pi ESG CLUB

Institutional investing has changed. Sustainable strategies are no longer considered niche; there is a strong argument that they have become mainstream, especially for long-term investors.

In response, fund managers are launching sustainable-themed funds that target issues such as equality, climate change and water conservation. This change in approach is partly the result of pressure from pension scheme members, but it is also being driven by regulators with pension schemes having to show how they are protecting savers from climate change. The government banning new petrol and diesel cars on the UK's roads from 2030 and announcing plans to launch a sovereign green bond shows how attitudes are changing.

Because ESG investing is now a major consideration for pension schemes, we have assembled a panel of asset managers and consultants to discuss some of the biggest issues of environmental, social and governance standards.

Welcome to *portfolio institutional's* ESG Club.

Members

THE NEW NORM: ESG DISCLOSURES AND SCIENCE-BASED TARGETS

Thomas Dreier is co-founder and CEO of DFGE, a sustainability-focused consultancy

Today, it is not only legal guidelines but also public attention and stakeholders' interests on ecological sustainability which persuade companies to step up environmental action. This is as critical for suppliers of raw materials and manufacturers as it is for retailers and service providers, since they are all part of the value chain, responsible for the environmental impact of a product, service or industry sector.

The Paris Agreement paved the way for driving more action among businesses. With climate change, its impacts on resource scarcity and the vulnerability of ecosystems regarded as serious threats to businesses, they are now actively seeking to respond and transform.

There is a huge shift towards sustainable practices. Tracking progress towards the Paris Agreement and its climate goals was among the top topics at the World Economic Forum 2020 and COP 2021 in Glasgow. One key factor pushing corporations to implement sustainable business practices are their investors. There has been rapid growth in the number of investors demanding companies reduce their environmental footprint, while delivering financial results. Larry Fink of Blackrock re-stated in his 2022 CEO letter that climate risk is investment risk, and that Blackrock is "increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures".

Companies that set ambitious climate targets can build long-term business value, drive efficiency and safeguard their future profitability in several ways:

- **Innovation:** Becoming a low-carbon business drives the development of new technologies and operational practices. Businesses that adopt ambitious targets will lead the innovation and transformation of tomorrow.
- **Reduce regulatory uncertainty:** Businesses acting now will stay a step ahead of future policies and regulations to limit carbon emissions.
- **Strengthen investor confidence and credibility:** Companies taking a leadership position on climate strengthen their credibility and status amongst their customers, employees, policymakers and campaign groups. A proactive approach helps increase integrity, profitability, and competitiveness.

Adopting bold targets can ensure a lean, efficient and resilient business in a world where carbon becomes increasingly expensive. This could make a material impact upon profitability. The Science Based Targets Initiative (SBTi) has developed the ideal mechanism for companies to set such targets and take a leading position. By independently approving whether targets are in line with the latest climate science, the initiative is considered the gold standard for target-setting.

Next step: Tackling net zero

Momentum behind net-zero commitments comes as the European Commission announced its plans to cut EU greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels, part of its European Green Deal and commitment to achieve climate neutrality by 2050.

Companies play a critical role in reaching net-zero. They have a responsibility to reduce their environmental impact and to cut their emissions according to science-based pathways. More than 2,800 companies are already doing so through the SBTi, a signal of the commitment of major companies and the importance of defining common science-based strategies to transition towards a climate-neutral economy. The first companies with science-based net-zero targets have now been approved.

Steering sustainable future investments

Policies must address the unfavourable economics of immature low carbon technologies, enable companies to overcome threats to existing revenue models and provide, long-term certainty for large transformational investments in capital intensive breakthrough technologies.

Increased public financing is required to de-risk private investment and support the development of new infrastructure. Reforms to improve transparency of climate-related data will help underpin efforts to incorporate climate risks into financial regulatory frameworks and develop transition risk modelling among financial institutions, helping to align capital allocation decisions.

Action on policies and regulation must be matched by action in the private sector. Among corporates, low-carbon investment decisions will be supported by emissions reduction commitments aligned with the EU's carbon neutrality goal, and the integration of climate into financial planning, strategic planning and corporate governance frameworks.

