pi roundtable

SUSTAINABLE INVESTING

JUPITER
ASSET MANAGEMENT

NEWTON
Investment Management

Ian Burger | Andrew Cole | Chandra Gopinathan
Henrietta Gourlay | Gustave Loriot-Boserup
Abbie Llewellyn-Waters | Oliver MacArthur | Simon Rawson

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SUSTAINABLE INVESTING

Bad habits can be hard to break. Especially when they have changed the world.

For more than a hundred years, the developed world enjoyed the benefits of booming economies thanks to coal, oil and gas as well as a continuous supply of freshwater.

Yet the commodities credited with driving growth to new heights are the same that are putting us on the road to extinction. Burning oil and coal fuelled an industrial revolution and helped us travel further and faster than ever before, but the cost has been that average temperatures are hitting dangerous levels, resulting in extreme weather patterns and rising sea levels. Meanwhile, rising populations and growing corporate demand could drive countries to war over access to freshwater.

Halting the damage to our climate, or even reversing it, is not easy as there is no efficient and scalable alternative to such unsustainable practices. But progress is being made. Technologies that generate energy from the sun and wind are maturing, while batteries are becoming more powerful, but national targets to decarbonise economies set at 2050 and 2070 show how tough replacing fossil fuels is.

Governments are raising billions to meet these targets, but pension schemes and insurers, which collectively control trillions in assets, are seen as being more influential. But are they using this influence over global markets and corporate boardrooms to drive the changes needed?

They are trying. I can't name a pension scheme that does not have a sustainable ownership policy or at least a climate friendly strategy, but how effective are they?

This supplement examines sustainable investing and responsible ownership, looking at the progress institutional investors are making in securing a future for the coming generations through promoting more sustainable practices.

We hope you enjoy reading it.

Mark Dunne
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$4trn

The annual investment needed to contain the threat of climate change

Source: Pictet/Institute of International Finance

£1trn

British pension scheme capital committed to achieving a net-zero economy by 2050

Source: Make My Money Matter

$4.5trn

The estimated size of the ESG-labelled bond market by 2025

Source: Pictet/Institute of International Finance

801

The number of sustainable funds launched globally in the first nine months of 2021, compared to 532 for the whole of 2020

Source: Morningstar

$53trn

The projected size of the global ESG investment market by 2025, making it more than a third of the expected $140.5trn of total assets under management

Source: Bloomberg Intelligence

6.9%

The average return from sustainable large cap equity funds between 2010 and 2020, compared to 6.3% for conventional funds

Source: Morningstar

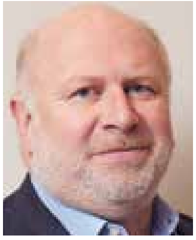
PARTICIPANTS

Ian Burger
Head of responsible investment
Newton Investment Management

Ian Burger is responsible for integrating ESG throughout Newton's investment process. He is also a member of Newton's Responsible & Ethical Investment Oversight Group.Burger helps shape the wider ESG debate through co-chairing the GC100 and Investor Group, and at the International Corporate Governance Network, where he is vice chair.
He is a member of the PLSA's Stewardship Advisory Group, a Fellow of the Chartered Governance Institute and a charity trustee.

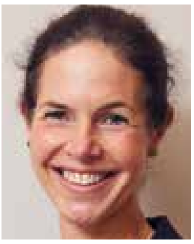
Abbie Llewellyn-Waters
Head of sustainable investing
Jupiter Asset Management

Abbie Llewellyn-Waters has been part of Jupiter's sustainable investment team for more than 15 years where she has helped build an investment framework that embeds all stakeholders into fundamental stock analysis. Llewellyn-Waters is also an ambassador for the Diversity Project, a member of the 30% Club Investor Group and an author for the CFA Institute on Climate and Investing certificate.



Andrew Cole
Trustee executive
BESTrustees

Andrew Cole has been a pension trustee for more than 15 years. He sits on the boards of several defined benefit and defined contribution schemes, is a trustee chair and the sole trustee of a couple of financial institution schemes. A 35-year investment banking veteran in Europe and the US, Cole sits on the Association of Professional Pension Trustees' ESG Working Group.



Henrietta Gourlay
Investment manager
Grosvenor Family Office

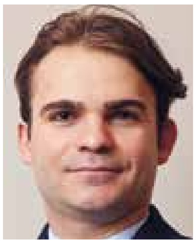
Henrietta Gourlay became an investment manager at the Grosvenor Family Office in 2018 after joining from Mizuho, where she worked on the high yield sales desk. Gourlay also specialised in high-yield bonds at Western Asset Management for nine years having started her career at Mercury Asset Management.

Oliver MacArthur
Senior consultant, impact research lead
Aon

Oliver MacArthur has been part of Aon's global investment manager research team since 2018, recommending sustainable equity managers. The economics graduate has also developed Aon's Global Impact strategy since becoming impact research lead in 2020. Before joining Aon, Oliver researched equity managers for the Church Commissioners for England. He started his career at the Royal Bank of Canada.

Chandra Gopinathan
Senior investment manager,
sustainable ownership
Railpen

Chandra Gopinathan is responsible for climate risks and opportunities at the railway workers pension scheme. Gopinathan has two decades of ESG and sustainable investing experience as well as a track record in credit structuring and portfolio management.

