

System-level Investment: Domini's Commitment

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Why System-level Investment?

In September 2007, the global financial system came to the brink of collapse. That shock and the subsequent global financial crisis that followed were a wakeup call for the investment community. Our financial system lacked the resilience we had thought it possessed. Risky practices had undermined the safety of the foundational system on which we had built our investments. How was that possible?

At the same time, climate change was emerging as a crisis of global proportions that would impact investments across all industries and asset classes. As responsible investors, we asked ourselves were there other global social and environmental challenges of similar proportions that we would need to confront in the 21st century? If so, what would a system-level investment approach to the management of the risks and opportunities of such challenges look like? Would a class of investors concerned with these systemic challenges emerge and who would they be?

Who Are System-level Investors?

We asked ourselves- how we might formulate a system-level approach to our investments; how we might define system-level investment. By 2016, we came to think of system-level investors as those who acknowledge that it isn't enough to only "clean up" their portfolios when it comes to the greatest social and environmental challenges of our time. They also acknowledge that their investment decisions impact environmental, social, and economic systems either positively or negatively, and that these systems in turn impact their investments. For example, there is no place to hide from the investment implications of climate change.

It only stands to reason that investors want the social, environmental, and financial systems within which they operate to be healthy and resilient so that they can build their investments on them. But system-level investors should not simply rely on others to ensure the health of these systems; they should accept responsibility for their impacts on these systems and take steps to help ensure that they positively impact them.

What Makes System-level Investors Different?

In practice then, what would system-level investors do differently from conventional and impact investors? Simply put, conventional and impact investor confine themselves to considerations of the management of risks and opportunities at the security and portfolio levels. System-level investors take the additional step of supplementing well-developed portfolio-management tools with additional techniques designed for influence at a system level. They intentionally seek to protect and enhance the stability and resilience of the foundational systems upon which their investments are built. By strengthening this foundation, they help create a "rising tide" of investment opportunities for all investors, including themselves.

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And what would these techniques look like? System-level investors understand, for example, that public policy matters in the management of systemic environmental risks, so they speak up for regulation that can help manage the systemic risks and rewards most relevant to their portfolios. They amplify their voice by joining with peers to set social and environmental standards for best practice when it comes to those system-level risks and opportunities for entire industries. They adopt a long-term view that looks to the future point at which social, environmental, and financial considerations converge to support healthy and resilient systems upon which a sound society, economy, and investments can be built. They look for system-level solutions, working to achieve a balance between investment as short-term value extraction and long-term value creation, including the intangible values that preservation of the systems themselves offer. They recognize that change is necessary in underlying paradigms. And they understand that at times a period of transition will be necessary when it comes to the creation of such a balance.

What We Have Learned

In 2016, Domini formally committed itself to the concept of management of systemic risks and began a pilot program to test out the implementation of that concept. In 2018, we settled on the Forest Project as a multi-year program to test out that implementation. Over the years since then, we have learned among other things: how to incorporate that commitment into our investment beliefs and principles; the importance of identifying leverage points within a complex system; the need to define the system itself and its most important subsystems; the usefulness of setting goals for each of those subsystems; which of the tools designed for system-level influence are easy to use and which are difficult; and how challenging but essential the measurement of our direct and indirect impacts can be.

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