The information companies use to inform about their investment strategies, is in many cases, the result of disclosing to CDP. The theory of change is that disclosing quality data leads to smarter decisions and informs investors, companies and governments of the actions they need to take. CDP's annual disclosure process enables new insights and evidence-backed behaviour.

Disclosing on ESG practices and setting science-based targets are becoming key differentiators for businesses to demonstrate their alignment with requirements from investors and policymakers to exist in a 1.5°C world. Incorporating the disclosures into their business strategies, companies can show the investment community that they have a vision to build long-term business value, drive efficiency and safeguard their future profitability. Going forward, they will become the new norm.

This article appears on CDP's website

ESG: IS THE TAIL WAGGING THE DOG?

Do pension schemes rely on asset managers for ESG insight or make their manager selection based on it? *Andrew Holt* takes a look.

How asset owners approach environmental, social and governance (ESG) issues has come under the spotlight as there are significant differences in how they address the issue.

A study by consultant Chestnut Advisory says asset owners rely on asset managers for their ESG strategies. This seems an interesting insight, as should it be the asset owners who dictate their approach to sustainability issues?

The study states this is happening because asset managers are ahead of the game on ESG.

Chestnut Advisory's chief executive, Amanda Tepper, notes that it is asset managers, as well as consultants, who have developed different investment styles in this area and formed the thriving terrain that ESG investing is today.

But have asset managers done this because they were nudged by asset owners?

This in turn will set aside the ESG thought leader asset mangers from the rest, Tepper said. "Over time we expect managers who are viewed as among the smartest on ESG issues to gain an edge over their competitors with investors who value their ESG expertise."

This contrasts with a poll last year which presented a different picture: one of asset owners believing that many asset management products use ESG as a marketing gimmick that do not deliver on their stated objectives. This highlights a clear lack of trust on ESG and has led to allegations of greenwashing amongst asset managers.

Limited practices

Another, more recent survey, questions, in part, the ESG work of asset owners: revealing that there is, in fact, limited ESG practices within asset owners' portfolios in the US and Europe – with only a quarter integrating ESG scoring into their investment manager selection processes.

That said, this area of ESG is developing and there is no standard approach. So, asset owners cannot be blamed for having an incoherent approach in an area that is, by definition, still pretty incoherent. In this study, asset owners said data gaps in company social and environmental performance reports remain their top concern: an issue that strikes at the heart of the ESG process and why efforts to measure it lack validity.

Sustainability role

Another study stated that the majority of asset owners say environmental and sustainability considerations play a major role in manager selection, turning the findings of the first study on its head. This has asset owners shunning managers that are not embracing the drive toward responsible investment.

What these often conflicting findings reveal is that ESG is a vitally important issue, but a lack of uniform approaches and measurements mean it is difficult to assess where we truly are in the ESG journey. For asset owners it is something of a maze.

The UN Principles for Responsible Investment (PRI) has identified the importance of the ESG dynamic between asset owners and their external managers but has its own take on the issue: indicating it is important both parties work together on ESG-related investments and practices, but it is the asset owner that can shift the debate.

"Once asset owners understand and can articulate their ESG values and beliefs, they have a powerful voice to influence the mandates of investment managers," it noted in its report.

"Having a consistent ESG approach that outlines clear expectations is critical in allowing investment managers to regularly focus on ESG factors in their investment decision process.

Clear communication and transparency from asset owners to their investment managers was identified as key to increasing accountability," the report read.

In an attempt to provide a transparency roadmap on the issue, late last year the CFA Institute released its Global ESG Disclosure Standards for Investment Products, providing a detailed list of recommended disclosures of ESG investments.

"This," said the institute, "includes, but is not limited to, approaches that are often referred to as ESG integration, exclusion, screening, best-in-class, thematic, sustainability themed investing, impact investing and stewardship."

As a transparent basis for ESG investments this is a good start, but these standards, like much else in ESG, are voluntary.

Rachel Pine is head of content for conferences at the PLSA

PLSA RECRUIT INFLUENTIAL LINE UP FOR EDINBURGH CONFERENCE RETURN

Investment Conference 22 brings some of the world's most influential speakers on the economy, financial markets and the political environment to Edinburgh!

