

Individuals increasingly demand and need more personal attention from their employers.

Organisations can become more “human” and approach every issue from a human angle first, with purpose and meaning. The new organisational model starts with strengthening the DE&I model.

The target-state organisation is one which:

- Builds a diverse array of people in its workforce
- Gives respect and inclusion to the whole identity of all its people
- Ensures inclusion is practiced
- Has a cultural signature that is people-oriented
- Has superteams that are capable of exceptional performance
- And as a consequence, achieves success in employee experience and enterprise results

Meanwhile, the target-state individual within organisations is one who:

- Feels overwhelmingly positive about colleagues
- Feels included and respected
- Feels a sense of belonging and allegiance to their organisation
- Has a strong cultural motivation in their work and in working with and helping colleagues
- Has the opportunity to work at peak performance in strong teams
- And, as a consequence, achieves success for themselves and their organisation.

Shift chart summary

Shift	From present state	To future state
People model	People working in groups and teams with weak culture, governance and diversity	People work in Superteams that have an edge with culture, governance and diversity to the fore





6. The 3D Investment Model

The nature of financial risks has evolved in a way where institutional investors can no longer expect sustainable investment outcomes if they limit their influence to specific assets.

Truly sustainable investment organisations are emerging whose success is underpinned by culture and capabilities.

Truly sustainable in this context means sustainable in its organisational longevity and in its investment focus. The key elements of this model are below.

Elements of the model

1. Bigger societal role for the AO, bigger opportunity for the AM from supporting this
2. Aligned organisation and value chain
3. Co-creator of new wealth, emphasis on primary capital
4. 3D investment model – return, risk and real-world impact
5. Net-zero emissions pathway
6. Universal ownership mind-set supporting net positive impacts and SDGs
7. Managing and influencing system risks and integrating these with other risks

3D and universal ownership models

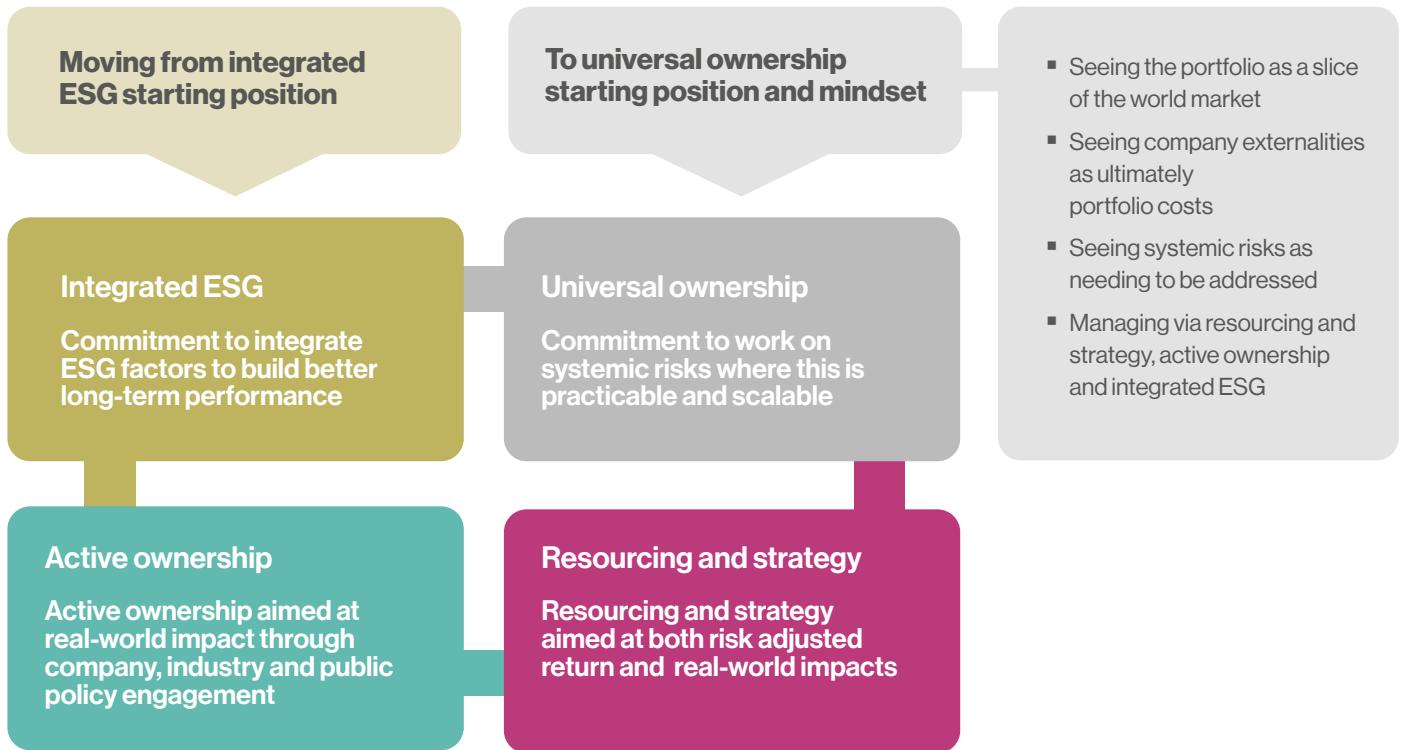
3D investing frameworks balance the risk, return and impacts of strategies. The key objective in the 3D framework is to integrate risk and return with impact, giving separate attention to all elements while satisfying the fiduciary principle to add impact with no concession to the risk-adjusted return.