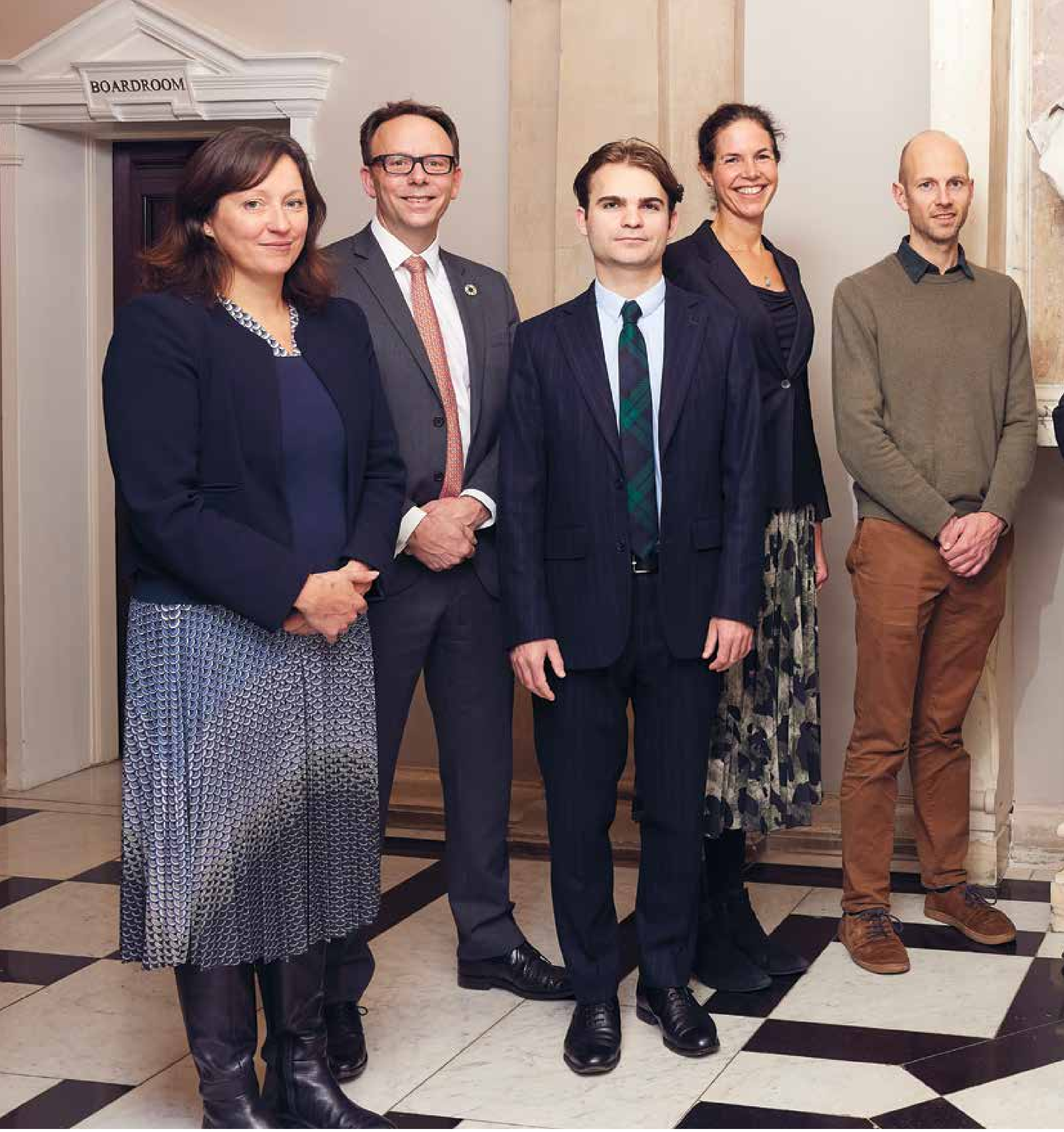


Gustave Loriot-Boserup
Responsible investment manager
London CIV

Gustave Loriot-Boserup joined London CIV as a responsible investment manager in November 2020. Having previously worked as a senior ESG data specialist for a large financial services organisation, he now leads the pool's ESG risk analysis team, providing insight into potential risks and opportunities. He studied the interactions between finance, economics and the environment at the London School of Economics, as well as Climate Change Management and Finance at Imperial College.

Simon Rawson
Director of corporate engagement
ShareAction

Former diplomat Simon Rawson leads ShareAction's work to create collaborative investor engagement initiatives to drive responsible business practices. Prior to joining the charity, Rawson built and led the social responsibility function at management consultancy McKinsey as well as advised global foundations and non-profits on strategy, governance and external relations.



Sustainable investing

Sustainable investing is no longer considered a niche strategy. Pressure from members, stakeholders and regulators mean that institutional investors have to be responsible owners. But what does that mean? We brought pension schemes and asset managers together with a consultant and a campaigner to find out how institutional investors are building a better world.

What does sustainable ownership mean to institutional investors?

Chandra Gopinathan: Sustainable ownership is not new. It has been discussed since the 1990s, when it was known as corporate social responsibility. That has since evolved into a mainstream investing strategy.

For us, it is about universal ownership. As asset owners we own a slice of the world that our members will retire in, so we have a responsibility to be effective owners to create a better future for our members.

Gustave Loriot-Boserup: We use ownership in companies to drive strategic outcomes. Active ownership is one of our most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment. Divestment alone, would leave us with no voice, no potential to help drive responsible corporate practices or add value for our clients.

We have all seen a flurry of net-zero commitments in the past 12 months and sustainable ownership will be a key lever to reduce carbon emissions in the real economy.

Simon Rawson: It is great that institutional investors managing $130trn (£96trn) are committed to a low carbon future, but in the next few years we will find out how that will be implemented. Active ownership will be critical.

Is promoting responsible investing in the current environment as easy as it sounds?

Rawson: ShareAction grew out of a movement 15 years ago that was calling on the Universities Superannuation Scheme to divest from fossil fuels. We talked then about creating a movement for responsible investment. Today it is not a question of asking people to make commitments but about the quality of those commitments, if there are credible plans to deliver them and holding organisations to account when they don't. So, we are not packing up yet.

Ian Burger: The responsible investment industry has been through a significant number of inflection points over the past 20 years, which is why Newton has remained in the space. Arguably, this is the longest and most severe inflection point of those 20 years.

The opportunity is there and we should harness it while recognising that being responsible asset owners means taking the relationship we have with companies seriously. A lot of us do. But there is a lot of greenwashing going on. It is for us, as investors, to demonstrate that we are doing what we say we are, which is critical as regulation evolves, particularly over the next 18 months.

How are asset owners making sure their managers are taking responsible investing seriously?

Andrew Cole: With great difficulty. I have yet to hear a presentation from an asset manager where they are not the best at everything.

Trustees are not necessarily investment experts, so it is difficult. There are organisations that can help us clarify what asset managers or funds are doing as there is a lot of talk out there: sometimes there is action and sometimes, to be frank, there isn't.

I look at it with a degree of cynicism. That does not mean people are not making huge strides forward, but it is difficult for pension schemes to understand, especially with the time they have to delve into the details. So, it is critical that there are rating agencies for fund managers in this space to give us more clarity.

Henrietta Gourlay: It is important to understand what the underlying manager is thinking. We have managers who are not going to be Article 8 [promoting environmental and social aspects of investments] because they are not sure what it means, whereas other managers are Article 8 in everything.

> **The next frontier, aside from biodiversity, will be climate resilience, or physical asset risk, and how we think about that in our portfolio will be increasing material.**
>
> Abbie Llewellyn-Waters, Jupiter Asset Management

So, it is important to understand what they have designated themselves and why. I have heard about someone who every investment they make must correlate with one of the Sustainable Development Goals. They invest in McDonald's, which they said alleviates global hunger.

That is how ridiculous it can be. So, it is important to meet your managers regularly to understand how they are thinking.

Cole: I agree, but pension schemes worth less than £20m do not have the time, or necessarily the knowledge, to do that.

Rawson: It is the role of the consultant to bring clarity and filter out the noise...and there is no shortage of noise.

Abbie Llewellyn-Waters: The investment consultant plays an important role for resource constrained smaller schemes. There are industry standards that are helpful also, including UN Principles for Responsible Investment ratings of investment managers. Interestingly, the UK Stewardship Code has recently reviewed its signatories and removed a third for not meeting the requirements. These are helpful industry oversight mechanisms which smaller schemes can also consider.

The Institutional Investors Group on Climate Change also keeps a list of asset manager net-zero commitments. In that list there are wide spreads of assets under management allocated to decarbonising portfolios in line with the Paris Accord, ranging from 1% through to 100%. Typically, specialist houses achieve 100% of assets under management alignment. When asset managers have broad product range across asset classes of fixed income, equities and alternatives it is more challenging to deliver.

We have allocated 42% of our assets to align to net zero across our developed equity range. That is one of the highest alignments in the initiative for broader asset managers.