The war in Ukraine, the aftermath of the Covid pandemic, the post-Brexit environment, strict climate regulation, rising inflation rates and unusual, perhaps structural changes to the labour market are conspiring to complicate the near- and mid-term investment outlook. For investment professionals needing to meet pensions promises or tasked with growing the pots of defined contribution (DC) savers, it has never been more important to understand the various factors impacting markets.

With these challenges top of mind, the PLSA made a conscious decision to fill this year's Investment Conference programme with world-leading speakers to discuss and debate these issues and others. We are excited to be presenting, live and in-person, a speaker line-up comprising global authorities on numerous topics of critical importance to investors, including the economy, politics, saver behaviour, infrastructure investment and the work revolution. Multiple perspectives will be explored as well – in addition to our annual panel of scheme chief investment officers, this year we are debuting an all-asset managers panel, populated by speakers who invest $15trn (£11.5trn) on behalf of investors around the world.

From international economist **Dame DeAnne Julius**, who was a founding member of the Bank of England's rate-setting Monetary Policy Committee, as well as a former chief economist of Shell and British Airways, straight through to noted political broadcaster and journalist **Adam Boulton**, most recently of Sky News, the Investment Conference 2022 programme is packed with expertise, experience and excitement, designed specifically to give pensions investors an edge in the months and years to come. Julius is discussing the global economics scene and Boulton will give an in-depth view of UK politics.

Noted behaviourist, broadcaster and the *Financial Time's* 'Undercover Economist' **Tim Harford** will discuss how to influence saver and investor behaviour to achieve common goals – aimed at increasing saver engagement with their pensions – an issue that bedevils so many PLSA members.

Scheme chief investment officers **Mark Fawcett** of Nest, **Jason Fletcher** of LGPS investment pool London CIV and Marks and Spencer's **Simon Lee** will discuss how they plan to meet various investment challenges and how they invest differently on behalf of their different types of schemes.

The UK's Productive Finance Working Group has given its recommendations on solutions to bolster investment in less-liquid assets and **John Flint**, chief executive officer of the newly-launched UK Infrastructure Bank (UKIB), who is the former chief executive officer of HSBC, join us to explain the types of infrastructure projects the UKIB plans to bring online, in sectors including clean energy, transport and digital.

A stellar panel of economists will discuss social issues, inflation and unusual events in the labour market which may have unforeseen knock-on effects on pensions. **Dame Kate Barker**, who chairs the Universities Superannuation Scheme and the British Coal Superannuation Scheme, and is a renowned international economist, joins **Paul Mortimer-Lee**, interim deputy director of the National Institute of Economic and Social Research and Schroders' chief economist **Keith Wade** to explore these topics in full.

Our new panel of asset managers features **Lori Heinel**, global chief investment officer of State Street Global Advisors, who, with $4trn (£3trn) in assets under management looks after more money than just about any woman in history, **David Hunt**, fixed-income leader PGIM's chief executive officer and BlackRock's **David Lomas**, who leads the alternatives specialists area there. The group will explain the ideas shaping their thinking in 2022 and beyond, and how this may influence the UK pensions sector and others.

Any one of these speakers is well worth a trip to Edinburgh to see, but all together the conference programme represents an unparalleled opportunity for trustees, scheme investment officers and others who advise pension schemes on investment to exchange ideas with our roster of globally-recognised experts.

For more details visit: www.plsa.co.uk/events/conferences/investment-conference

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

ESG: WHAT A WASTE

Reducing the waste companies produce is a more complex problem to solve than simply filling a recycling bin. Unless answers are found, net-zero targets will be tougher to achieve. *Mark Dunne* reports.

There is a famous joke about a guy ordering a pint of beer while traveling on Ryanair, an airline that specialises in cheap flights, if you don't want any extras. It goes something like this:

"How much is a pint of beer, please," the passenger asks.

"£1," replies the stewardess.

"A quid for a pint of beer, that's great. I'll have one," he says, smiling.

The stewardess hands him a glass of ice-cold beer and says: "That will be £6, please."

The passenger, feeling a little puzzled by what he has heard, replies: "But you said it was £1?"

"It is," she says, "however, the glass will cost you £5."

That joke has become reality. In April, Burger King announced it would charge customers £1 for the packaging their meals come in.