Building better beta, via significant stewardship with individual companies and industries and via public policy engagement, is critical to 3D frameworks.

The 3D framework is likely to include core sustainability and impact strategies and scorecard reporting. In its fullest form, it will include total portfolio thinking, strategic partnerships and universal ownership strategies.



The pitch - universal ownership mind-set



It is important to balance societal contributions with financial considerations. Few organisations are prepared to compromise their financial performance over the long term.

Working Group Insight

“3D investing is an obligation for an active manager. If we’re supposed to allocate capital responsibly, we need to be given the time allocation that’s needed, we need to change the incentives, we need to change the commercial pressures”

This is the crux of the issue. If an organisation sought transformational change now, it would need to either define its own benchmarks or abandon benchmarks altogether and go back to how active management was done before benchmarks existed. That is a very big step in the context of the high demand for accountability and measurement. So, an approach that is somewhere in the middle may be taken by many organisations.

In other words, 3D investment is going to present very differently depending on the organisation. “3D lite” was a term used by some members during panel discussions.

Whatever, the model adopted, governance will need retooling. Organisations used to exercise control through tightly-formulated benchmark-oriented mandates that emphasized risk and return. The new, forward-looking, 3D world does not have benchmarks as anchors. So, organisations must formulate, monitor and evaluate performance in a way that both provides the control clients need, but also the freedom organisations need in order to perform.

Total portfolio approaches support the integrated thinking that is needed for the achievement of sustainability within fiduciary constraints. This involves portfolio quality being assessed as a combination of (1) risk/return efficiency; (2) other key factors like resilience, liquidity, costs, governance; (3) the addition of sustainability and impact metrics integrated into the scorecard.

The table below – using categories aligned to the CFRF framework – sets out a metric that is suitable for current use, taking account of the availability and robustness of existing methodologies, and an indication of what metric might be preferred in the future as climate data and metrics evolve.

Category	Preferred metric(s) – current state	Preferred metric(s) – possible future state
Carbon	Absolute emissions Carbon footprint – emissions / \$ invested	As per current
Alignment	% portfolio emissions attributable to assets aligned with a well below 2-degree pathway (e.g. using NZIF criteria for individual asset classes)	Implied temperature rise
Transition finance	% portfolio allocated to climate solutions (e.g. using EU Taxonomy or IIGCC definitions)	As per current or GHG emissions mitigated / \$ invested
Engagement	% of portfolio emissions assessed as aligned or subject to direct or collective engagement (subject to a minimum number of engagements per year)	As per current with a minimum bar added for the nature of the engagement activity (e.g. number of “advanced” interventions)
Transition risk	Expected change in asset prices resulting from a well below-2 degree transition being priced (CTVaR)	As per current
Physical risk	% portfolio exposure to key physical perils	Expected change in asset prices resulting from losses under a “business as usual” scenario

Net zero is a bold ambition

For many organisations, lack of scale means 3D investing focuses predominantly on climate impact rather than societal considerations. But net zero is an important goal for all asset owners:

In your personal view, which of these areas would you wish to give particular emphasis to in the future (choose one)	AOs	AMs
Producing the best investment performance/business performance	36%	17%
Producing the best employee and team experiences	18%	67%
Contributing positive impacts to members, sponsors and society (net positive)	27%	0%
Contributing positive impacts to the climate challenge (net zero)	18%	17%

And net zero and SDG goals will become even more important in the future:

Which of the following areas are likely to require increased attention at your organisation in the next 5 years (choose up to two)	AOs	AMs
The investment model issues - private markets, role of bonds and LDI, global and emerging market assets	22%	0%
The operating model issues – governance, partners, mandate design, strategic relationships, outsourcing	33%	75%
The mainstream sustainability/ ESG issues – integrated ESG, exclusions, voting, ESG in multi-asset settings	33%	25%
The sustainability impacts issues - addressing systemic risks, net zero ambitions, SDG goals	78%	75%

The commitment to net zero encumbers funds with a sizeable commitment irrespective of investment circumstances and legal context, and will be measured and scrutinised by all.

While net zero ambition may well seem like “doing the right thing”, it does not necessarily mean “doing things right”. In particular the investment policies to deliver both the highest risk-adjusted returns and alignment to net zero may seem aligned in current conditions but not at future points. The tension between the two goals appeared particularly during 2022 with the exceptional performance from high emissions oil and gas companies.

Governance issues with climate data

The net zero area has produced a very sharp rise in the governance budget required for successful investment practice. In response, we suggest AOs should first ensure the resources are in place; and second align with certain governance working principles. AOs should aim to build an edge in the fulfilment of their risk management and reporting motivations, but it will take prolonged effort to do so.

AOs should also aim to elevate their stakeholder management skills and processes to adapt to increasingly onerous multi-stakeholder obligations. And build out the data platform from which decision-making and reporting are derived. The key for AOs is not to wait for the market infrastructure and data sources to mature but instead to learn how to evaluate and acquire the best available data and work with this in its imperfect form.