The tools and transparency are improving. The Task Force on Climate-Related Financial Disclosures (TCFD) becoming mandatory across the G7 in the coming years will help standardise

> **It is the role of the consultant to bring clarity and filter out the noise…and there is no shortage of noise.**

Simon Rawson, ShareAction

and harmonise some of these issues. So, we are moving in the right direction, but it is worth remembering it took decades to standardise financial accounting. This is a journey.

Cole: The direction of travel is critical. From a trustee's perspective, it is laudable that regulation is being channelled in one direction.

It is great that there are entities developing and pushing responsible investment products, but it is a challenge for trustees who do not have a financial background to sort the wheat from the chaff.

Aon and other information providers help clarify that for trustees, but it is still through their research lens, so trustees could be missing something.

So, it is difficult for trustees to get clarity as this area means different things to different people. That is a challenge trustees have.

I am a former investment banker who used to sell products to asset managers, so in some respects I am fox-turned-gamekeeper. I look to see if fund managers are signed up to the UK Sustainability Code for example. If not, why not? It is not to say that they should be, I just want to understand why they aren't.

As a trustee of small schemes, I do not have the power to change how asset managers run their money, but I can and believe I should ask pointed questions.

Burger: They are great questions. A plethora of them come through to us, often similar but requiring uniquely different responses depending on the client.

The frameworks we are building are slightly running behind what we as investors have been asking companies to develop their reporting against. We are seeing consolidation in those reporting frameworks and that is where we need to be in the next few years.

The Investment Consultants Sustainability Working Group is an initiative helping investors to the next level of reporting to provide consistency by comparing apples with apples rather than apples with oranges.

Gourlay: It will happen naturally. When new regulation comes through this year, companies will have to look for metrics to report on, which should take the onus off fund managers.

Will this new regulation improve the quality and standard of reporting?

Llewellyn-Waters: Harmonisation and standardisation are key to quality. It increases reliability which increases comparability.

We should not be too disparaging about this as it took decades to standardise financial reporting standards globally.

We are on that pathway now and it is accelerating faster than anticipated. We could see meaningful improvement on the horizon. When we look at issuer commitments, the accountability and delivery against the short, medium and long-term targets will be key.

Gopinathan: We don't need more information; we need relevant and succinct information. When it comes to carbon reporting, Scope 1, 2 and 3 disclosures should be mandatory. It would make it easier for asset owners and asset managers to use and contextualize the information to their portfolios and net zero journeys.

Gourlay: It is difficult. The regulation is European and the UK will adopt it, but Indonesia is not in Europe and is responsible for most of China's carbon footprint. There is no way of measuring that, so Scope 2 and 3 become grey areas. I do not know how to look at it from a global perspective.

Gopinathan: In developed markets, with Scope 1 and 2 being mandatory, there are no excuses, but there is a big question mark over Scope 3. That should be resolved as research is happening around how it should be accounted for.

Back to the point about our smaller peers. They may have a lack of resources, but they can still hold asset managers to account, on net zero, for example.

Trustees do not need to be bogged down with knowing where to start with net zero. They should look at their asset allocation, their sector allocation and the countries they are allocated to? This is a great starting point.

Then industry collaborations can help. You can have additional agreements which talk about what you want your asset managers to do, which they are probably doing already. You could have a rating system for asset managers, but that introduces the principal agent problem.

There is a lack of contextualisation of the sustainability themes, such as net zero, to an individual's pension liabilities, which is unique to every scheme. Each pension scheme has a set of unique considerations depending on whether you are open or closed, DC or DB and what the members want. Contextualising that is the scheme's fiduciary duty. No one else can do that for you.

It comes down to the industry collaborations and the team within pension funds. If you don't have a team, make your asset managers do it.

As asset owners we own a slice of the world that our members will retire in, so we have a responsibility to be effective owners to create a better future for our members.

Chandra Gopinathan, Railpen

Loriot-Boserup: Local authority pension pools play a critical role in setting a common strategy and building capacity in terms of sharing knowledge and intelligence. They can also support their partner schemes' TCFD reporting by providing climate analytics on the funds within the pool. There is also the strategic element that comes into play in setting a net-zero target and climate-risk thresholds.

Although I agree that all pension schemes are unique with their own strategic asset allocation, when it comes to climate-related risks schemes tend to have the same exposures. So, setting a common uniformed strategy at a local authority pension pool scheme level can be helpful in tackling resource constraints.

Pension schemes exist to fund members in their twilight years, but trustees are under pressure from regulators and their stakeholders to make greener investments. Should returns be sacrificed to achieve this?

Rawson: There are pension schemes that could listen more to their members to understand what they mean when they talk about best interests. Climate is one example, then there are social equality and health, which are all in the best interest of members.

We would encourage more member engagement and that there may be trade-offs with financial returns but looked at in the long term and across members best interests. That is a judgement for members and schemes to make.

Burger: There is not necessarily a sacrifice to be made here. We can sight plenty of examples, such as ESG Nifty 50 names trading at super valuations because of their ESG profiles and an increasing number of sustainable assets looking to invest in sustainable companies, which are not growing at the same rapid pace.

They are not necessarily mutually exclusive. There is a consideration around your timeframe and we are seeing more strategies and scenarios where there are greater headwinds and tailwinds on certain asset classes. It is ultimately about choosing assets that fit your sustainable definitions and approach.

Llewellyn-Waters: I would go further in that you can enhance returns through a climate lens. Our sustainable strategy seeks a stakeholder balance between planet, people and profit. That intersectionality could improve long-term risk-adjusted returns because ultimately, we are looking for economic resilience from companies living within their planetary bounds.

We saw an example of this last year with a drought in sub-tropical Taiwan, which led to the government rationing water. Manufacturers who had invested in water conservation technologies did not suffer a drop in productivity, giving them a competitive advantage. Those early, long-term investments have given them an economic resilience factor as they realised we are living beyond planetary bounds as a global economy and are adjusting to that.

Human capital is a big component of improved productivity as well, which typically leads to better customer retention.

Electric is better than fossil, but there are other problems it creates.

Henrietta Gourlay, Grosvenor Family Office

Depending on your client's objective and the application of these considerations, it can serve to enhance returns.

Oliver MacArthur: The sustainable transition is shifting the base of competitive advantage. There are going to be winners and losers and companies with the right transition will deliver superior returns.

On the question of return sacrifice, investors already trade returns for fees, liquidity and for their risk profile. Your question is a false choice for me as it is important that investors contextualise their sustainability beliefs with their risk and return. There is a danger of investors zoning in aggressively on their sustainability considerations in isolation but lose touch with risk-return and liquidity.

Gourlay: Pension fund trustees have a fiduciary responsibility to their members. If a scheme is woefully underfunded there must be a temptation to invest in cheap high yielding assets

which do not look good, like oil and tobacco, to fulfil that responsibility. It is a balance between their fiduciary duty and environmental responsibility.

Gopinathan: Between the sustainability strategy and the message, there is a lot of nuance to be factored in. Is a greener portfolio what we are targeting, even if the world remains dirty? Not from our definition of sustainability.