But rather than being a sneaky way to boost revenue, the fast-food giant is hoping the scheme will reduce its waste. The idea is that once the re-usable cups and containers are returned, the £1 will be refunded. If successful, the five-branch trial will be expanded nationally.

Through this innovation, Burger King is tackling a problem that goes beyond overflowing bins on the high street. The "take, make, dispose" economic model is a major cause of pollution and is a threat to the natural world.

Indeed, the World Bank expects 3.4 billion tonnes of house-

hold and commercial waste to be thrown away in 2050, up from 2 billion tonnes in 2016. This is all the more alarming when you consider that this forecast exceeds the World Bank's population-growth projections over the same period.

Yet the main issue is not how much waste is being created but how it is disposed of. Our rubbish typically finds its way into open dumps and landfills or waste treatment plants, which do not have systems to collect escaping gases.

This is important because the World Bank estimates that disposing of rubbish generated 1.6 billion tonnes of carbon dioxide equivalent greenhouse gases in 2016, or 5% of global emissions.

The situation is worse than the headline figure. It does not include the waste generated by industry, which can send scrap metals to be disposed of by private contractors. So, the harm to the climate is certainly a lot graver than reported.

The world has a rubbish problem, and investors need to solve it if they are serious about decarbonising their portfolios.

Take me round again

Burger King may have found the answer to this problem. It is trialling a circular model. This is where everything is re-used in one form or another.

This could mean sharing, leasing, re-pairing, refurbishing and recycling materials and products for as long as they possibly can instead of throwing them away.

Reducing the waste companies produce, and the resources they take from our planet, is a core investment driver. "It is in a company's interest to manage its waste, because it is about efficiency," says Rebecca White, a responsible investment analyst at Newton Investment Management.

"There are opportunities for companies to think outside the box by not just reducing waste but thinking about what the circular economy could mean for their business model," she adds.

An alternative model for luxury goods companies could be to copy the second-hand car market, for example.

We cannot recycle our way out of the waste problem.

Rebecca White, Newton Investment Management

There is another reason why investors should be raising the issue in meetings with corporate boards. Investors are trying to encourage companies to keep ahead of two evolutions: regulation and consumer demand. "Investors want companies to be positioned to meet future consumer expectations," White says.

This may not be easy. Especially for an industry obsessed with measuring output and change. White points to a big challenge with waste, recycling and the circular economy: there is no single way to measure the problem. When it comes to climate change, for example, the focal point is greenhouse gas emissions. There is no similar standard when it comes to waste.

A closed-loop mindset

Another issue is there is no one-size-fits all solution to this problem.

"Recycling is not the only option," White says. "It is a big part of the circular economy but is no silver bullet. It is not the only element. We have to think about other solutions to get around these challenges; we cannot recycle our way out of the waste problem."

There are significant challenges around recycling. One of the issues is that there is a limited number of times you can recycle a plastic bottle. In response to this problem, using different materials, the sharing economy and circular design processes are options to consider.

"We have to think more broadly about the solutions when we think about the challenges within the recycling space," White says.

Companies may not be able to reduce their waste, but perhaps they could find alternative markets for it. "Some are trying to find a use for their by-products," White says. As an example, she points to a small beer company in the US, which sends its spent yeast and grain to dairy farms to use as animal feed or fertiliser.

Hideki Suzuki, a director of ESG research and integration at Manulife Investment Management, offers a different example of a furniture company that build its products from dismantled materials. The products are then placed in the smallest flattest packaging possible so the user can decide whether to recycle or refurbish. "Such innovative ideas are coming from a closed-loop mindset," he says.

External forces

Awareness of the issue and the need to tackle it has been growing, which could be good news for investors.

"Recognition of the importance of a circular business model has been heightened in the past few years," Suzuki says.

This has opened up opportunities in the two main areas of the capital markets.

It is important to consider the restoration of soil and biodiversity if our farms are to continue producing food, but balancing yields with soil health is challenging.

Hideki Suzuki, Manulife Investment Management

"In the public equity markets, there are some interesting pure plays in terms of the recycle economy, from waste management to using different material inputs," Suzuki says.

