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.

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Andy Agathangelou is the founder of the Transparency Task Force. He is also the chair of the Violation Tracker UK Advisory Board and the secretariat committee to the APPG on Personal Banking and Fairer Financial Services

HOW PENSION TRUSTEES AND INVESTMENT MANAGERS CAN AVOID THE ESG DATA TRAP

Investors and pension savers are finding it increasingly unpalatable to put their money into companies that are failing to do a decent job when it comes to any aspect of ESG. That's good news, but it does create policy and operational challenges for pension scheme trustees and their investment managers.

Those challenges can be expressed by two questions:

- Firstly, in terms of the policy challenge: "What is the right thing for our pension scheme to do, in relation to selecting companies we should and shouldn't invest in?"
- Secondly, in terms of the operational challenge: "What data do we use to base our ESG-orientated selection decisions on?"

I am not going to dwell on the policy challenge question because there are so many subjective, scheme-specific factors to be considered that any necessarily generic commentary would not be of any practical use.

However, I do think I have something of use in relation to the operational challenge question, so here goes:

There's no problem finding sufficient quantities of ESG data because so many companies are now pushing it into the market.

But because of the extent of greenwashing, there is a huge issue around data quality – much of it is little more than corporate marketing spiel that pension scheme trustees and their investment managers cannot rely on for stock selection decisions. That's a worry for many reasons, including the possibility of a troublesome disconnect between pension schemes' Statements of Investment Principles and what's happening in practice. It's anybody's guess what future litigation there might be around that in decades to come.

It's for all these reasons that I rate Violation Tracker UK so highly, and why I am proud to chair the Violation Tracker UK Advisory Board. Violation Tracker UK is a massive online database that offers a treasure chest of valuable, verifiable data that shows a wide range of regulatory infringements by all kinds of companies, throughout the UK. It's a powerful research tool that tracks corporate misconduct. And thanks to donations by The Joffe Charitable Trust, The Joseph Rowntree Charitable Trust and The Reva & David Logan Foundation, pension scheme trustees and their investment managers can use it for free. What's not to like?

All the hard work to bring the data together has been done for you – it's been painstakingly assembled and made available in a remarkably easy-to-access and simple to search way. And the important point is that the data is trustworthy, with the original data source of each case being provided in just a few clicks. The data sources are typically regulatory announcements, court decision statements and so on.

Trustees and investment professionals can search the data in many ways, including:

- By company name, for example, BP, KPMG or Southern Water
- By offence group, for example, employment infringements or environmental offences
- By regulator, for example, The Pensions Regulator

It's not surprising, then, that Violation Tracker UK has won public statements of support from politicians, academics, thought leaders, investment professionals and a range of stakeholders.

The phrase "knowledge is power" certainly rings true when it comes to Violation Tracker UK – you can think of it as "a transparency machine" or an "MRI scanner for poor corporate conduct" or an "ESG optimiser" or even an "anti-greenwash engine" – it has a multitude of uses and it's set to play an important part in driving positive, progressive and purposeful corporate reform, especially if pension scheme trustees and investment professionals take time to learn how to get the most out of it.

The database was compiled by a team of UK and US researchers led by the Corporate Research Project of Good Jobs First – the Washington DC-based NGO founded in 1998. It's a non-profit, non-partisan resource centre promoting government and corporate accountability.

If you would like to meet online some of the senior members of the team from Goods Jobs First, and be shown how to get the most out of Violation Tracker UK to help avoid the ESG data trap, get in touch:
andy.agathangelou@transparencytaskforce.org

DEVELOPING SUSTAINABILITY 3.0

Sustainable finance needs to move to a new, more improved phase, and it has to take governments, regulators and investors with it. *Andrew Holt* reports.

Soaring energy prices, the war in Ukraine and further damning evidence on the treat to our environment from the Intergovernmental Panel on Climate Change (IPCC) requires sustainable finance to move into a new phase, a leading academic has said.

Speeding up the replacement of today's fossil fuel energy system with one powered by clean energy is one of the central tasks of sustainable finance, says a paper authored by Nick Robins, professor in practice of sustainable finance at the London School of Economics.

In the paper, Robins said the current crisis should prompt us to reflect on the fossil fuel shocks of 1973 and 1979: the first triggered by the Arab-Israeli conflict and the second by the Iranian Revolution.

"As well as causing stagflation, these events also spurred the first serious efforts to improve energy efficiency and develop renewable sources of energy – Vestas sold its first turbine in 1979, for example. In 1973, the UK hit its peak level of carbon dioxide emissions; in 1979 the European Union followed suit."