There is a need to act collectively. The resolution of systemic challenges will ultimately require collective action in which various collaborative groups develop standards around net zero investing and measurement. The commitment of AOs to various industry groups is highly desirable and will over time produce significant pay-offs including better decisions through access to best practices and better scale through collective action.

The success of net zero will depend to a large extent on applying a systems leadership approach.

System leadership view of bridging purpose and net-zero vision

Recontextualise self interest	Agree common problem	Depen understanding	Work in coalition	Benefit from the results
Universal owners - large, long-term, leadership-minded investors				
Build out the investment industry context with increasing systemic risk - facing tragedy of the commons challenges	Engage across the universal owners that face systemic risks - addressing prisoners dilemma issue	Map the interconnections between investor size, strategy and systemic risk - and the need for active ownership	Build the coalitions for change that catalyse network benefits - using coalition organisations like GFANZ and IIGCC	Achieve real-world impact and better financial outcomes - using the 3D investment framework

Shift chart summary

Shift	From present state	To future state
Investment model	Investment built around asset level and portfolio level principles in which alpha pursuit is central	Investment combining traditional MPT principles with systems-level 3D investing principles

7. The Measurement Model

The working group viewed the balanced scorecard with multiple metrics as the best model for measuring the complex world of investment decisions.

Multiple metrics	Smart goals	Check-ins	Accountabilities	Comp
<ul style="list-style-type: none">▪ Progress is multi-faceted▪ Measures of progress are both soft and hard, and inputs and outputs▪ Blend them together to calibrate progress	<ul style="list-style-type: none">▪ Systemic, <u>multiple</u>, agile, reflexive and time-bound▪ Specific, <u>multi-stakeholder</u>, absolute/relative assessments, and transparent	 <ul style="list-style-type: none">▪ Help to energy, motivations and accountability▪ Can incorporate agility▪ Judge <u>indicators</u>▪ The perfect is the enemy of the good	 <ul style="list-style-type: none">▪ Put results into fair context with accountability and culture respected▪ Progress monitored carefully and reported openly▪ Allow for data provenance	 <ul style="list-style-type: none">▪ Measure and reward on team behaviours and contributions to goals▪ Allow discretions and judgement by applying narrative▪ Align <u>motivations/incentives</u> to goals

Check-ins

Regular monitoring check-ins help accountability, motivations and support agility. The measurement provides context and produce the milestones that can act as steppingstones to bridge the actions to the goals.

Accountabilities

Applying clear accountability to desired outcomes must involve putting results into a fair assessment with context and narrative applied. This suggests an accountability culture, with progress monitored carefully, reported openly and assessed without bias.

Note, there is an inherent conflict between agility and accountability. With changes in goals and strategy, the track record is interrupted.

Compensation

Measurement may be used as support for decisions on remuneration or be a formulaic component of that remuneration.

There are some general principles for remuneration strategy for large asset owners. It starts with using remuneration to attract, retain and develop talent while reinforcing the mandate and objectives and strategy and reinforcing culture. It has to align with stakeholder preferences and constraints – notably board views come into this. And of course the remuneration must align with achievements of personal and collective KPI's.

Larger funds have tended to develop more formulaic practices on remuneration and the complexity of these formulae have led to increasing difficulty reconciling the principles. What is fair is often a heavily contested issue. This suggests that a direction involving more judgement and subjectivity in the process may be more appropriate.

There is also a desire to ensure less volatility of outcome being designed into arrangements and a better blend of team and individual contributions.

Take-up of balanced scorecards

Take-up of balanced scorecards across the industry is patchy. Polling suggests use is limited and where they are used their design, implementation and the way they are used requires refining.

To implement balanced scorecards successfully organisations need an alignment with respect to philosophy, objectives and underlying beliefs, a supportive culture and strong leadership.

One member noted that it had in place a balanced scorecard to holistically assess investment outcomes which incorporates sustainability and liquidity alongside traditional metrics. However, to ensure this remains effective, it was looking for an approach to provide early warning of developing risks and a framework to incorporate those risks.

The key strands for further development of a balanced scorecard could include: a) measuring systemic risks that go beyond individual assets; b) measuring outcomes of system level engagement; c) defining measurement metrics outside environmental considerations (eg biodiversity, inequality).

Figure 9: Do you use balanced scorecards in your organisation?