"From a fixed income perspective, there are green bonds and sustainability bonds which speak to these take, make, recycle themes," he adds.

For Suzuki, regulation and consumer demand are playing a role in shaping attitudes here.

The EU's Sustainable Finance Disclosure Regulation (SFDR) has a requirement to look at waste intensity alongside water and energy consumption. Then there is the UN's global plastics treaty, which has been endorsed by 175 countries to end plastic pollution.

This is not just promoting greater disclosure, but to actually manage these issues. "External forces are making us look at these issues," he says, adding that more work is needed.

"The regulator could do more around education on the cycle economy and its impact," Suzuki says. "We hear that younger generations are thought to be more sustainability conscious, but they still want fast fashion and 24-hour online delivery. There can be a disconnect between the younger generation's actions and their beliefs.

"Governments could be doing a lot more," he says.

The 26% club

Agriculture is an important part of any conversation on the impact the waste we produce has on our planet. Growing crops harms the environment. Indeed, agriculture accounts for around 10% of human-induced emissions, while the wider food system contributes around a quarter (26%). The situation is made worse by the fact that almost half of all food ends up in the bin. "Approximately 40% of the food we produce goes to waste and we need to tackle that," Suzuki says.

But when it comes to protecting the planet, the conversation about waste should go further than the amount of food we never eat.

"The environmental impact of the food production system goes beyond greenhouse gas emissions and climate change," White says. "There is an inter-dependent collection of risks that includes water waste, pollution and biodiversity, so we need to think about it in a holistic way."

Producing food close to the point of consumption and employing closed-loop systems to recycle water used in these processes are examples of how farmers and companies can limit the environmental damage of food production.

"We all need food, it is a huge industry, so incorporating concepts of circularity is essential to reduce waste," White says.

Regenerative agriculture is important, Suzuki says, if we want to continue growing food, but this is not easy. "It is important to consider the restoration of soil and biodiversity if our farms are to continue producing food, but balancing yields with soil health is challenging.

"Initiatives that use less water and maximise the crops that are grown are encouraging," he adds. "Producing less waste is equally critical as regenerative agriculture."

So, waste touches just about every part of our lives and there are several options in how to deal with it. New business models may appear in the coming years to adapt the "take, make, recycle" model as investors cannot achieve carbon neutrality by focusing on oil and gas alone.

Who knows? Perhaps loaning customers the box a burger comes in could be the way forward.

It is in a company's interest to manage its waste, because it is about efficiency.

Rebecca White, Newton Investment Management

Joanna Sharples is chief investment officer at Aon DC Solutions

INNOVATING FOR CLIMATE CHANGE PROTECTION AND IMPACT

Investors, including pension scheme members, want to protect their investments from the effects of climate change and make a positive contribution to society, supporting the transition to a low carbon economy in a sustainable way.

Our objective is to help manage climate-related risks for our members and to do so in a fair and just way. Specifically, we want to reduce carbon emissions and to keep doing so in the future. Equally, we want to achieve these carbon reductions in a sustainable way, in line with a just transition.

When we started thinking about how we achieve this for the thousands of members invested in Aon's range of DC solutions, including The Aon MasterTrust and Aon's Group Personal Pension Plan, we felt that existing strategies in the market didn't meet our objectives. While many funds achieve the desired carbon emissions reduction, the connection with the Sustainable Development Goals was not yet widely explored.

We wanted to introduce a global equity strategy that combines a strong climate focus and positive contribution to society within our two default strategies. Additionally, we were seeking a strategy that would allow us to achieve our net zero commitment on our default funds. Reflecting this, having a fund that evolves and decarbonises over time was a must-have.

We explored possible interest with UBS, and other major index houses, regarding potential collaborations on product development. UBS was quickly identified as a high-quality partner in the product development process. As leaders in rules-based customisation and sustainable investing UBS was ideally placed to help us.

This culminated in the co-development and recent launch of the innovative UBS Global Equity Climate Transition Fund (the fund), which brings together UBS' Climate Aware Framework and global stewardship programme. The fund provides cost-efficient and broad-based exposure to global equity markets, and tilts towards companies that are better placed for the transition to a low carbon economy and have higher sustainability characteristics than the benchmark.

