pi ESG CLUB

More and more institutional investors are making commitments to fighting climate change and nature loss or promoting greater equality. But what themes will investors be discussing with their investment managers in 2024? To find out, we asked the members of our ESG Club.

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Members

ENGAGEMENT NEEDS TO IMPROVE - REVIEW

Investor group highlights areas where asset managers are failing on stewardship. *Andrew Holt* reports.

The UK Asset Owner Stewardship review has warned that there is a misalignment and misunderstanding of the importance of stewardship between asset owners and asset managers – with the latter coming under the spotlight for their stewardship failings.

The review, conducted by the UK Asset Owner Roundtable, which comprises asset owners and asset managers, offers five potential explanations for the misalignment.

The first is attributed to cultural/political misalignment. The participating asset owners are all UK based, while most participating asset managers are not, which may lead to a slight "cultural misalignment," said the review.

The second is a misunderstanding on the relevance of stewardship and voting, or the urgency of climate change as a key priority theme within stewardship.

Third is a misunderstanding of fiduciary duty itself. Therefore, following the prudent rule, asset managers should target a high, or even "optimised return per unit of risk ratio," commented the review.

Then there is a "conceptual disagreement" as to the most effective combination of stewardship processes. From the voting patterns revealed in the review, it is evident that some asset managers appear to see voting and engagement as mutually exclusive while others view it as much more complementary.

The final point concerns governance – as asset managers and/or financial firms owning them tend to have many "more commercial relationships with the issuers" than the asset owners whom the asset managers serve, said the review.

This means there are big challenges for the Asset Owner Roundtable to address going forward on the all-important issue of stewardship.

Long-term interests

The aim of review has been defined as the need to understand how "asset owners' long-term interests have been served by their managers" when exercising their stewardship and proxy voting at major oil and gas companies within the global universe of the Transition Pathway Initiative (TPI).

Specifically, UK asset owners have been concerned that despite unequivocal warnings from the United Nations and the Intergovernmental Panel on Climate Change about the risks of delayed action on climate change, short-term interests of asset managers may be trumping the long-term interests of pension funds.

To address these concerns the review explored two crucial areas. First, it studied the actual votes cast by asset managers between 2015 and 2023 for TPI universe oil and gas companies and correlated them with the equal-weighted average of asset owner voting as contributed by the 10 participating asset owners.

Second, it reviewed the voting rationales provided by asset owners, with asset managers misaligned with asset owners.

Big insight

Here the review revealed three trends. One, only selected asset managers "publicly reason" like asset owners.

Two, some asset managers somehow see voting and ESG engagement as mutually exclusive and appear to fear the loss of access to management if they vote against them.

And third, among asset managers, there appears to be a substantial divergence as to their interpretation of shareholders' and even society's interests.

The study also reviewed the ESG engagement success across all relevant issuers, which revealed three different engagement processes.

The first is so called "textbook", based on persistent, long duration, large-scale engagement with substantial progress.

Second is a "quick fix" style, with engagements characterised by less consistency, shorter duration and more mixed progress.

Third are the engagements defined as "jumping the bandwagon", as they appear to target only firms that already have been improved.

Next steps

To address these points the Asset Owner Roundtable has set out three areas to address. The first is to explore the potential for extending this research to cover US asset owners.

Two, having one-to-one meetings between the UK Asset Owner Roundtable's members and their investment managers to discuss the voting decisions at global oil-and-gas company AGMs.

And three, set stewardship expectations for asset managers that will be developed by the UK Asset Owner Roundtable.

Leanne Clements, head of responsible investment for The People's Partnership, provider of The People's Pension, and member of the roundtable, said of the findings: "We have reached an impasse with respect to net-zero stewardship and we are running out of time."

She therefore added: "A complete dismantling of failed status quo approaches to stewardship is needed by the fund management industry, with voting escalation not seen as a last resort approach used on an exceptions basis, but rather a powerful signal to companies of what investors expect of them."

Faith Ward, chief responsible investment officer at Brunel Pension Partnership, and also a roundtable member, was more upbeat. "I am optimistic about the practical steps discussed, and the willingness of participants in the process to address the perceived gap verified by this report."

ESG INTERVIEW – SARAH GORDON

"There is still a misconception that delivering positive outcomes means you take concessionary returns."

The visiting professor in practice at the Grantham Research Institute at the London School of Economics and Political Science (LSE), tells *Andrew Holt* about making impact investing universal, the need for an oversight unit in government, the benefits of blended finance and leaving your comfort zone.