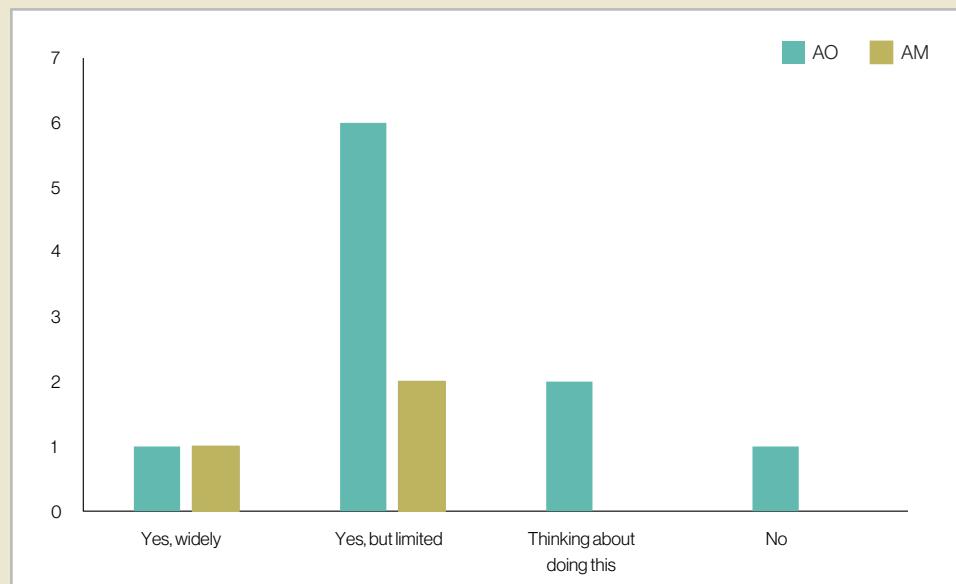
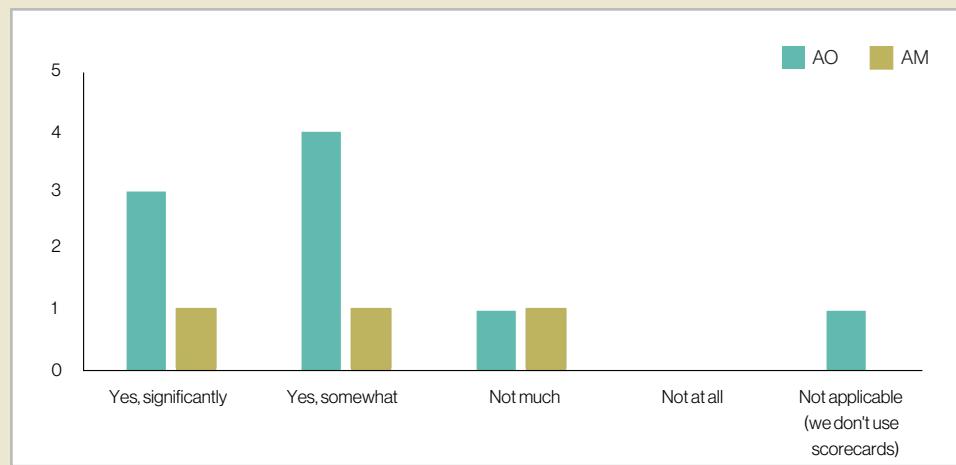


Figure 10: If you do use balanced scorecards, do you consider the design, implementation and use of the scorecard can be improved?



Shift chart summary

Shift	From present state	To future state
Measurement model	Measurement heavily focused on value-add outcomes (alpha) framework	Balanced scorecards consider the multiple facets of progress including total return outcomes vs goals



8. The Change Model

Conditions for successful change

Working group conclusions on change were suggestive of many factors needing to come together to make it successful.

- It is preferable that the three areas of change – business, people and investment – are delivered together given their inter-dependence. Change in one area will be less successful if changes in the other areas are not undertaken.
- The resources needed to carry out successful change will be substantial, but the rewards are commensurately sized when executed well.
- Various enablers are needed to successfully achieve change: a strong organisational culture and the right skills and technologies together with a compelling vision, an aligned coalition and rigorous process.
- The influence of culture on change is considerable and for transformational change will be dominant. Culture is the balm to soothe the conflict between the fuel driving change and the friction resisting it – a conflict which is at the heart of all change.

Behavioural psychology holds that people are willing to change once they're personally motivated to do so. The persuader's role is to fuel this motivation.

At the same time, friction encapsulates the factors that hold back the adoption of a new product or process. Friction is concerned with various costs – the time and energy costs, the emotional and energy cost, the cost of losing something precious from the past and the present. Friction factors include context and individual experience and are difficult to qualify and quantify, especially when we have a natural focus on the fuel in the arguments for change.

But because friction is an opposing force, it is powerful in the equation. If we can reduce friction, the fuel required to motivate change will be substantially less.

Levels of change

Governance research points to considerable governance gaps in the investment industry, impacting the capacity for change. Levels of commitment to change can, however be graduated.

We see three distinct levels, described below.

Incremental change

- 'most stones unturned'
- light adaptation in response to major issues as they arise or are identified
- low time and energy commitment to change
- most problems don't get addressed with this approach

Step-up change

- 'some stones turned'
- review of current practices and identification of gaps
- commitment to change those issues that are less complex
- moderate time and energy needed
- can yield some quick wins, but deeper-set issues not accessed
- can embed and option to go further

Transformational change

- 'all stones turned'
- problems addressed at root with holistic analysis and treatment
- strong innovation and implementation required
- strong change sponsorship required for major time and energy commitment

We would not advocate for one particular approach given the many contexts. However, initially adopting a step-up change approach leaves open the option for transformational work to follow.