A holistic approach to sustainability is the right way, but there will be situations where emissions may temporarily increase because of that investment strategy. For example, you may have a miner who is on a transition plan which will take time, so emissions will remain high for a few years. How is that messaging going to be presented to members who are expecting a greener portfolio?

Your greener portfolio may not look as green next year, but if there is a story attached to it of a long-term transition, and if you have conviction and are stewarding company actions using voting as an accountability mechanism, that still applies.

Gourlay: There is also a social responsibility. In parts of India and Indonesia, mining drives the economy. There are millions of jobs at stake if those mines close.

Llewellyn-Waters: A just transition was at the heart of the global diplomacy at COP26. That was the tension that they sought to address.

In the global policies coming out of COP, we saw down to the wire the tension around the rhetoric from phasing out to phasing down and that is coming through a social equity perspective. For 100 years we have had unprecedented economic expansion in the developed world and now we are imposing restrictions on developing economies, which is fraught with tension.

It was bare-knuckle diplomacy. John Kerry on Chinese soil last year and the co-operation statement they re-signed at COP was important, but it was hands on shoulders, heads pressed together diplomacy but the two largest emitters are now agreeing to co-operate, so we should anticipate accelerated climate policy.

Gourlay: China can do that because it is outsourcing its carbon footprint to other emerging markets.

Llewellyn-Waters: There is a risk of carbon leakage. That was an aspect they sought to address to stop it becoming cheaper to manufacture in regions where there are less onerous carbon pricing mechanisms because carbon does not care for borders.

We have the design of the Carbon Border Adjustment Mechanism in the EU, which proposes to price carbon content of products at the point of import. Our overarching investment thesis is that there will be an internalisation of carbon costs. This will be material from an economic return perspective going forward.

The divestment angle is well understood, but we must accept that these externalities will come at a direct cost to business at some point. It is less about stranded assets and more about how every company in the world competes on an economically resilient basis. If they have less externality to price in, they are better positioned on margin and market share, which goes to fiduciary duty.

Burger: We have been talking for years about the increased cost of capital that comes from the internalisation of externalities. We are seeing more metrics coming through that can impact financial viability and resilience. The more examples of that we see, the more it needs to be managed.

There are regional biases in Indonesia, for example, where, because of the localised impact signing-up to an initiative would have; we have to recognise that this is a global problem and a concern. It is a global problem that requires a global solution. We cannot get away from that.

Just because a company has great green credentials does not mean it is a viable investment.

Ian Burger, Newton Investment Management

Bringing it down to an investment angle, back in the late 90s and early 00s, capital flows into wind power were fantastic, but they were overpriced and the management of a lot of those businesses was not great. So, just because a company has great green credentials does not mean it is a viable investment.

Rawson: I am going to slightly challenge that in saying that we are ignoring the signs. In one respect, the IEA (International Energy Agency) has made it clear that if we are going to keep global warming to 1.50C above pre-industrial temperatures, there can be no new fossil fuel expansion. If you are an asset owner choosing to pick up cheap assets in oil, gas or coal you need to be transparent about that trade-off.

On the point of the just transition, it is critical that investors create opportunities for those effected by the transition out of these legacy industries – but these are also the populations who are going to be most affected by climate change.

So, there is a lot we could do while waiting for the frameworks, while waiting for things to align. Committing to no further investment in fossil fuels would be a great first step.

In some respects, the renewables coming on stream means that we have solved a lot of that in the energy market, but there are a lot of heavy industries at the beginning of their transitions. We need to create the transparency around the trade-offs.

Loriot-Boserup: Pension schemes are increasingly under pressure to do what seems to be the "right thing". This should not be the goal of responsible investment. Rather, responsible investment is about recognising your fiduciary duty and acting to maximise the long-term interests of your clients or shareholders.

However, local government pension schemes are inherently political organisations and so they may approach responsible investment as a result of their political agendas rather than attempting to maximise long-term returns. This could create sub-optimal strategic asset allocations, not only from a fiduciary perspective but also in terms of their climate responsibility.

We have seen a flurry of net-zero commitments in the past 12 months with some local government pension schemes targeting net zero as early as 2030.

Net zero is not a race, such strategies should focus on reducing carbon emissions in the real economy and support assets and companies that help deliver that transition.

We need a smooth decarbonisation rather than a rapid shift towards net zero. Removing the most carbon intensive investments from your portfolios could be considered greenwashing as you are not delivering impact in the real economy. That is why setting bottom-up targets in your net zero investment strategy, such as engaging with heavy polluters or retaining key sectors in your portfolio, such as mining or energy, are incredibly important in delivering a low carbon economy.

> The sustainable transition is shifting the base of competitive advantage.
>
> Oliver MacArthur, Aon

Climate change is an enormous challenge. We need science-based tools and risk-based metrics to set our strategic agendas.

Is the renewables market mature enough to meet the demand for energy, especially as the government wants to increase the number of electric vehicles on our roads?

Gourlay: We have a 2015 hybrid car which has stopped fully charging. The question is, what happens when all these hybrids need to recycle their batteries? Electric is better than fossil, but there are other problems it creates.

Burger: There is a European company that recycles batteries, so there are opportunities there.

Significant capital raisings illustrate that there is a funding gap in renewables, especially in its infrastructure. The returns are attractive and that is fundamental. Three or four years ago, we started to see an equilibrium in the return profiles of renewables and fossil fuels.

That creates its own market. There was a recent capital raising for a renewable infrastructure fund which was well over-subscribed. That will continue.

Gopinathan: In 2020, nobody predicted that gas prices would be where they are today. There have been unpredictable consequences of the journey to net zero. This does not need to derail or slowdown such commitments, but we need to acknowledge that there are limitations in terms of where we stand today.

Are we positioned well enough on the renewables side to have the security of supply to avoid a heat or eat situation? We need to be honest about such things to strike a balance. There are things we do not know that we need to learn as every year goes by, so our sustainability strategy needs to be flexible to incorporate those inputs.

Re-adjustments may need to be made, perhaps because of the just transition, alternative fuels being more capital intensive or questions about whether certain technologies will work or not.

Rawson: The bottleneck for industry in the UK is on the regulatory side, in the consenting process. The capital is there, the industry is standing ready, it is a massive job creating opportunity but if it takes 10 years to consent a wind farm…

There is a lot the government could do if we are to get through those challenges. That is another trade off we need to be honest about.

Llewellyn-Waters: There is a tenure tension across everything we have discussed. The average chief executive is in place for seven years, good governance dictates nine for a non-executive director, you have a 30-year net zero action plan that needs to be delivered, democratically elected officials sitting on pension fund capital decisions on a four-year cycle and local governments in charge of planning development on a four-year cycle. We need to address this tenure tension with the actionability of the plans we look after.

The only way to do that is to deliver short, medium and long-term targets. Those in the position of stewardship, whether it is a democratically elected position, a corporate position or a material risk taking position, the accountability of the investee companies will be crucial to deliver against these multi-decade strategies.

Rawson: How about tying long-term incentives to long-term performance? I would like to get out of this cycle of being fixated on the short term.