You have experienced the practitioner side of investment at the Impact Investing Institute and now look at ways in which investment can change the dial on ESG. What conclusions have you reached on how investors can create greater sustainability?

It is encouraging that there isn't an institutional investor who doesn't think about ESG. They have different ESG approaches and the range is still broad, but 10 years ago there wasn't much focus on what you could call ESG investment.

However, a lot of ESG is done through what I would call a 'do no harm' lens, rather than delivering a positive impact. And importantly, allocations dedicated to impact investing are tiny. We need a regulatory push to encourage institutional investors to dedicate more investment to positive outcomes. But some of that investment is achieving amazing results.

My research highlights that in the UK and emerging markets there are incredible examples of the impact that can be delivered alongside a solid financial return.

There are also some fantastic examples of asset owners and asset managers working with local authorities to deliver positive social and environmental outcomes.

But they are not universal. And they are not at the scale to deliver the impact to really deliver, for example, on the government's Levelling Up policy demands.

Why are allocations to impact investing so small?

There is still a misconception that delivering positive outcomes means you take concessionary returns. We need to park that perception. There is also an important blocker around fiduciary duty: the duty of investment managers to responsibly look after their clients' money and that, for many decades, has been interpreted in a narrow way as delivering a maximum financial return.

And that has discouraged investors, like pension trustees, to think more broadly about what outcomes they are seeking to deliver from their investment decisions. We therefore need new guidance on fiduciary duty. The Impact Investing Institute, where I was CEO, and Share Action have come up with concrete proposals for what new guidance could look like.

How could the government help channel capital from institutional investors into ESG investments?

The work I have been leading at the LSE is advocating to the government: "Look, there is this real opportunity to mobilise private sector capital at scale for economic, environmental and social outcomes."

Different pockets in some government departments are working with private investors. But there needs to be a commitment across government, and therefore, by central government to be much more ambitious about mobilising private investment for public policy outcomes.

You need a manifesto commitment by the leading political parties to do that. We also need an oversight function within government on this issue.

When we launched the Impact Investing Institute in 2019 the main question asset managers would always ask me was about the lack of standardised ESG and impact metrics. We should be encouraged by the fact that over the four years since, we have made enormous progress in moving towards much greater transparency and accountability across ESG.

We have had global developments like the International Sustainability Standards Board at the International Financial Reporting Standards Foundation – the first effort at global sustainability standard setting.

We have also had regulatory developments in a number of countries and regions. In the EU, the Sustainable Finance Disclosure Regulation, along with other regulations, has provided more demanding frameworks.

What do you make of the backlash against ESG in some quarters?

What I find particularly unhelpful is the idea that ESG is somehow anti-economic growth. That is the way the debate gets framed in the US and a lot of that is from a Republican pushback.

But it is broader than that. A lot of the pushback against ESG is that it is a liberal agenda that only the rich can afford. I would tie the renewable energy argument to the growth argument. Using more renewable energy will actually contribute to people's personal wellbeing and prosperity, which is incredibly important.

Does the social side of ESG get neglected?

There are many fantastic social impact investments going on. And in a way, the S pre-dates the E in terms of businesses and investors thinking about ESG.

If you take an organisation like the Co-operative Bank, for example, that was committed to ethical values and delivering positive impact – what we would now call positive social outcomes – a century ago.

The S has an amazing history, and for me, it is not E versus the S. The E and the S

What ideas have you put forward to government on this issue?

One of the proposals in my report is for a growth fund. There is a lot of interest in the leading political parties around mobilising capital, particularly from pension pots. What I have examined in my report is the different approaches and outcomes that public and private investors seek, the process of working, whether the different goals of a private investor and a public investor can be reconciled and trying to give agency to public and private investors, which is important.

What concerns me about some of the proposals out there for a growth fund is that they don't necessarily respect the approach and the outcomes sought by different investors. I also talk about a UK community growth fund, because we need to channel far more private investment into the social enterprise and charity sectors. They are delivering fantastic positive impact and can deliver much more investment at scale. So I am proposing a blended finance expertise and oversight unit in central government, working across departments and with private investors, which could oversee both funds.

How are pension funds doing in regard to ESG?

As with the institutional investment industry more broadly, there has been a positive shift in pensions towards being serious about ESG factors and integrating them into their investment principles.

But it is more of what you might see as a negative screen, that 'let's do no harm', or 'let's have some exclusions,' rather than delivering positive outcomes.

And a lot of pension funds now have an explicit net-zero commitment, and some funds have been quite taken by surprise as to how much radical change that requires in their approach.