But the 1970s also drove the search for new sources of hydrocarbons and dependence on fossil fuels continued, not least in emerging and developing economies such as China, India, Indonesia and South Africa, Robins said.

"The result: most of the carbon dioxide from fossil fuels has been emitted since 1991 and according to the International Energy Agency, 2021 saw the highest ever level of carbon emissions from energy, despite pandemic lockdowns," he said.

"Governments must avoid being lured once more into boosting domestic coal, oil and gas production in reaction to crisis," Robins added.

Net-zero transition

In Europe at least, the signs are that the crisis could in fact help fast-forward the net-zero transition.

Launching the REPowerEU package, two weeks after the Russian invasion of Ukraine, the Commission's green new deal commissioner, Frans Timmermans, called for a "dash into renewable energy at lightning speed".

"This needs to be matched by action to structurally eliminate fossil fuel demand, which will happen by improving energy efficiency, electrifying heat and transport and ramping up green hydrogen production," Robins says.

It also puts the strategies of investors into sharper focus. "The Ukraine conflict has moved key energy transition strategies such as divestment centre-stage as corporations and investors race to exit Russian assets," Robins said. "It has shown that fire-sale divestments in a time of crisis brings the ultimate crystallisation of stranded asset risk."

BlackRock's chief executive, Larry Fink, has said he believes "that recent events will actually accelerate the shift toward greener sources of energy in many parts of the world".

To make this come about, sustainable finance needs to deliver a 'double punch', Robins said, which confronts the twin sources of fossil fuel unsustainability – climate change and energy insecurity – and closes the green investment gap, most importantly in the Global South.

Indeed, models have shown that annual net-zero investments must increase three-to-six-fold by 2030, according to the IPCC. In developing countries, an even greater expansion of four to eight times is required, from less than $500bn (£400.4bn) a year to potentially more than $3trn (£2.4trn).

Co-ordinated effort

To move forward, a unified approach in finance is therefore needed, Robins said. "Financial institutions and the actions of central banks and regulators all need to work in a fully co-ordinated effort to reallocate capital across the financial system," he said. "This investment-led approach will not only help overcome the twin flaws of fossil fuels, but also drive a more attractive and inclusive development pathway.

"Guardians of the financial system – central banks and supervisors – also need to raise their game to explicitly factor the instability of fossil fuels into their strategies alongside climate risks," Robins added.

He continued to explain that governments could also "tap into the growing investor demand for green assets by delivering a significant issuance of green, social and sustainability sovereign bonds".

At the European Central Bank, Isabel Schnabel has distinguished between the 'fossilflation' that lies at the root of the recent energy price spikes, 'climateflation' as physical shocks impact on production and 'greenflation' as rising demand for clean energy solutions prompts supply chain bottlenecks.

"These point to the need for further action to make sure that monetary policies are fully aligned with the goals of the Paris Agreement, by incorporating, for example, net-zero factors into collateral frameworks and asset purchases to counter price instability," Robins said.

"Rising interest rates risk making the clean energy boost harder, so ensuring that costs of capital reflect the full risks of fossil fuels is essential."

INVESTING FOR REAL-WORLD DECARBONISATION MEANS ENGAGING WITH KEY COMPANIES

TO ENSURE THEY HAVE CREDIBLE PLANS FOR A NET ZERO WORLD.

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PENSION FUNDS FACE 2050 CLIMATE TARGET CHALLENGE

With most pension schemes expecting to miss their net-zero deadline, a survey highlights the challenges they face. *Mona Dohle* reports.

The COP26 climate change conference in Glasgow has been the catalyst that has made the 2050 net-zero strategy mainstream.

From McDonalds to the Gulf States, organisations and governments are committing themselves to reducing their carbon emissions, and that includes pension funds. But in trying to achieve these targets, asset owners face stumbling blocks.

Pension funds have made enormous progress when it comes to being aware of climate change. Almost three quarters, some 74%, of UK pension schemes have net-zero plans or will commit to one in the next two years, according to a Pensions and Lifetime Savings Association (PLSA) survey.

And this trend is replicated on a global scale. A report published by Create Research, a strategic change boutique, which surveyed the opinions of 50 large pension plans across North America, Europe and Australasia, found that 42% are implementing a net-zero target.

But the poll also showed that only 16% had fully embedded these targets in their asset allocations. More worryingly, 60% of respondents believe that they will fail to meet their 2050 targets. Only 16% believe it is “very likely” that they will meet their net zero targets and another 24% say it is “somewhat likely”, Create Research’s survey revealed.