The aim is to shape the portfolio towards a net zero trajectory in line with the Paris Agreement. The fund also tilts towards companies with revenues aligned with selected UN Sustainable Development Goals relating to health, clean energy, decent work, responsible consumption and production, and climate action. This provides us with the ability to mitigate climate-related investment risks for our members while aiming to make a positive contribution to society.

Commenting on the fund, Ian Ashment, head of portfolio engineering and trading, says: "UBS' portfolio engineering and trading, and sustainable and impact investing teams collaborated on the design of the fund. We want to provide investors with efficient exposure to a global equity index, but with risk-controlled tilts in favour of companies that have a lower current and future carbon footprint; decarbonise in line with the IPCC's 1.5°C warming limit; and are aligned with five UN Sustainable Development Goals relating to health; clean energy; decent work; responsible consumption and production and climate action. The fund is able to leverage UBS' firmwide engagement efforts."

Now we have introduced the fund within our default funds, members of Aon's DC scheme solutions can protect their investments from the effects of climate change and make a positive contribution to society, as well as supporting the transition to a low carbon economy in a sustainable way.

The Aon MasterTrust and Aon's Group Personal Pension Plan seeded the fund with more than £700m in February. This replaces a large proportion of the passive equity exposure within our default funds, as it offers broad-based exposure to global equities but with better client metrics, lower carbon emissions, improved ESG scores and is focused on making a positive contribution to society.

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CAN WE REVERSE THE 'TAKE-MAKE-DISPOSE' CULTURE TO REACH NET-ZERO GOALS?

Global recycling day in March was a timely reminder of how Covid 19 exposed the many failures of a linear 'take-make-dispose' use of resources and highlighted the need for a more circular 'reduce-redesign-reuse' approach for many stakeholders including investors.

Recent research from the University of Warwick concluded that a circular economy could help the world recover from the pandemic, while also helping nations reach net-zero carbon emissions goals.

As things stand today, it would take 1.6 Earths to produce all the renewable resources used by humans, and this is set to rise to the equivalent of two Earths-worth of renewable resources a year by 2050. Simply put, this is not a sustainable path for the planet's future.

If there is one upside of any kind that has arisen from the pandemic, it is that it motivates the world to fundamentally rethink societal, business and economic growth models: to avoid waste and seek innovative, less wasteful opportunities.

The linear economic model is just no longer viable. A circular model of production and consumption is needed, one that focuses on extending the life of products, reducing and reusing waste, and leasing and sharing goods and services.

At the 2020 World Economic Forum, it was estimated that there is some $4.5trn (£3.4trn) of value potential in the circular economy. The Ellen MacArthur Foundation, which works to speed up the transition to a circular economy, believes that, post-Covid, "the circular economy, as an instrument to decouple economic growth from resource use and environmental impact, opens up the way for a resilient recovery".

The foundation recently set out 10 circular investment opportunities across five key sectors:

- The built environment: Renovation and upgrade of buildings; building materials reuse and recycling infrastructure
- Food: Tools enabling farmers to shift to regenerative agricultural production; food surplus and by-product redistribution and valorisation infrastructure
- Plastic packaging: Innovative reuse business models; plastic recycling infrastructure
- Fashion: Rental and resale clothing business model; clothing recycling infrastructure
- Mobility: Shared vehicle systems; low-carbon and resilient transport infrastructure

Companies can also boost their resilience against future pandemics by using disruptive digital technologies or smart manufacturing tools. Big data, for example, can help streamline supplier selection processes. Cloud computing can be used to facilitate and manage supplier relationships. Logistics and shipping processes can be improved through automation and the internet of things.

Circular economy – Ways to close the gap

There are numerous ways for investors to play a role, for example, by:

- Supporting circular economy pure players,
- Considering green bonds and sustainability-linked loans integrating circular economy performance indicators and targets
- Supporting product-as-a-service approaches and ways to optimise product end-of-life, for example, for information technology equipment.

Companies themselves have begun thinking circular, too.

- A leading US sporting goods maker has committed to doubling its business with half the impact. It fights waste through more efficient design and manufacturing technologies.
- Another has an IT equipment recovery unit that processes nearly 30,000 devices a week. More than 99% of the end-of-life equipment and product waste returned is reused or recycled.
- A large earthmover maker operates remanufacturing and rebuild programmes, reducing waste and minimising the need for raw materials for new parts.