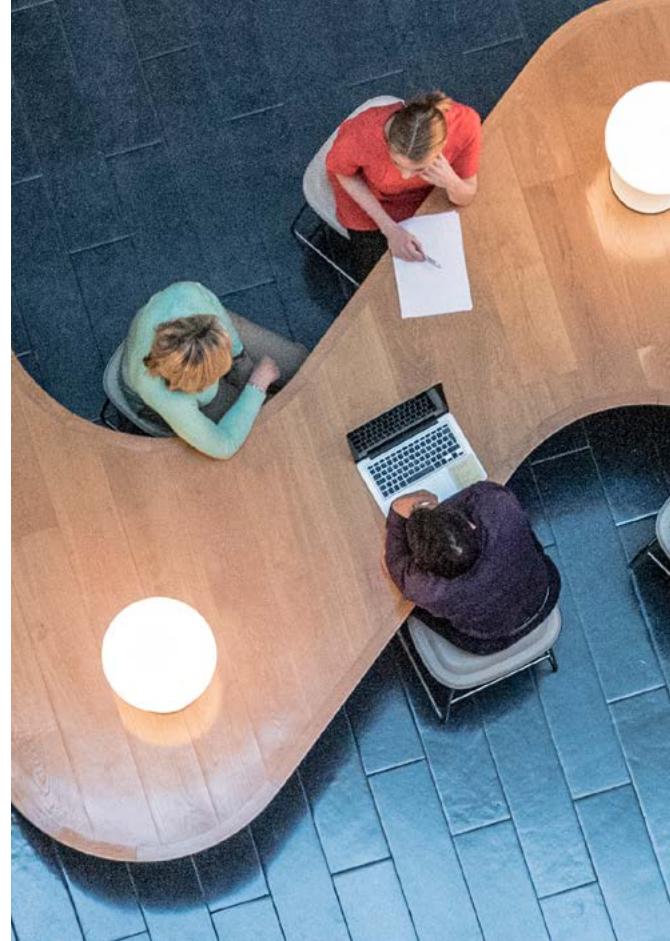
Due to the multiple internal drivers, external market and regulatory drivers, change will necessarily be an iterative and adaptive process and the direction of travel may vary along the way.

Leadership and followership for change

The cultural aspects which enable change stem from both leaders and colleagues.

Leaders must not only demonstrate the ability to think deeply about strategy and implement change from a technical standpoint. They must have the human qualities that motivate others to commit to the change. Empathy and clear and consistent values will be a critical part of this.

Colleagues have a big part in this as well. Being consistently supportive to respond to change initiatives is a particularly valuable characteristic. And being adaptive and T-shaped are also sought after qualities in the change journey.



The human leader

- show empathy
- clear and consistent on values
- be empowering
- create safe space

The versatile leader

- be a strategist, conductor, overseer and cheerleader
- innovate
- be a B-shaped leader

The systems leader

- aim for systemic change
- apply collective action to benefit all
- be a T-shaped thinker

The rock solid colleague

- show generosity
- clear and consistent on values
- be imaginative
- cherish safe space

The adaptive colleague

- build the give and get with you firm
- apply a growth mindset
- be opportunistic

The T-shaped colleague

- work through the silos
- connect the dots
- aim for win-wins
- think laterally

How to pitch change

Investment groups were asked how they might pitch significant organisational change to their boards and their scheme members. This is one example below of the outputs from this exercise. For confidentiality reasons, the other pitches were kept within the group.

Change Pitch to the Board:

"The case for this shift to a systems-based approach to investing rests on five key parts. The first of those is the need for and importance of adopting a systems perspective, the second is to recognise a wider set of stakeholders than we currently do, the third introduces the idea of a three-dimensional investment challenge, the fourth talks about measuring success and lastly, we talk about what we would need to succeed.

So, starting with the systems perspective, we now understand that we live on a finite planet where everything is connected and where we recognise that human activity has reached the point where it is impacting the planet's ability to sustain life as we know it.

Today our mindset is that we can compartmentalise our activities, that they can be viewed as somehow apart from the social, ecological and planetary systems. We can no longer assume this is the case.

To help preserve the planet's ability to sustain human life and therefore the future security of our members we must think of ourselves as investors operating within and impacting on a much broader system.

Up until now we operated with a particular set of stakeholders in mind - our sponsor, our members, our staff and our regulators. They, of course, will remain key stakeholders. However, adopting a perspective that we are part of an interconnected system, we must take into account a much wider group of stakeholders. And as public understanding of this interconnectedness of all things grows, we can expect that our direct and indirect stakeholders will want more of a voice in the way that we operate.

The governing paradigm that powered our investment approach for the last several decades has been that really all that matters is how much risk we take and how well we're compensated for that risk. As we move to viewing ourselves as part of a system, to these two dimensions of risk and return we must add a third, the impact we have as investors.

This impact, positive and negative, will need to be measured over multiple dimensions. For example, impact on people, on ecosystems, and on the planet.

Measuring our success to date has been relatively simple - have we delivered a return to our members that helps them meet their retirement goals and have we been fairly compensated for the risk we have taken? A three-dimensional investing paradigm needs new measures that provide a more holistic picture.

As we transition to this new way of doing things, we have to recognise it won't be easy and it will need time for us to develop the new disciplines and new decision-making frameworks.

Importantly, we will need a new mindset. I believe this is a challenge we cannot shrink away from. The future prosperity of our members, the society and other life forms we share this planet with, depend on us rising to it".



Change Pitch to members:

"I want to talk to you about an important shift that we're going to make to a systems-based approach to investment that rests on three key premises. The first is that all things are connected, the second is that we must have retirement in a world that's worth living in, and the third is that investing is better done in three dimensions rather than two.

We now understand, and we share in the story with you, that we live on a finite planet where everything is connected, and recognise that human activity has reached a point where it is impacting the planet's ability to sustain life as we know it.