The true cost

The cost of climate change is a key reason why pension funds want to tackle the problem head on. Reducing the associated investment risk is the motivating factor for 66% of schemes, compared to domestic regulation, which the survey reported is a motivating factor by 52% of schemes, according to Create Research.

But accounting for the cost of climate change is also a pension fund’s biggest obstacle. Until the full costs of the issue have been priced in, trustees will find it hard to justify investing in renewable energy, particularly at a time when fossil fuel and mining companies are offering record level dividends due to rising commodity prices. “The ecosystem of capital markets remains centred on short-term financial goals, regardless of the uncompensated damage they inflict on wider society,” said Amin Rajan, chief executive of Create Research, who co-author of the report.

A study by University College London (UCL) published in Environmental Research Letters in 2021 backs up the argument that the cost of climate change remains grossly understated. Using the latest climate modelling risk metrics, researchers predict that the economic damage of climate change could be six times higher by the end of the century than previously anticipated. This would mean that by 2100, global GDP would be 37% lower.

This raises serious problems for asset owners. Some 70% of respondents in the Create Research report fear that the inability of capital markets to price in climate risks will impair pension finances, another 66% believe government action is required to address these imbalances.

Passive on polar bears

But pension funds are also slow to adopt climate strategies for their passive investment strategies, the Create Research report revealed. While 74% of their active funds factor in climate change risks, those criteria are only applied to 42% of passive funds.

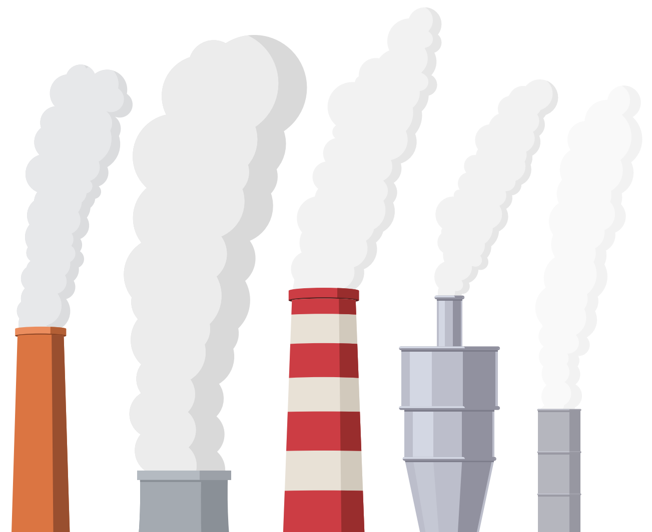
This could be addressed by customising passive funds to factor in climate risk trends, and demand among asset owners is growing. While 40% of pension funds surveyed rely exclusively on off-the-shelf indices, 28% say they are now using custom-built indices to factor in climate risks, Create Research’s report shows.

The road to hell

It is clear that as the number of headlines on climate-related damages continues to increase, so will the heat on pension funds, particularly the 26% of UK schemes which have not set a net-zero target yet. Campaigners such as Make My Money Matter have called for a legal obligation for pension funds to have net-zero targets in place.

But committing to eradicating fossil fuels by 2050 might not be enough. Only 28% of pension funds surveyed by Create Research said that they had interim targets and clear milestones in place to show how they would achieve their net-zero target.

In the absence of those, a 2050 target could be a case of kicking the can down the road. And as the saying goes, the path to hell is paved with good intentions.



Lisa Hampton is marketing manager at the Pensions and Lifetime Savings Association (PLSA)

PLSA LOCAL AUTHORITY CONFERENCE 2022: LOCAL GOVERNMENT, GLOBAL IMPACT

13-15 June

De Vere Cotswold Water Park

It looks set to be another major year for local government pension schemes (LGPS), with the likelihood of new climate-related reporting requirements on the horizon, the pandemic's long-term impact on scheme finances yet to be fully realised, and the government's invitation to fuel an investment 'big bang' pending.

After three long years we are delighted to reunite our LGPS members in person at the PLSA Local Authority Conference. The programme will cover all these topics and more, including the launch of the PLSA's new research report into the future of the LGPS.

Last year many PLSA members attended our LGPS workshops where their thoughts and opinions contributed to our research programme on the challenges they face. They participated in roundtables and shared insights on the key issues that need to be addressed. Our findings will be presented at conference and we will share an analysis of your collective views and the policy implications.

The conference session will include leading LGPS practitioners giving their perspectives on the measures needed to help local authority pension funds face the future with confidence. Most importantly, we will discuss the next steps that the PLSA will take with you to continuously develop this piece of work, and to represent you and your needs to government, regulators and policymakers.