Asset managers often cite their ESG commitments, particularly on climate. Are they substantive in your view?

are incredibly inter-linked and inter-dependent. We need to be driving the E and the S and, of course, the G going forward, but at a much greater scale and with far greater urgency.

The E is easy to define and measure, but that is not the case with the S.

It is a problem to be grappled with, but around the social side a lot of work has been done to help investors think through the standards to look at. But the E isn't terribly easy either. Net-zero targets, while appearing to be simple, can be quite counter-productive.

If you look at the work of the Transition Plan Taskforce, for example, which is designing templates for transition plans, they have thought through how to think about the S as well as the E and how you integrate them. There is an increasing amount of guidance out there to help investors.

You have been looking at how a potential Labour government could mobilise capital from pensions and other investors for a social benefit. What have you concluded?

Rachel Reeves has come up with some incredibly exciting ideas for what a Labour government would do around mobilising private investment. One of the encouraging things is how the shadow cabinet is demonstrating a real willingness to work with the financial services industry.

That constructive collaboration, which seeks to work with the industry rather than against it, is absolutely critical in delivering flows of private investment towards the challenges that need that capital.

How can blended finance help Britain catch up on its climate challenges?

Blended finance is a broad approach. It means different investors, different types of capital with different types of risk and return expectations working together to deliver positive outcomes – whether that is a financial return, a socio-economic outcome or an environmental outcome.

A lot of ESG is done through what I would call a 'do no harm lens', rather than delivering a positive impact.

The focus I take in my report is around the role that public money can play in providing catalytic capital, which then crowds in private investment. The Inflation Reduction Act in the US and the Green Deal and InvestEU in the EU are blended finance programmes using a range of tools, whether that is guarantees, tax credits, first loss capital or creating a market. The UK needs to catch up, as these programmes are putting it at a competitive disadvantage.

Why did you move from impact investing to the academic world?

At the Impact Investing Institute we worked to connect different parts of the investment spectrum to each other. For example, sharing the experience of social investors and the positive impacts they deliver, with mainstream investors. My work is still focused on doing that.

The project I am leading at the LSE is designed to encourage the UK government to be much more ambitious in mobilising private investment into economic, environmental and social policy priorities.

One of the key messages from the research which has just been published is how investors with different risk and return profiles, as public and private investors have, can collaborate closely to design financial solutions to pressing challenges like the climate crisis or social inequality.

So I don't feel like I have moved from practice to theory, but that I am continuing to encourage collaboration between different types of investors and move investment that delivers positive environmental and social outcomes more into the mainstream.

What is the biggest lesson you have learned in your career?

There are two. Firstly, push yourself out of your comfort zone. I have found this gets more difficult as you get older but have never regretted doing so. I left journalism after a nearly 20-year career at the *Financial Times* in 2019, to move into the world of impact investing, which required learning a new set of skills, and exercising some different professional muscles.

But I have found it enormously rewarding. In particular, because of the huge amount I have learnt from the great people I have had the opportunity of working with in the last few years.

Secondly, collaboration achieves more than confrontation. And collaboration only works if you engage with other people with kindness and respect. I wish I could say I always practice what I preach, but I do try.

What are your aims for the future on ESG and personally?

I hope that investors in the future will, as standard, take environmental, social and governance factors into consideration when investing in assets. Not just the 'do no harm' approach, but that we recognise, and maximise, the positive outcomes of our investment decisions as well as financial returns.

Personally, I hope to get the opportunity to continue sharing the benefits of sustainable finance in addressing the climate and nature crises as well as social injustice and encouraging and energising more policymakers to work closely with private investors to deliver sustainable and inclusive growth.

Nigel Peaple is the director of policy and advocacy at the PLSA.

PLSA ASKS FOR SIX POLICY, REGULATORY AND FISCAL CHANGES TO ENCOURAGE FURTHER PENSION SCHEME INVESTMENT IN UK GROWTH

Since early 2023 there has been considerable discussion by politicians, think tanks and the media on whether and how pension funds can be encouraged to invest more in the UK economy, especially regarding companies with the potential for high growth, albeit usually also at high risk.

While it is imperative that pension schemes' freedom to invest in the best interests of their members, however they see fit, is protected, the PLSA has worked hard to identify specific policy reforms that could result in further investment in the UK, following the Mansion House reforms in July.

Introducing a number of regulatory and fiscal changes could bring benefits to pension scheme members and the UK economy, without the need for radical, highly disruptive changes to the operation of the UK retirement savings system.