Gopinathan: That will not ensure short-term targets will be met. The issue is the short-term needs to drive the long term. How do you ensure there is delivery around the short and medium targets to keep the long-term on track?

Loriot-Boserup: On the topic of renewable energy and the trade off with other sources, such as natural gas, what are your thoughts on the EU Taxonomy and the integration of natural gas and nuclear energy?

In the initial draft, these energy sources were technology agnostic in that to be compliant with the taxonomy you needed a carbon footprint of under 100g per kilowatt hour. There has been a lot of push back from some countries for the integration of natural gas as an EU Taxonomy compliant industry.

Rawson: It is a political outcome. I am more interested if gas and nuclear will be allowed within the UK equivalent of the EU Taxonomy.

Llewellyn-Waters: The IEA has said they are part of the solution. We are mindful there is a political element to the taxonomy accreditation.

Cole: This debate is interesting because it shows how complicated this is for trustees. We have a fiduciary responsibility and have to engage with our members, but the reality is that at least in the defined benefit schemes I am involved with, no individual has yet asked where we stand on ESG. That is probably a function of the age group, which is slightly older.

For defined contribution schemes, which have younger members, it is particularly important in terms of fiduciary responsi-

bility to offer individuals a diverse set of assets.
To the point on local authorities, if a pension scheme decides to be 'green' and the returns are not there yet, then the constituents of that authority will have to pick up the tab. That is not necessarily a bad thing, but it comes with risk. This risk may or may not be something that is acceptable to corporate schemes.
Change brings opportunities, but from a trustee's point of view, you are highlighting how difficult our position is to make rational decisions.
MacArthur: You raise a fair point on the patchwork quilt of regulation in the EU along with the FCA developing their own version of the taxonomy.
Navigating these acronyms can be confusing even for professionals, and I am concerned about the implications for middle market asset managers.
If you are a sustainability boutique, you can pivot quickly onto the new reporting requirements at speed. By contrast, if you are a bulge bracket manager, you may have millions of pounds to invest in data per year. The middle ground of the market may struggle and I am cautious about the unintended competitive effects of this regulatory patchwork.
Llewellyn-Waters: Are clients enquiring about transitioning portfolios?
MacArthur: The enquiries are increasing and flowing through the investment value chain, and rightly so.
Interestingly, I spoke to one investor recently who said his most aggressive hiring was in the request for proposal team to address all the ESG questionnaires they receive. From a consultant perspective, there are choices to make about streamlining and focus and whether the questions we ask are value added and get the clarity needed rather than adding to the acronym zoo.
Llewellyn-Waters: Could we talk about physical risk? A net-zero economy supports a 1.5oC scenario and a 1.5oC scenario is a warming scenario which requires adaptation.
The next frontier, aside from biodiversity, will be climate resilience, or physical asset risk, and how we think about that in our portfolio will be increasingly material because we are committing to a warming world. It is hard to slow that warming down, but it is still warming and we need adaptation.

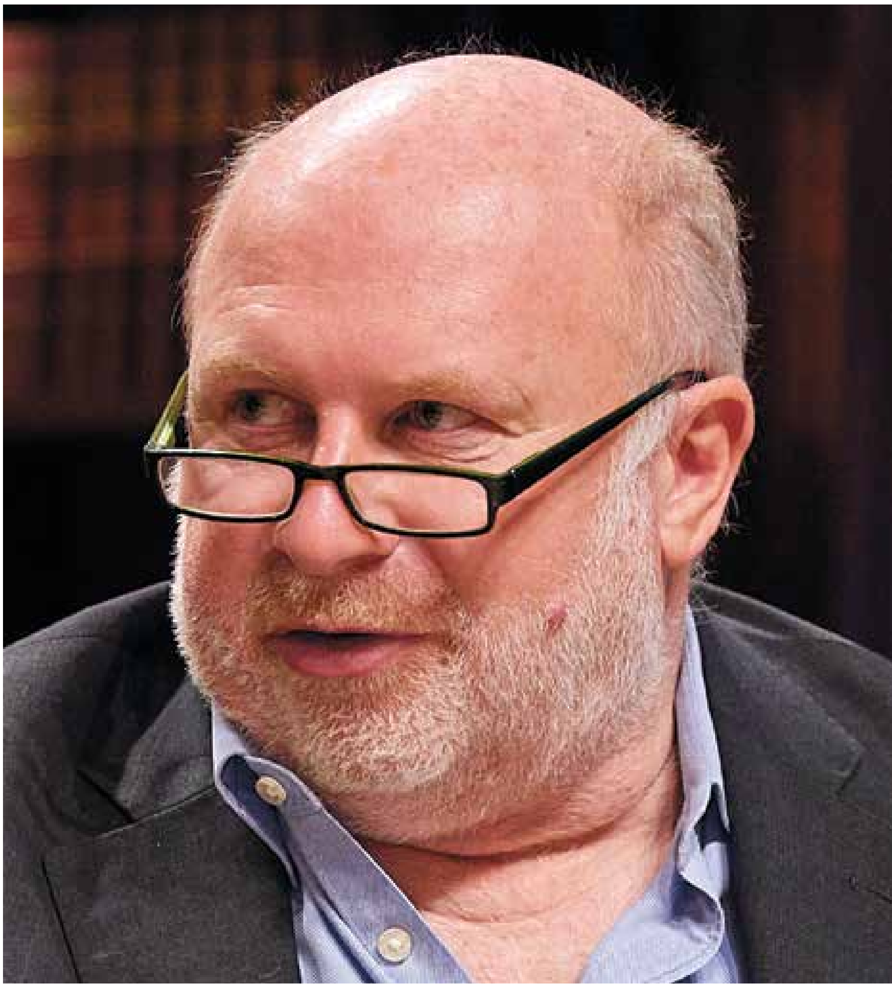
Is the quality of data improving?
Burger: The reliance and consistency of data is becoming more of an issue. We took a portfolio and mapped it against three methodologies. One came out at 1.5oC, one at 2.5oC and one at 4oC. That is not healthy.

We need a smooth decarbonisation rather than a rapid shift towards net zero.

Gustave Loriot-Boserup, London CIV

I do not have access to a lot of data, which is part of the problem.

Andrew Cole, BESTrustees



Loriot-Boserup: Forward looking metrics such as implied temperature rise metrics are incredibly important in the transition to a low-carbon economy. However, these are only as useful as your understanding of the methodology, its assumptions and limitations behind them. These tend to vary significantly between data providers.

High-level statistics are usually not that useful, but they guide you to the portfolios you should focus on. Once you have the implied temperature, check that specific sectors are within their 20C threshold or the carbon budget. Then you can dig into specific issuers.

Rawson: If I could leave one message on the table it would be for all parts of the value chain to send signals through their consultants to managers that they have a stewardship responsibility and should be engaging with high emitting companies.

Gopinathan: Engagement impact is an area which is less focused on. There is talk around how greenwashing relates to carbon metrics and disclosure, but quantifying engagement impact and keeping the feedback loop going to get enough data to see what has been accomplished is crucial. We need more clarity here. You have made three calls to a company this year, but what does that mean? What change have we affected?