Other topics that will be covered include responsible investment – what the Task Force on Climate-Related Financial Disclosures (TCFD) for the LGPS could and should look like – asset pooling in LGPS; the likely direction of travel for funds and pools; how pensions dashboards will work in the LGPS, and how funds can get ready for them; enhancing user experience and combating pension fraud – technological advances for local authority administrators. We will also debate if the local government pension scheme is sustainable? And you will learn what to expect when you are implementing the McCloud judgement.

We also have one of the most influential people in the public sector, Ben Page, global CEO for Ipsos, who will join us and look at all the ways in which the world is transforming, and rapidly.

Sandra Stewart, director of pensions for the Greater Manchester Pension Fund, will talk to the PLSA's Joe Dabrowski about how local authority pension funds will need to meet new requirements to report on climate change, regulations that are similarly being phased in for private sector schemes. They will discuss how TCFD works, how funds and pools can plan to report and lessons learned from the private sector.

The conference will not just be about pensions – for those delegates who do not mind an early start we have a birdwatching walk at 7.15am on 14 June with our own expert, James Walsh, who will be happy to point out the dozens of bird species that live around the lake just outside the conference venue.

The event will conclude with the Conference Gala Dinner – hosted by John Pienaar, a former chief political correspondent for the BBC perhaps best known as the presenter of *Pienaar's Politics*. It will be a great opportunity to catch up with friends and colleagues.

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

GREEN BONDS: DIFFERENT SHADES, SAME PRICING

Research on asset pricing in different shades of green bonds and the investor preference for them presents an interesting picture, but one that is open to debate, finds *Andrew Holt*.

A study that sought to unearth the pricing and ownership of the different shades of green bonds in issuance has been criticised for some of its findings.

The research undertaken by EDHEC, a business school, categorises these bonds as 'dark green' – those deemed to be the greenest of green – and 'light/medium', as well as conventional bonds.

And in terms of asset pricing, the research said: "It is not only the green label that does not have implications on the yield and price of the bonds, but also the shade of green is not reflected in differential pricing of sustainable fixed income securities."

But Sean Kidney, chief executive of the Climate Bonds Initiative, contests this. "On straight comparative data, we see pricing differentials in green liquid currencies. Where you do not see differences in pricing is where you do not have liquidity. It is a function of liquidity to get the price discovery.

"And primary price differentials, where it occurs, is not driven by sentiment," he adds. "It is not driven by investors saying this is green. It is paid for because of the secondary market: where there is liquidity you get price differential. And these bonds perform better in the secondary markets."

The EDHEC research uses Cicero's labeling definitions to explain the green bond market. "But the green bond market is not divided up this way," Kidney said. "For example, they talk about light green bonds that use fossil fuels, but actually, you do not get those in green bonds. There has been a campaign to kill those off, and it has been successful."

No greenium?

In the debate of the 'greenium' surrounding green bonds, the research is consistent with its initial pricing point. "By matching these green bonds with otherwise similar non-green bonds we find that there is no greenium for the dark-green nor for the light/medium green bonds."

The report highlights that the premium for dark-green bonds increases over time, but it has been particularly penalised in 2020, possibly because of less investor focus on assets' environmental footprint during the Covid-19 pandemic.

"I find the greenium point quite bizarre," Kidney said. "Our data is quite different. And our anecdotal reporting is even more different. We speak to treasurers, basically everyone, and they get a greenium."

The research does assert that institutional investors who report climate-aware investing, do hold more dark-green bonds in their portfolios.

On this point, the report said: "The shades of green do matter for climate-aware institutional investors even if the demand for dark-green assets does not translate into a tangible premium as far as bond pricing is concerned."

These institutional investors have signed up to the United Nations' Principles for Responsible Investment (UNPRI) and have a significantly higher ownership of dark-green bonds than of similar conventional bonds – about 16% more.

The light/medium green bonds do not feature significantly in the higher holdings of UNPRI investors meaning such investors are proving all in when it comes to a commitment to green bonds.

In turn, this result implies that UNPRI investors prefer to hold green bonds, and that they perform thorough due diligence and end up holding a significantly higher percentage of dark-green bonds.

Green switch

Although Kidney offers another assessment. "The bulk of demand is driven by mainstream vanilla funds that want to switch to green, wherever they can," he said.

And he added that the focus needs to be different, and not particularly on pricing. "What we are concerned with is: what is a minimum requirement for investment to be consistent with the Paris Agreement?" he said.