Investment in the UK economy was a key topic for debate at the PLSA's recent Annual Conference in Manchester, and after consulting with a wide range of pension providers, policymakers, think tanks and other stakeholders over the summer, the PLSA has made policy recommendations to government in six key areas:

Pipeline of assets: Ensure there is a stream of high-quality investment assets suitable for pension fund needs. The British Business Bank should be given the task of identifying and providing UK productive finance assets that achieve the right risk-return characteristics and low cost needed by pension funds. These should not only include unlisted equities but also other illiquid assets such as unlisted debt and infrastructure. The government should also support action by the asset management industry in providing suitable growth funds or investment vehicles, such as the LTAF. We believe pension funds will be much more likely to invest in UK growth if the government adopts a strategic and long-term approach to supporting key industries, and key tasks such as the green transition to achieve net zero by 2050.

DB regulation: The funding regulations that apply to DB pension funds should be amended to provide greater flexibility over their investments. In particular, DWP regulations, and the related TPR DB Funding Code should allow open DB pension funds, and closed DB pension funds with long investment time horizons, to take more investment risk where this is appropriate to protecting member benefits. For example, the regulatory regime should allow pension funds to place more reliance on the support of the sponsoring employer, more flexibility over the discount rate used, and not force schemes to reduce the investment risk they take by aiming to achieve the "low dependency" funding level.

Taxation: Fiscal incentives should be introduced that make investing in UK growth more attractive than competing assets. We would like the chancellor to make the following changes: allow tax free dividends on investment by pension funds in UK companies, and provide additional tax incentives, like the LIFTS initiative, in UK startups and companies requiring late-stage growth capital.

Consolidation: The government should prioritise the passage of a Bill through Parliament to establish a secure and statutory regime which will enable the growth of DB superfunds. It should also take other action necessary to support the consolidation of assets in DB master trusts and with insurers through buyout and buy-in contracts. Measures to encourage the consolidation of LGPS (England and Wales) assets into the eight asset pools must only take place where the pools can offer the right investment products and it should be done at a pace that protects the value of the contributions paid in by employers and employees. The government should continue with its planned programme of action to encourage the consolidation of DC schemes, notably through the use of value for money tests.

Market for DC under automatic-enrolment: The operation of the market in which employers and trustees select their DC pension funds for automatic-enrolment purposes must be reformed so that there is less focus on cost and more on performance. Currently, a mandate can be lost due to a difference in annual charges of only a few fractions of a percentage point. Often, this lower cost is achieved by adopting a simpler, less sophisticated investment strategy. In addition to action already being taken by the government on introducing a value for money test, we believe the advice by corporate IFAs and investment consultants to employers on pension schemes should focus on net performance rather than cost and be aligned with achieving the long-term interest of savers.

Raising pension contributions: The UK must increase the flow of assets into pensions by gradually increasing the level of pension contributions under automatic-enrolment from today's 8% of a band of earnings to 12% of all earnings starting in the mid-2020s and finishing in the early 2030s. Today, employers only pay 3% while employees pay 5%; we believe this should be equalised so that each pays 6%. Raising automatic enrolment contributions in this way will provide a deep and lasting pool of investment assets for decades to come.

ESG IN 2024

Regulation, natural capital and methane could be on institutional investors' agenda in 2024, says *Mark Dunne*.

ESG is not a passing fad. Institutional investors today are just as, if not more, committed to building sustainable portfolios that generate a positive impact on the natural world and promote equality than they were a decade ago. No longer seen as niche, such strategies are increasingly becoming a cornerstone of institutional portfolios.

Climate change has typically been the priority here, but other issues have emerged, such as providing access to fresh drinking water as well as adequate healthcare, housing and education. Then there is protecting our ecosystem, building resilient communities, ensuring that companies are well behaved and treat their employees with dignity and respect.

Building a sustainable and fairer world is a big job. Therefore, it is not surprising that new themes emerge in conversations between pension schemes and their investment managers.

Each year, *portfolio institutional* surveys the opinion of the members of its ESG Club to discover what they believe will be the big themes in the year ahead. One of those people is Laura Brown, who is head of client and sustainability solutions at Legal & General Investment Management (LGIM). She expects ESG-led investing to mature in 2024, in that there is likely to be increasing focus on real-world impacts and the outcomes investors are creating through their actions.

With this in mind, LGIM launched an engagement-led strategy in 2023 focusing on companies that traditional net-zero strategies would tilt away from. "It is focused on the subset of companies where we can identify that they are currently climate laggards but have the potential to become leaders and unlock shareholder value in the process. A detailed, pro-active engagement programme with very specific actions and KPIs aims to move them along that journey over time," Brown adds.

New disclosures

The disclosure regime will also be a big part of investment conversations in 2024, believes Nico Aspinall, a sustainability advocate at Newton Investment Management.