Diversification potential for investors

Such companies would qualify for a circular economy index. The ECPI Circular Economy Leaders Equity index, a euro-denominated gauge of 50 major companies, is one point of access for investors interested in this approach.

A tracker on the index includes companies in five categories – circular supplies, resource recovery, product life extension, sharing platforms and product as a service. The variety of sectors covered allows for portfolio diversification benefits and participation in a broad future-proof growth trend.

The circular economy is about ways of producing and consuming that concern all stakeholders in society. Companies that understand these challenges and implemented the necessary changes should have a sustainable competitive advantage, making them worth investors' consideration.

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A PLASTIC PLANET: TIME TO IMPLEMENT CHANGE

2022 represents a key year for the circular economy in light of upcoming regulation and tax covering plastics and waste.

These catalysts, plus discussions on a consumer deposit scheme and recognition of the need for greater investment in the supply of recycled content, give us hope for more positive change as companies endeavour to hit 2025 goals, which today look increasingly ambitious.

We live in an age with the highest-ever level of plastic consumption, using resources unsustainably. Absolute consumption is still climbing, despite pledges from corporates and the best intentions of consumers. However, new regulation this year – including a broader focus on plastic waste management to cover all single-use plastics – gives reasons to be optimistic for change.

Countries recognise the need to build better waste infrastructure and deliver a system that is more circular. The success of consumer deposit schemes – whereby a small deposit is paid when consumers buy recyclable materials like plastic bottles, repayable if they are recycled – in countries such as Norway, Germany and Latvia reinforce what is possible through sustainable infrastructure management.

Regulation is also evolving, with a number of country-specific taxes being introduced to target plastic waste. The UK is a first mover, having launched a polymer-agnostic approach in April that will force companies to meet a minimum percentage of recycled content in plastic packaging or pay a tax. This should help level the playing field from a cost perspective. There is a cost that comes with being more sustainable, but this should be manageable over time.

From tax to taxonomy

Another consideration is the implications of the revised EU Taxonomy, which we believe should push plastic packaging up the sustainability agenda for more sectors. As the Taxonomy expands from primarily focusing on climate-change mitigation and adaption, the next wave of environmental objectives will begin to tackle biodiversity and the transition to a circular model – two areas where consumer companies are firmly in the crosshairs. Under the new proposal, we will see a much greater emphasis on the manufacturing and sourcing of products and ingredients, which should foster a more collaborative approach between corporates, government bodies and NGOs.

While a plastic tax is evidently on the minds of C-suite corporate management, one could argue it's not costly enough today to warrant taking action. Plastic packaging accounts for 9% to 10% of the cost of goods sold for consumer food and staple companies (and double that number for beverage names), we estimate, but it is still fairly easy to offset that cost through the pricing of premium or healthier products.

More pertinent as an issue is finding recycled materials to meet new guidelines. There is a real need to scale infrastructure technology to capture and collect recycling supplies, which in its absence is clearly driving the price of recycled PET (rPET) skywards. Today, in the US alone, Barclays estimates we have a rPET deficit of one billion pounds in weight.

Given this, are corporate targets for plastic reduction remotely achievable? If not, we could see a disappointing regression on timelines for ESG goals. Many companies have set ambitious goals for a 25% to 50% improvement by 2025. With companies in Europe today around the 10% mark on that journey, by our calculations, 2025 commitments could be delayed. We are running out of time, so we need to see change through investment in 2022.

There are some positive examples. The early weeks of the new year made clear the opportunity for positive impact across the value chain. We have had corporate news from Biffa* (waste collection), Eastman* (chemicals), Tomra* (industrials) and DS Smith* (paper packaging) regarding recycling solutions or infrastructure spend, highlighting the importance of these companies as industries look to transition to a more circular model. Encouragingly, we are also seeing more consumer companies like Coca-Cola HBC* and L'Oréal* commit capex to vertically integrate supply and recycling facilities, which augers well for positive change. As we look to have an increasing influence on capital allocation and endorse a more circular economy, this will be a key focus of our engagement model in 2022.

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