In its own report, the Climate Bonds Initiative said of the green bond market: "We expect demand to continue to outstrip supply for the foreseeable future as funds seek to classify themselves as SFDR Article 8 or Article 9 in Europe, and US policy increasingly encourages accountability around responsible investments.

"However, as interest rates rise, bond prices generally fall, and while a lack of supply may temper the magnitude of the impact, a green label is unlikely to offer complete protection from this."

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EMERGING MARKETS: CLEANING UP

Emerging markets now emit most of the world's greenhouse gases. But addressing the many ESG challenges is complex. *Mark Dunne* reports.

China's influence over the world takes many forms. It is the globe's second largest economy after its GDP expanded by an average of 10% a year in the decade to 2021. It controls the world's largest army of 2 million soldiers and it emits more of the planet's climate-destroying greenhouse gases than any other country.

China's rapid industrialisation has lifted millions of people out of poverty, but that has come at a price. It has been largely fuelled by coal. Two-thirds of its energy emanates from those little black rocks, making it the world's largest consumer, accounting for half of the coal burned globally. Demand in China is expected to increase, as they have been building more coal-fired power stations since 2018.

The figures already make difficult reading. China is responsible for a quarter of the world's greenhouse gas emissions. When the rest of the developing world is included, the figure shoots up to 63%, the Centre for Global Development says.

This makes it difficult for some to invest in emerging market assets, with almost three quarters (74%) of UK pension schemes working to a net-zero target or planning to commit to one in the next two years, according to the Pensions and Lifetime Savings Association (PLSA).

"Emerging markets face some of the biggest sustainability challenges in the world," says Eric Nietsch, head of ESG, Asia at Manulife Investment Management. "Companies that are addressing these challenges could outperform."

Keep it clean

When it comes to investing in the developing world while building net-zero portfolios, an obvious asset class stands out.

For Nietsch, wind and solar power look likely to be the winners, as governments become increasingly concerned with energy security. "Renewables tend to be domestic sources of energy, so they can increase energy security," he says.

Asia, predominantly China and South Korea, is where most materials for wind and solar power infrastructure are produced along with batteries for electric vehicles. "With the global energy transition there is a huge opportunity for emerging markets to meet that demand to help the world meet their energy targets," Nietsch says.

But climate change is not the only issue investors are considering. Inflation is raging across emerging markets, so investors need to ensure that bond issuers can raise the capital needed to meet the interest payments on their debts.

"In higher-rated emerging market sovereigns, the buffer to absorb higher food and fuel prices is greater than in weaker, single B-rated names. This does not mean, however, that investment-grade credits are immune," says Uday Patnaik, head of emerging market debt at Legal & General Investment Management (LGIM).

"India is a case in point – in the light of higher international energy prices, the sovereign has temporarily suspended limiting the use of coal to ensure cheaper domestic energy supplies to help reduce inflationary pressures," Patnaik adds.

For some, investing in a heavily emitting company that is moving in the right direction could be more important than one that just ticks all the boxes to be a green investment.

"We are not trying to get the best-in-class, we want the companies and governments which are an improving story," says Carl Shepherd, an emerging market fund manager at Newton Investment Management.

"What is happening in Ukraine will accelerate the move away from a dependence on fossil fuels, but it will create a backward step in the near term, as countries scramble to source energy from elsewhere as cheaply as possible in light of inflation.

"Short term there is bad news, but it could accelerate a move to cleaner energies. So, it is not all doom and gloom," he adds.

Take them with you

No matter what you invest in, you need to make sure that in trying to solve the carbon emissions problem that you do not cause a social problem. A just transition means that no one is left behind and that instead of decimating communities, investors are providing alternatives by, for example, funding education programmes.

"It is important for investors in emerging markets to not just consider the energy transition, but a just transition," Nietsch says.

However, fears that reducing carbon emissions in these markets could pull more people into poverty may be misplaced.

"We believe that reducing carbon emissions in emerging markets will have a net positive social impact. It is expected to create more jobs than it would displace," Nietsch says.

"It would protect some jobs from the physical risk of climate change and reduce the death and illness associated with air

We are no longer a lone voice knocking on the door asking to talk about climate change.

Madeleine King, Legal & General Investment Management

pollution. So, there are pronounced social benefits from reducing carbon emissions," he adds.

It is not just about the social benefits; it could lead to workers being moved into alternative roles. Nietsch uses the changing demand for natural resources as an example of how mass unemployment could be avoided while the world transitions to a low carbon economy.

"A low carbon scenario has a higher demand for materials such as steel and copper. There could be a reduction in mining of thermal coal, but those jobs could potentially be repurposed to other parts of the mining sector," he says.