How much weight do you put on data when making investment decisions, Andrew?

Cole: I do not have access to a lot of data, which is part of the problem. So, I am looking for guidance. Trustees engage with managers maybe once a year, so it is difficult to get into the granularity of what they are doing. It is a complex area and is why there are a lot of firms providing information about how managers are performing. Some are doing it in a thoughtful way and some are not, but it costs money.

We are here to provide pensions for our members and so want to minimise costs. If I spend £20,000 for a scheme with £5m in assets to hire a consultant, it is something we think about. This is why my big plea is to have clarity and uniformity in data, to have analysis that is equivalent to Moody's and S&P for the smaller schemes who do not have the resources to cut through everything.

There are lots of different acronyms and data firms are doing a lot of good work, but I am trying to unify that into a simplified way, because if I am in a four-hour board meeting, only 30 minutes could be allocated to investment.

People are willing to consider these issues, but there is a time limit. It is an important risk, so simplifying it for our benefit would be great.

Abbie Llewellyn-Waters
is head of sustainable investing at Jupiter Asset Management

OUR HOPES FOR PEOPLE, PLANET AND PROFIT

Abbie Llewellyn-Waters, who leads Jupiter's Global Sustainable Equity strategy with Freddie Woolfe and Jenna Zegleman, sets out the progress the asset manager would like to see in 2022 and in the years ahead on climate change, inequality and biodiversity.

This decade is key if we are to achieve the necessary progress in tackling the multi-decade challenges facing the planet we live on and the people we coexist with. In 2021, financial markets were largely driven by short-term considerations, but for long term economic prosperity we need to look beyond the near term to address vital issues.

For this reason, we focus on companies leading the transition to a more sustainable world. This requires a long-term outlook, in line with solving vital issues facing climate change, inequality and biodiversity. The imperative for sustainable investing has never been greater.

Action on climate change

COP26, the intergovernmental climate change conference that took place in Glasgow in November 2021, was a milestone in the acceleration of policy change to address emissions reduction and biodiversity decline. While the outcome of the conference could have gone further, the direction of travel is clear. We have held the view for some time that there needs to be global collaboration around carbon pricing and there was positive momentum from COP26 around these policy measures. Governments pledged to revisit and strengthen their 2030 targets to align with the Paris Agreement goal of limiting global warming to 1.5oC above pre-industrial levels.

We are hopeful that the ambition gap will be addressed. We expect to see greater collaboration, led by the reiteration of joint commitment from the US and China, and that there will be a rapid but just transition to a low carbon future.

As investors, we need to see clear actionability and irreversibility from companies as they move to decarbonise their processes. Companies able to tangibly reduce carbon emissions, rather than offset, will be better positioned to deliver sustainable returns as increasingly we see externalised costs becoming an internalised cost of doing business. In 2022, we except to see further policy acceleration to address the current mispricing of the use of nature. It is vital that companies move to live within planetary bounds and mitigate their environmental impact, from a resilience perspective but also from a financial one. This also applies to our own company, of course. Jupiter is a signatory to the Net Zero Asset Managers Initiative and has committed to align its operations and investments with net zero emissions by 2050 or sooner.

It is important that the transition to a low carbon future is a just transition, uniting climate change with social justice. At COP26, for the first time the just transition was core to the agreement, acknowledging the importance of fairness in how the burden of addressing climate change is borne.

Compensating vulnerable nations for loss and damage caused by climate change has also started to enter the dialogue and sets a trajectory for commitments on financing by richer nations to lower-income countries. The developed world has enjoyed more than a century of unprecedented economic growth at significant environmental cost. It is imperative for the global climate action success that developing nations avoid a similar environmental crisis.

Action on inequality

In addition to investing in companies leading the transition to a more sustainable world, we also seek companies which are driving a transition to a more inclusive world.

Covid has exacerbated and revealed social inequalities. The economic shock caused by Covid-related closures has fallen disproportionately on vulnerable groups. In the US, the unemployment rate skyrocketed at the start of Covid, across the board, but the impact was significantly greater for those individuals with less than a high school diploma. Similarly, during the pandemic when children were unable to attend school, access to technology became imperative for the continuance of education, again disproportionately impacting those with more limited resources.

Covid has led to the increased vulnerability of many women, particularly in terms of financial independence, and to many exiting the job market altogether. Worldwide, women's labour force participation has rapidly declined. This has a wider reaching social impact, as there is a correlation between female underemployment and children living in poverty. We look for improved wage transparency, and higher participation of women in the work force as an indicator of high-quality businesses.

Action on biodiversity

Addressing the loss of biodiversity is increasingly becoming a key topic for policy makers. Half of the world's GDP depends on biodiversity, yet we continue to use natural resources at an alarming rate. COP15, the intergovernmental conference on biological diversity, started in Kunming, China, in October 2021, and will continue there in April 2022.

Our hope is that lessons learned from climate change will be usefully applied to the urgent need to reverse loss of biodiversity. Companies' impact on nature will increasingly be re-evaluated as a cost – just as has happened with carbon.

Just as with carbon, the internalising of externalities around biodiversity will present opportunities and risks. While companies have been producing carbon data for a long time, the measurement of companies' impact on nature is nascent. There are already frameworks coming into force in the next few years to improve standardisation of disclosure, notably the Taskforce on Nature-related Financial Disclosures (TNFD).

This is a positive step but one that needs to be followed with clear actionability and irreversibility from companies. Addressing these challenges is of enormous importance now, for our society and for our long-term capital growth objective. The imperative for sustainable investing could not be greater.

JUPITER
ASSET MANAGEMENT

Ian Burger is head of responsible investment at Newton Investment Management

ESG AND DATA: THE NEED FOR CONSISTENCY

The growth in environmental, social and governance (ESG) data providers has been prolific in recent years, leaving no shortage of information for investors to pour over. The issue, however, is that there is no internationally agreed framework on ESG standards and, thus, little consistency in how data is collected and reported by these third-party data providers. There are also gaps and misalignment in the types of data and methodologies used for handling data.

As responsible investors, we need to have confidence in the public statements and reports published by the companies we invest in. If anything, as sustainable investing grows, the reliance on data is becoming increasingly evident, as is the need for that data to be consistent and of high quality.

As an industry, we must be conscious of the methodologies data providers use and ensure that we are aligned with them. We anticipate that data providers should soon expect to receive increased regulatory attention as more and more capital is directed into specific sustainable and ESG-related strategies off the back of third-party ESG ratings providers.

An independent view

At Newton Investment Management, while we are cognisant of third-party ratings, we think it prudent to focus more on the raw data provided by companies, where this is available and accessible. This data is often either audited or assured and reported directly by the companies themselves.

That is not to say that we don't believe that third-party ESG data can be a useful tool; it is important to understand where third-party data providers' and rating agencies' current thinking is, as part of a holistic approach to assessing the sustainability and ESG credentials of companies. We believe it is also important to understand and be comfortable with the methodology one is choosing to rate investments from a sustainability or ESG perspective.

A consistent approach

Take the tackling of climate change, for example. While this is still a nascent area, examining the temperature alignment of a portfolio to see if it is consistent with the goal of minimising global warming is among the most developed in terms of analysis within the ESG area. Again, the need for consistency comes to the fore.