Recognising this we strongly believe that we must change our way of thinking about investing to help preserve the planet's ability to sustain human life and therefore your future security. We must think of ourselves as investors operating within and impacting on a much broader system – one that incorporates social, ecological and planetary systems.

What won't change is our primary focus on investing to secure the returns you need to support your comfort and security in your retirement.

What does change is a recognition that we must provide those financial returns within a world worth living in and to do that we must consider the impacts of the investments we make. Those impacts can be positive or negative.

We can build up the societies that we are a part of and the ecosystems that support them and all life or we can degrade them. Our goal is to ensure that while we deliver returns that support you financially, we're also creating a net positive impact through how we invest.

Historically, all that mattered to most investors has been how much risk they take and how well they are rewarded for that risk. As we move to viewing ourselves as part of a system, to these two dimensions of risk and return, we must have a third – that is the impact that we have. With our new approach we need to add measurement that demonstrates we are also delivering on our ambition to create a positive impact on society's ecosystems.

Now, we don't pretend that transitioning to this new way of doing things will be easy, it won't and will take some time. There are a range of new approaches that we will need to develop and, frankly, some of it we will be learning alongside our peers as we go.

To succeed we need your help in two ways – first, we need your patience, second, we need your input. We need to know what matters to you, so that we can use those matters to help focus our attention on those impacts where we can make the biggest difference.

We don't undertake this change lightly, but we strongly believe that this is a challenge that we cannot shrink away from. The future prosperity of all of us – the societies we are a part of and other life forms with which we share this planet depend on us rising to the task".

Conclusions on change

- Change is more than just shifting mindsets, it is about defining and actualising the pathway.
- All organisational change is difficult. Change hurts because you have to give up things you are attached to.
- The common feature of moving one notch from a current position to a target position can seem like incremental change but when applied to multiple dimensions it becomes transformational change. Most often we need a change program more than a change project.
- The most significant change initiatives involve working in collaboration and partnership. This is particularly resonant to the investment industry where many of the systemic challenges are better addressed through collective action. Net zero investing is a particular example of this.

Shift chart summary

Shift	From present state	To future state
Change model	Incremental change mindset with light adaptation in response to issues as they arise	Transformational change mindset with issues seen and addressed systemically with holistic treatment

9. Conclusions on the Investment Organisation of Tomorrow



The Working Group's coverage of the complex industry issues was broad and deep, and we appreciate the clear insights that were developed in the journey.

The key conclusions were these:

Multi-faceted change – change is multi-faceted being much more than just shifting mindsets, but in addition defining and actualising the pathway in the face of considerable friction - all organisational change is difficult because it involves giving up things you are attached to. It becomes critical for investment organisations to adapt in all major areas – in our thinking this is about the models for business, technology, people, measurement and investment - in order to fulfil their full potential. All organisational change is difficult because it involves giving up things you are attached to. *Decreasing the change 'frictions' is more important than increasing the 'fuel' in the argument for change*

Change vision is crucial – and this will major on a significant shift to consider wider stakeholders, modernise thinking and practice and incorporate sustainability issues, which are all critical to stay relevant and resilient. Investment organisations need to adapt internally at a speed and scale to match the accelerations taking place externally and in sync with the increasing uncertainty and complexity around them.

Communications need to be layered to meet stakeholder needs

Leadership of change – To effect change on the scale suggested, the leadership needed is holistic and strategic and premised on building a leadership coalition of board and executive stakeholders. The leadership has the role to apply a disciplined change process that works in a transformational change setting that is more substantive, co-ordinated, agile and time-intensive than we have been accustomed to.

A step up in ambitions is needed

Collaboration – the AOs and AMs need to be collaborative organisations that value teamwork and inclusiveness and are effective and influential through various engagements and partnerships. There is a congruence in the need for AOs and AMs to change in similar ways given that AOs have heavy dependencies on AMs and strong philosophical and cultural alignment will act to create more effective arrangements.