Are you local?

Madeleine King, head of research and engagement at Legal & General Investment Management (LGIM), acknowledges that there are challenges when investing in emerging markets, such as difficulties with data and having to consider the sovereign element when assessing corporates. But these challenges are not insurmountable.

"Emerging markets and ESG can be compatible," she says, adding that much of ESG analysis is based on basic data points, including assessing what a company does and if it is meeting sustainability standards.

"For any bond we invest in, whether it is an emerging market corporate or a developed market blue chip, we want good information about the company's operations and where its revenues come from," she adds.

King says emerging market corporates are open to discussions around improving their operations. "It is a widespread conversation now. We are no longer a lone voice knocking on the door asking to talk about climate change.

"They are willing to have these conversations in a way they were not five years ago. The big emerging market issuers understand that the rules have changed with investors looking for more than they once did."

The issue is their ability to act on those discussions is difficult in certain countries. "They are not able to deliver on everything we want, but the tone has changed," she adds.

It appears that emerging market governments have worked on improving their dialogue with investors to build a vibrant market.

"Communication has developed over the past 10 years," Shepherd says. "A lot of that is down to governments issuing more local debt. They have upped their game to develop a domestic funding market that is credible and also less volatile.

"Dollar liquidity is a worsening picture, so you want to create a demand for local debt," he adds.

Being realistic

The ESG development of emerging markets is a big part of the world's net-zero ambitions. They have to decarbonise for the world to make a huge dent in climate pollution. Yet investors need to be realistic on what they can achieve.

"You cannot set the same standards in emerging markets as you do in the developed world with respect to climate change," King says. "You have to be realistic in that it takes longer.

"While developed markets have had the benefit of industrialisation, many emerging markets are only just getting to that point," she adds. "We cannot expect emerging market countries to decarbonise at the same rate as those in developed markets."

LGIM wants its developed world portfolio companies to phase out coal by 2030, but emerging market companies have more time. "We cannot apply the same standards to a Dutch electricity company as we would to an Indian electricity company. They are in different stages of their life cycle," King says.

"With ESG, no one has the right answer," Patnaik says. "A client sitting in Germany's view of ESG will be different from that of a client sitting in Saudi Arabia."

Being at different stages of their lifecycle might be why corporate data in emerging markets is less mature than that released in the developed world.

"Investment decisions in emerging markets can often be more complex because of a lack of robust information to base decisions on," Shepherd says.

Patnaik says that the issue with transparency is not always down to companies not wanting to release data, but in lacking the systems to do it. "Sometimes these corporates have grown so quickly because their economy has grown quickly, so the quality of their information has to catch up."

He adds that considering ESG factors is important to invest successfully in emerging markets. It is about assessing the owner of the company, determining if the directors are independent and ascertaining if the company changes auditors regularly. "These have always been issues and what ESG has done is put a framework around it," he adds.

The long game

"Emerging markets are emerging for a reason," Shepherd says. "Something has not gone right or there is an institutional weakness."

This could mean that some changes will take longer to implement than others and investors may need to be patient. "The results will not be immediate for something that is improving people's lives," Shepherd says. "If there is a need for improved sanitation, it will have a big impact on people, but the results will come through in 10 years' time.

"That shows me that they are committed to improving lives," he adds. "It is the same with education, where positive results will not be evident for 10 to 15 years. They are not after quick wins and are serious about fixing these problems."

SUSTAINABLE CHANGE FOR ASIAN CITIES

Compared to the developed world, the urbanisation theme is more prevalent in emerging markets (EM). Covid-19 has forced developed markets to reassess the pace of urbanisation, and may have even triggered some gradual de-urbanisation due to the prevalence of remote working and the reassessment of the work/life balance. By contrast, the pace of urbanisation in EM remains strong, particularly in Asia. This has made the sustainability of cities in the region more of a challenge. We believe there is an attractive opportunity for investors to address this issue.

Home to more than 4.5 billion people, Asia is the world's largest and fastest growing economic region and its urban centres are some of the world's densest. By 2050, some 1.2 billion more people will live in Asian cities, and the region will account for more than half of the world's urban population[1]

With such steep growth, the current urban infrastructure simply will not cope. Add to that the impact of frequent and severe climate events, and the need for Asian cities to achieve more sustainable change has never been more urgent. Upgrading infrastructure is essential to make these cities more resilient to the economic, social and climate challenges.