At Newton, we have taken a random portfolio from across our investment universe and undertaken a temperature alignment analysis of it using three different methodologies: one came out showing it to be aligned with a 1.5-degrees Celsius rise, the second methodology indicated a 2.5-degrees Celsius rise, and the third revealed a rise of 4-degrees Celsius.

Given that significant disparity, the natural tendency would be to pick the one with the lowest temperature increase, but because this is a nascent space where methodologies are changing frequently, it is not a question of selecting the one with the best results. Instead, providing a consistent methodology so investors can make a comparison between different strategies and companies' ESG credentials is paramount.

Once the correct approach has been determined, it needs to be maintained and widely adopted, but we are yet to reach the point at which the best approach has been determined and adopted across all industries, including the investment industry.

There are frameworks being developed to this end, notably from CDP (formerly known as the Carbon Disclosure Project), which has been reporting for more than a decade, and which is providing some consistency because it requires companies to report against its framework. However, the CDP framework is not being reported consistently across different jurisdictions – a requirement for most global investors.

Setting the standard

At the United Nations Climate Change Conference (COP26) last November, the International Sustainability Standards Board (ISSB) was created to work alongside the long-standing International Financial Reporting Standards (IFRS) on accounting standards.

The ISSB will be convening soon to establish a board which should start producing a framework and methodologies during the next 18 months to two years, so that companies can be provided with a useful structure and guide rails to determine the qualitative factors needed for consistent and efficent ESG data reporting.

Accounting frameworks and standards have been in place for over a century, and while there are no agreed accounting standards for ESG considerations as yet, we believe a shift in momentum is finally under way.

As a member of the IFRS Advisory Council, I see first-hand how various parts of the accounting standards framework are under constant and thorough scrutiny and review to find the path of best fit across all stakeholders.

We believe the ISSB will ultimately follow a similar model, using stakeholder inclusion to arrive at the best possible framework to ensure a level of consistency for the global ESG rating of individual companies.

NEWTON
Investment Management

Governments want greener roads

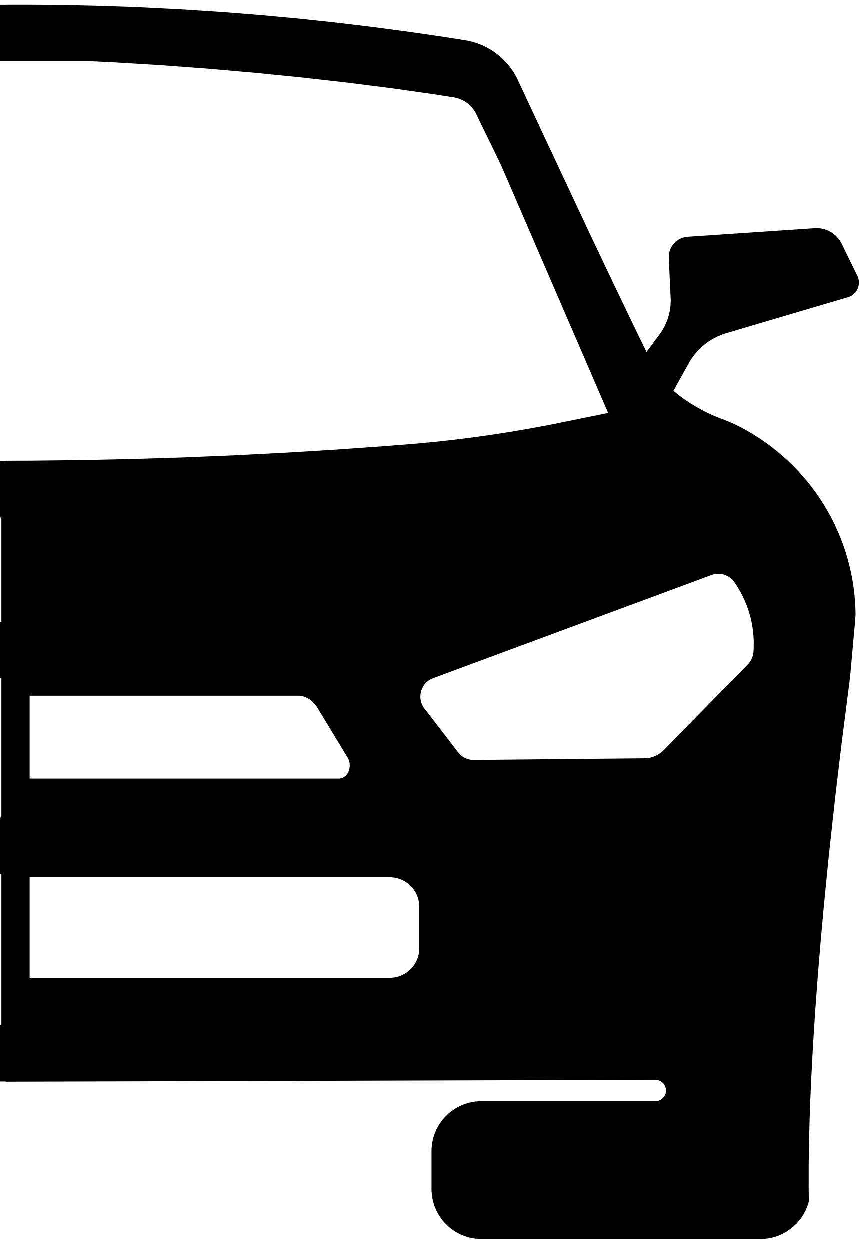
and investors are funding this revolution,

but is the world ready

to dump oil for electricity?

Mark Dunne reports.

ELECTRIC DREAMS



The internal combustion engine is an endangered species. Its death warrant was signed by prime minister Boris Johnson last year when he banned the sale of new petrol and diesel vehicles from 2030. Any new car or van sold in Britain from this date must be powered by electricity, although some petrol-electric hybrid models will get a further five years grace.

The move is part of the government's plans to decarbonise the UK economy by 2050. The public appear to be behind the strategy, with sales of electric cars jumping 186% during 2020, or by 108,000, according to the Society of Motor Manufacturers and Traders.

There are reported to be around 200,000 electric cars driving on Britain's roads today and their number is expected to accelerate. In May, 6.5 million people told energy watchdog Ofgem that they intend to buy an electric vehicle within the next five years. This is one in four (24%) British households, and their motivations for ditching petrol for battery-powered vehicles is clear.

Cars, vans, trucks and buses in developed economies are responsible for almost a third (30%) of the world's harmful gas emissions, the United Nations believes. In the UK, the government puts the figure at 27%, so failing to make our roads cleaner greatly reduces the chances of the UK achieving carbon neutrality. To help make this transition easier, Johnson has committed £2.8bn to the strategy. But is this enough?

Having sufficient infrastructure to facilitate a switch to battery-powered cars within nine years is ambitious. Unless the high cost of vehicles, not having charge points close to every home in Britain and batteries that are only powerful enough to drive short distances are tackled, the government is unlikely to see widespread use of electric vehicles.