Systems thinking is an essential feature of this shared philosophy

In conclusion

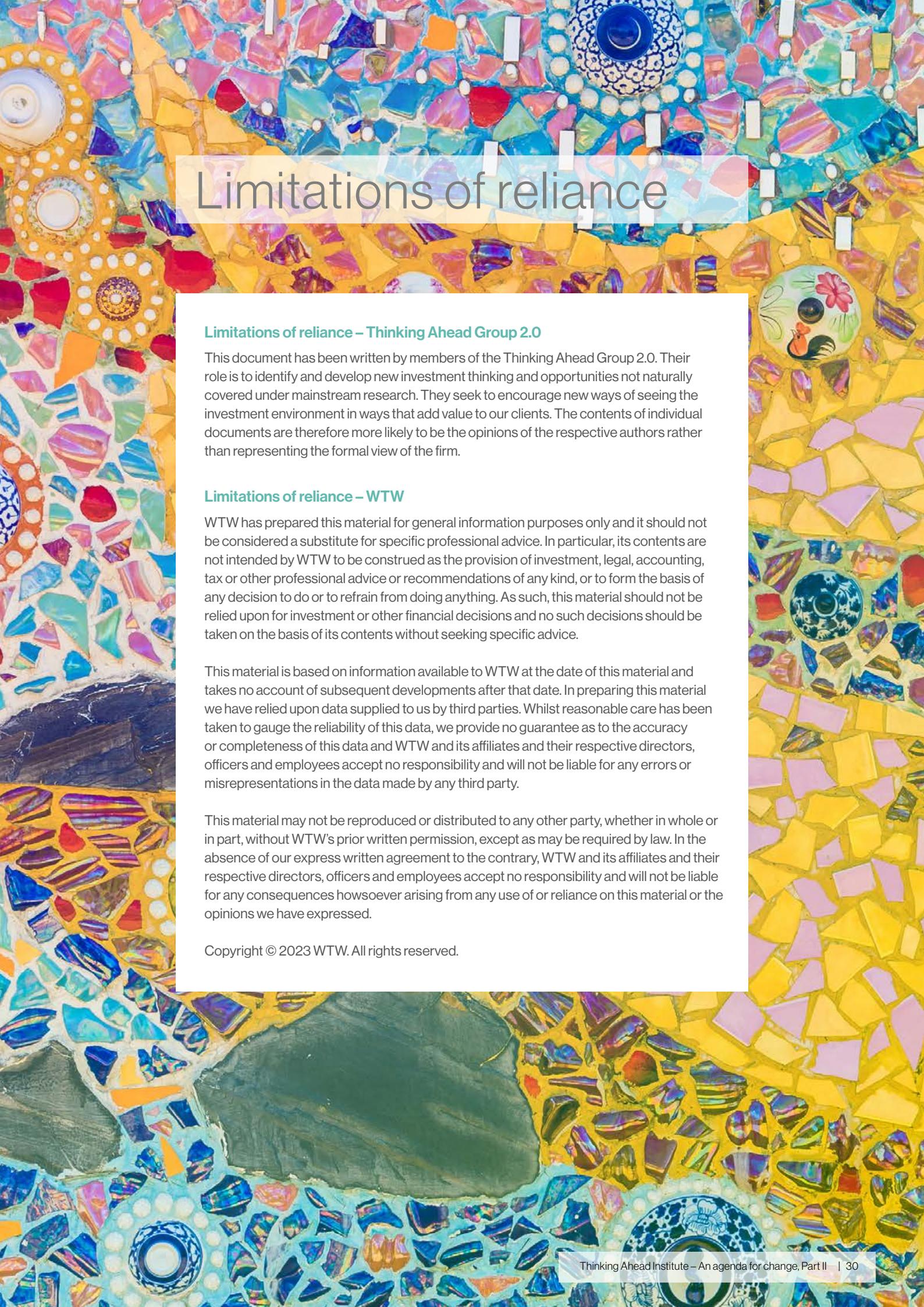
Through the Working Group we have created a vision following the key steps of developing a narrative and a set of principles. We believe the narrative is transferable to others in the industry and supports socialising the Group's thinking in other contexts. Similarly, the principles can be transferred as open-source materials to support the application of the thinking in other contexts. In so doing, the Group has accomplished its specific goals of providing transferable intellectual capital to benefit the industry and its end savers.

In this second paper on 'an agenda for change' we have built out from the foundation in previous work to define more precisely broadly what changes are needed at an execution level.

We suggest further work is now required to consider certain more detailed execution issues to successfully conclude the agenda for change with a roadmap for change.

- How to build coalition resources, skills and strategies in order to address systemic risks that are too large for single organisations to tackle
- The refinement of multi-stakeholder management and balancing multiple interests
- How to evolve effective measurement, particularly using balanced scorecards, in order to better track progress against goals and allocate the organisation's finite resources
- Evolving work arrangements alongside new technologies in AI and ML, and how to capture the best of the AI + HI combination ie people plus technology

These are the subjects of our next target for *investment organisation of tomorrow* research in this field.



Limitations of reliance

Limitations of reliance – Thinking Ahead Group 2.0

This document has been written by members of the Thinking Ahead Group 2.0. Their role is to identify and develop new investment thinking and opportunities not naturally covered under mainstream research. They seek to encourage new ways of seeing the investment environment in ways that add value to our clients. The contents of individual documents are therefore more likely to be the opinions of the respective authors rather than representing the formal view of the firm.