At the human level, they will need to be upgraded to ensure that they remain habitable. Already, the proportion of sub-standard housing in several Asian countries ranges from 23% to 62% of the total. Many residents suffer from inadequate access to clean water, sanitation and power, as well as the effects of traffic congestion and air or water pollution. Such problems often arise from inadequate government funding, poor access to private financing and inefficient local planning and management.

Sizeable investments are required to make Asian cities more environmentally sustainable and inclusive. According to the McKinsey Global Institute[2], Asia's urban infrastructure need is projected to exceed $1trn (£815.3bn) by 2050, up 7% per annum from 2017. Additionally, due to the inadequate access in some parts of Asia, the water market is expected to grow by more than 4% a year in the near term.[3]

A growing market

Adding to the market development perspective, we have been seeing a significant proliferation in 'green financing' in Asia, particularly in the form of sustainable-labelled bonds (green, social and sustainability (GSS) bonds) and sustainability-linked bonds. While such bonds have been available for some time in more mature markets in Europe, they are relatively new in Asia. That said, the market for these bonds has grown during the past five years, with US dollar issuance in Asia reaching more than $60bn (£48.9bn) in 2021 (see chart). We expect this segment to continue to grow, given the increasing demand from investors and greater regulatory support.

Participating and investing in sustainable change for Asia cities

Now that we have established the investment case for investing in a greener and more sustainable future for Asia cities, we come to the central question: how should investors participate in this emerging and fast-growing theme?

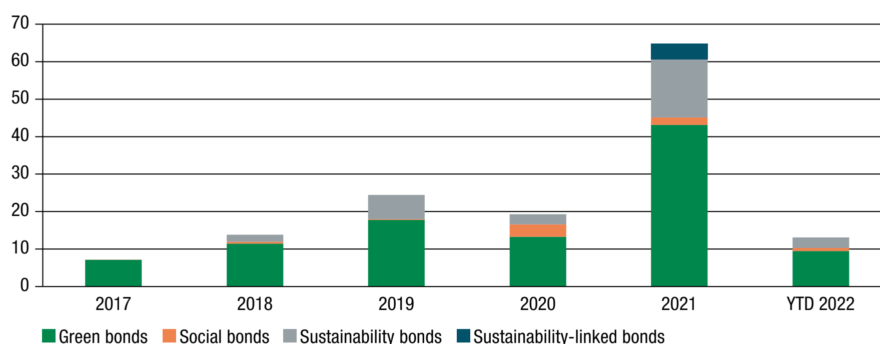
In our view, the need for capital in Asia to make cities more sustainable is secular rather than a passing fad. Approaching this theme from a fixed income point of view makes sense as there is a direct link with the capital. Infrastructure projects in Asia are capital intensive, and often require more than one round of cash injections. This fits with the nature of fixed income: bonds are typically issued in multiple rounds, as compared to equity financing.

We see this as a long-term opportunity, marked by sufficient demand, and most importantly, continued growth.

The full whitepaper can be read at:
investors-corner.bnpparibas-am.com

1) United Nations. 2014. "World Urbanization Prospects"
2) Sustainable Cities Strategy: Financing Solutions for Developing Sustainable Cities in Asia, Asian Infrastructure Investment Bank, December 2018.
3) GWI. Consultant's analysis. Sustainable Cities Strategy: Financing Solutions for Developing Sustainable Cities in Asia, Asian Infrastructure Investment Bank, December 2018.

Issuance of Asia USD GSS and sustainability-linked bonds (in US dollars)



Source: Bloomberg, year-to-date, as of 6 April 2022

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Randeep Somel manages M&G's Climate Solutions strategy

THE CIRCULAR ECONOMY: BETTER IN THAN OUT

The pathways to reaching net zero are many, and while slashing fossil fuel based energy-related emissions remains the largest addressable area, moving towards a circular economy is inextricably intertwined with this endeavour and has a pivotal role to play in reducing global emissions.

"The earth that we live on does not have inexhaustible resources that are going to be available forever – we are depleting our natural resources and fast," reflects Randeep Somel, manager of the M&G Climate Solutions strategy.

"We are using up our resources of arable land, fresh water and vital minerals – including those that are needed for green infrastructure, such as nickel and cobalt. Therefore, it is in everyone's interest to keep these systems going through a closed loop system, which means we design out waste as much as we can by constantly re-using the resources we have already extracted. We need to do this before scarcity and emissions become even bigger issues."

Currently, circularity on the vast sphere that we call our planet stands at 8.6%, according to the Circularity Gap Report 2022[1], and doubling this globally could reduce global emissions by 39% as well as slashing total material footprint by 28% by 2032.