Another concern is whether the national grid will have the capacity to satisfy the increase in demand. This has been given more weight in the debate considering the rises in energy prices this year partly caused by a supply-demand imbalance.

"The UK's 2030 target could be achievable," says Rebecca White, a responsible investment analyst at Newton Investment Management.

"But the devil is in the detail as to how we get there. We face notable challenges."

Three challenges

Boosting the number of electric vehicles on Britain's roads will mean removing the three barriers mentioned earlier. The largest of which is the high cost of battery-powered cars, which is deterring 59% of those questioned by Ofgem from buying one.

"It is costly to switch to an electric vehicle," White says. "Lower income individuals will be priced out of the market because, outside of China, there are no low priced EVs."

However, as part of the government's 10 Point Plan for the Green Revolution, £500m of the £2.8bn package has been earmarked to reduce the asking prices of some electric vehicles. This means covering £3,000 for vehicles worth less than £50,000. But is this discount deep enough to drive higher sales?

Indeed, a SEAT e-Mii will set you back £16,000 for what is a small car that only has the capacity to drive 135 miles before needing to be recharged. At the other end of the price spectrum, you can expect to part with almost £120,000 for a new Tesla Model S.

A short battery life was a reason behind why 38% of respondents may not buy a new car after 2030. Who can blame them? The RAC are unlikely to rescue you on the hard shoulder of a motorway with a fresh supply of electricity. Or perhaps one day they will have vans designed to do just that.

Part of what White calls "range anxiety" is the slow speed of vehicle charging, which can take from 30 minutes to 12 hours, but this "will improve going forward", she says.

Before working on improving the speed of charging a car battery, governments need to build charge point networks to ensure that there is one close to every household, in town centres, rural areas and along motorways. Having nowhere to charge their vehicle close to their home was noted as a concern by 36% of the drivers the regulator spoke to.

This is a big job. Accountancy giant Deloitte estimates that by 2030 the charging infrastructure needs to be 10 times greater than it is today and could cost between £8bn and £18bn to build.

The UK Committee on Climate Change, an independent body that advises the government on emission targets, estimates that 280,000 charging points are needed in the next nine years to avoid a decline in the sale of new vehicles.

Sin stocks

Yet the biggest challenge for auto companies could be convincing investors and consumers that their green products are as green as they say they are. They want to show that "dieselgate", where Volkswagen's green cars were programmed to activate their emissions controls only when tested, was a one off.

This is important as it is not just about selling cars but attracting investment, too. "Legacy issues such as EV infrastructure and charging speed need to be watched closely," White says

This is not just a reference to the Volkswagen scandal. "The auto sector, it is fair to say, often lags other sectors on ESG. This is not just a hangover from 'dieselgate'," White says.

Auto is the worst-performing sector in the Corporate Human Rights Benchmark, where two-thirds of companies score zero on due diligence indicators.

The sector also does not perform particularly well on the World Benchmarking Alliance, which compares performance against the UN's Sustainable Development Goals. "It is a sector where ESG improvements and the need to demonstrate sustainability is apparent," White says. "There is a significant runway for improvement."

And there is plenty of room for that with electric vehicles. Investors should not fall into the trap of believing that they do not have a carbon footprint and are examples of sustainable excellence. The weak link here is the battery supply chain.

Many of the components in these batteries are made from nickel, lithium and cobalt. There are significant environmental impacts of mining those materials as well as the social challenges of potential child labour and human rights abuses.

There have been efforts by institutional investors through engagement strategies to make developing world miners more responsible, but there is still a lot of work to do. "The social impacts of the transition will be a challenge if we want to shift to a greener economy," White says.

> **The auto sector, it is fair to say, often lags other sectors on ESG. This is not just a hangover from 'dieselgate'.**
>
> Rebecca White, **Newton Investment Management**

There are more sustainable fuels than petrol, but they are still problematic in terms of their environmental impact.”

Rebecca White, Newton Investment Management

Hard targets

To meet political targets and an expected rise in demand from sustainably-conscience consumers, automakers have set some steep targets. Volkswagen, for example, wants 20% of its sales to be electric vehicles, up from 3% four years ago.

White believes there is the capacity in the industry to meet demand. She is seeing companies retrofitting existing plants, while some are constructing purpose-built factories, which are designed for one aim. “The ultimate goal now is that we have the technology to decarbonise vehicles, and scale up facilities to bring costs down, so that electric vehicles become widely accessible and more profitable,” White says.

But this is not just about changing the vehicles that auto companies are making. Some are changing their structures to position themselves for broader industry changes.

Volkswagen, for example, has launched a mobility services division. “You could criticise that as simply marketing, but perhaps it is more about focusing on changing consumer travel habits and building a model that is resilient to that,” White says.

This changing and growing market is what institutional investors are backing and current figures show that they are doing just that. Electric carmaker Tesla’s market cap hit $1trn (£732bn) for the first time in October and traditional car companies have issued green bonds to fund their electric plans. Toyota, for example, has successfully issued six.

Then there are the market penetration figures. “In September, EV sales in China were almost 20% of the country’s auto market, while in Europe it was in the mid-teens,” White says. “We are seeing significant news-flow in this space that indicates that there is interest here,” she adds.

Backing such companies is part of pension schemes’ remit to protect savers from climate risk. “The green premium they are attracting can be significant and proves there is growing interest in this space,” White says.

But it is not just about environmental benefits. There are structural motivations, too. “If decarbonisation is something we must achieve over the longer term, then investing in companies that are well positioned for this shift will ensure a level of resilience over the next five to 10-plus years,” White says.

Cheese and wine

Electricity is not the only alternative to petrol and diesel. Prince Charles hit the headlines in October when showing off his 50-year-old Aston Martin, which he explained is largely powered by “cheese and wine”.

Yet some claim bioethanol made from food stuffs, which can include palm oil, does, although cleaner than burning fossil fuels, damage the environment.

Greg Archer, a director of clean transport campaign group T&E, was quoted by *The Guardian* as saying: “On a large scale, biofuels do more harm than good, driving deforestation and land use change that worsens the climate crisis.”

While White acknowledges that it is challenging to produce biomass sustainably, it could still be an alternative in areas where emissions are harder to tackle as batteries will not work, such as air travel.

Hydrogen, an alternative to natural gas, needs perfecting. “The technology is not quite there yet and there are many shades of hydrogen...blue, grey, green,” White says.

The point is that, as yet there is no perfect alternative to fuelling cars, planes and trucks. “There are other options, which are not without their challenges,” White says, “and these challenges could be more significant than batteries from an environmental perspective. “There are more sustainable fuels than petrol, but they are still problematic in terms of their environmental impact,” she adds.

The long game

Solving the problems that have featured in this article are essential if we want to decarbonise the global economy. There is no other way. We must overcome these barriers to wider adoption that many consumers and manufacturers are facing.

“We have to think about EVs as part of the sustainable solution,” White says. “Like all things we consume, it is not just about getting sustainable products, but also tapping sustainable means of consumption. There is a bigger picture to think about.”

It is a picture that governments, manufacturers, consumers and investors need to buy into to make this revolution a reality.

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