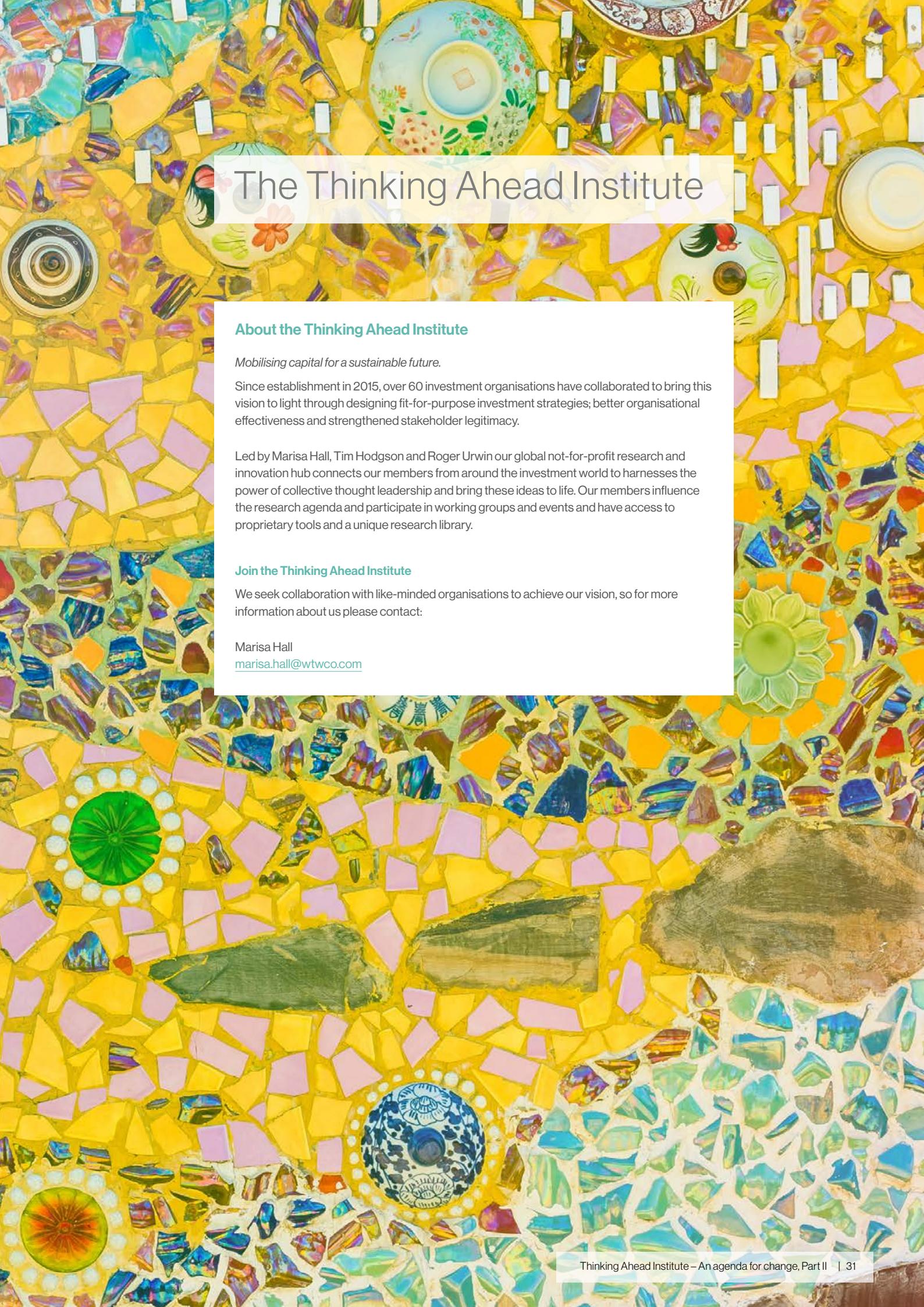
Limitations of reliance – WTW

WTW has prepared this material for general information purposes only and it should not be considered a substitute for specific professional advice. In particular, its contents are not intended by WTW to be construed as the provision of investment, legal, accounting, tax or other professional advice or recommendations of any kind, or to form the basis of any decision to do or to refrain from doing anything. As such, this material should not be relied upon for investment or other financial decisions and no such decisions should be taken on the basis of its contents without seeking specific advice.

This material is based on information available to WTW at the date of this material and takes no account of subsequent developments after that date. In preparing this material we have relied upon data supplied to us by third parties. Whilst reasonable care has been taken to gauge the reliability of this data, we provide no guarantee as to the accuracy or completeness of this data and WTW and its affiliates and their respective directors, officers and employees accept no responsibility and will not be liable for any errors or misrepresentations in the data made by any third party.

This material may not be reproduced or distributed to any other party, whether in whole or in part, without WTW's prior written permission, except as may be required by law. In the absence of our express written agreement to the contrary, WTW and its affiliates and their respective directors, officers and employees accept no responsibility and will not be liable for any consequences howsoever arising from any use of or reliance on this material or the opinions we have expressed.

Copyright © 2023 WTW. All rights reserved.



The Thinking Ahead Institute

About the Thinking Ahead Institute

Mobilising capital for a sustainable future.

Since establishment in 2015, over 60 investment organisations have collaborated to bring this vision to light through designing fit-for-purpose investment strategies; better organisational effectiveness and strengthened stakeholder legitimacy.

Led by Marisa Hall, Tim Hodgson and Roger Urwin our global not-for-profit research and innovation hub connects our members from around the investment world to harnesses the power of collective thought leadership and bring these ideas to life. Our members influence the research agenda and participate in working groups and events and have access to proprietary tools and a unique research library.

Join the Thinking Ahead Institute

We seek collaboration with like-minded organisations to achieve our vision, so for more information about us please contact:

Marisa Hall
marisa.hall@wtwco.com

About the Thinking Ahead Institute

The Thinking Ahead Institute (TAI) is a not-for-profit research and innovation network motivated to influence the investment industry for the good of savers worldwide and to mobilise capital for a sustainable future. Since its establishment in 2015, over 90 investment organisations have collaborated to bring this vision to light through designing fit-for-purpose investment strategies; working towards better organisational effectiveness; and strengthening stakeholder legitimacy.

Led by Marisa Hall, Tim Hodgson and Roger Urwin, the Thinking Ahead Institute connects our members from around the investment world to harness the power of collective thought leadership and develop innovative solutions for the investment industry.