So, without the need to ostensibly create anything new, how can investors ensure that everything in the system stays for as long as it can and be used more efficiently? Here are three ways to help de-couple economic growth and natural resource consumption while driving greater competitiveness in what is a limited window of opportunity to move towards and operate within a 1.5-degree heated world by the year 2100.

1. Incentivising behavioural change through regulation

Regulation, education and incentivisation go hand-in-hand to foster wholesale change in the right direction – particularly amongst individuals who will need to change their daily patterns of behaviour and consumption to help reduce waste and emissions.

In 2015, the UK government introduced a 5p charge on plastic carrier bags in England in order to tackle plastic pollution. "Lo and behold the purchase of those bags fell by 95% – now that's incentivisation," Somel says. When contextualised at an individual level, the average household has slashed its consumption of single-use plastic bags from 140 per year pre-2015 to just four today[2].

Going a step further, last year the UK government increased the charge on plastic bags in England to 10p, extended it to all retailers and anticipates the use of single-use plastic bags to decrease by 70% to 80% among small and medium-sized businesses.

"We need to reduce the amount of waste that an organisation, country or individual produces and say: 'This is neither acceptable or necessary, and lets find a way to price for all the externalities caused.' So, you have a disincentive, effectively, and at the same time you need to incentivise the companies that do use that closed-loop method over that linear method," Somel adds.

2. New technologies closing the loop

New technologies bring the opportunity to take a previously linear – and therefore, wasteful – model and close the loop, boosted by incentivisation and regulation. For example, in 2020 the UK government announced[3] that the sale of new internal combustion engine vehicles will be illegal from 2030 and hybrids from 2035 (regulation) with grants available for homeowners, businesses and local authorities to install charging points (incentivisation). But in addition to incentivisation and regulation, how is the manufacturing

Regulation, education and incentivisation go hand-in-hand to foster wholesale change in the right direction

process of these vehicles integrating circularity into the design process to ensure minimal waste?

"Electric cars are now being built to ensure that the supply chain is carbon neutral and components recyclable," Somel says. "There is an obligation that at the end of its life, the battery in an electric car has to be recycled and we can do this as with relatively new supply chains and product chains we can ensure we only engineer in materials that have these properties."

"This can not necessarily be said for older products in the economic system today as the environmental onus was never there when the products were originally engineered. Now that we have more sustainable products i.e., electric cars because they help reduce emissions, let's make sure we build in the circular economy element as well.

"Speaking to the larger car manufacturers they will openly share that: 'We have to do this now because it's what our customers want, and at the same time this also improves the cost comparativeness between electric and combustion vehicles.' Having more recyclable parts at the end of life will also incentivise the close loop system, as there are economic as well as environmental reasons to recycle."

Our relationship with food is complex, often wasteful and both resource and carbon-intensive

3. Removing waste from our diet

Our relationship with food is complex, often wasteful and both resource and carbon-intensive. According to a study by Nature Food[4], 57% of global greenhouse gas emissions from the production of food corresponds to the production of animal-based food, including livestock feed. While behaviours are changing – daily meat consumption in the UK has dropped by 17% between 2008 and 2019[5] – we still need solutions to take as much waste as possible out of the system.

In order to help combat waste, M&G's Climate Solutions team invests in US-listed Darling Ingredients, which transforms waste products into feed and fuel. This ensures that the carbon from meat by-products is captured and reused rather than left to rot and release further greenhouse gas emissions while decomposing, which serves no purpose.

"Darling Ingredients has 124,000 unique pick-up points across the US where they pick up waste meat carcasses, recycle and then convert them into bio-based fuels so they can be redeployed in a way that helps us reduce emissions," Somel says. "It takes a lot of waste out of the system that would otherwise decompose, and it substitutes for a product that is far more carbon emitting.

"The key with circular is that it's in every area, and the potential remains very large," Somel reflects

1) Circle Economy, "The Circularity Gap Report 2021".
2) UK government, "10p plastic bag charge introduced in England", (www.gov.uk), 21 May 2021.
3) UK government, "Government takes historic step towards net-zero with end of sale of new petrol and diesel cars by 2030," (www.gov.uk), 18 November 2020.
4) Nature Food, "Global greenhouse gas emissions from animal-based foods are twice those of plant-based foods," (www.nature.com), 13 September 2021.
5) The Lancet Planetary Health, "Trends in UK meat consumption: analysis of data from years 1–11 (2008–09 to 2018–19) of the National Diet and Nutrition Survey rolling programme," (https://www.thelancet.com/journals/lanplh/home), October 2021.

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