The final rules of the Sustainability Disclosure Requirements (SDR) were confirmed in November and will have a big impact on sustainable strategies. "We will spend a lot of next year working out which products will meet those rules and presumably creating new ones," he says. "That for me is huge.

"We are supportive of the SDR regime as it aligns with many things we do and how we think about sustainability.

"How investment management firms think about ESG is pretty foundational, so that could start to move things around next year," Aspinall adds.

SDR is not the only reporting disclosure that investment managers will need to get to grips with in the coming year. The Carbon Border Adjustment Mechanism will be implemented in the EU in 2026, but its reporting phase comes into force from

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Tim Manuel, Aon

January 2024 targeting iron, steel, aluminum, fertilisers, electricity, cement and hydrogen imported into the bloc.

The mechanism is being introduced to "prevent carbon leakage from their own carbon standards", says Abbie Llewellyn-Waters, an investment manager for global sustainable equities at Jupiter Asset Management.

"So at the point of importation, the carbon content of the product sold within those initial seven categories will now be initially measured, [and] ultimately priced," she adds.

The international response to this initiative has been expedited with several carbon-based initiatives being developed.

The US, for example, has initially responded with The Prove It Act – provide reliable objective verifiable emissions intensity targets – which requires the Department of Energy to study and compare the emissions of carbon-intensive sectors.

Other global mechanisms have developed, notably in China and Australia; with the former developing a carbon footprint management system for 50 products by 2025, introducing national level accounting rules. The UK is also working on its own version. "So it is logical to assume that over the next two to three years, we will have established mechanisms that internalise the price of carbon on a direct basis," Llewellyn-Waters says.

"From our perspective, what we look to in our capital allocation process, is those companies that are well positioned for when markets better reflect the climate-related financial risk and ultimately the valuation of the companies that we are investing in," she adds.

Those companies, Jupiter believes, are ready for this transition, in that they can "respond to those regulatory developments", which gives them a competitive advantage.

Llewellyn-Waters uses cement as an example. "If you want a tonne of cement, and you receive two quotes of the same quality that can be delivered on the day you want it, then you are probably going to go with the cheaper option.

"Companies with less carbon to price in their products therefore have a competitive advantage," she says.

"For us, companies who understand the direction of travel and have sought to decarbonise their businesses to prepare for a low-carbon transition are much better positioned than those who have not."

So Llewellyn-Waters believes that this mechanism has the potential to make "a significant difference" in the transition to a 1.5-degree climate scenario.

"And the mechanisms that will come into force, will accelerate internalisation of climate-related financial risks, with the valuation of equities better reflecting their transition strategy," she adds.

Rage against the machine

But the new year could see a pushback against the rules. "I'm going to call it a rebellion against regulation," says Tim Manuel, Aon's head of responsible investment.

A raft of ESG-related regulation has been introduced in the past few years emphasizing policy, process and disclosure. In short, it requires investors to collect more data to prove they have considered the environmental risks of their investments.

"It has done a great job of putting climate on the agenda and getting the issue firmly in the minds of investors," Manuel says. "But the issue is that regulation hasn't created an impetus for action.

"Many investors have recognised the importance of the issue, and they want to do something about it, but their resources are being drained by what regulation is continuingly asking them to do, which is more disclosure, more data.

"That is taking energy and attention away from what investors know they need to do, which is to start investing differently," he adds.

So Manuel expects to see some pushback here. It could start with the consultation looking at what the Sustainable Finance Disclosure Regulation should look like in future, which some are questioning if we should rip it up and start again. "I wouldn't be surprised if there is a high degree of support for that," he says.

"At the end of the day, change is not going to happen on the basis of nice disclosures. It is going to happen if people start behaving and investing differently."

The regulatory focus on transparency is making some people too cautious about the accuracy of the data they are disclosing, Manuel believes, which is acting like a barrier to action. There are instances, he says, where it is doing more harm than good.

"In most cases, we are going to be judged on action at the end of the day, not glossy disclosures. So I'd like to think that a theme in 2024 will be a focus on what is meaningful, rather than what is accurate," Manuel says.

Plain speaking

ESG has dominated investment conversations for many years, but if you asked five people what it means, you could receive five different answers. Indeed, an asset owner once told me that ESG is "three random letters that have been thrown together which we have to work with".

Such confusion could cause problems. "ESG is a term that has been prodded and twisted out of shape over the past year or two," Manuel says. "If ESG as a label is not used well it could cause more confusion than clarity.

"It is important for people operating in this space to be more conscious about language, to speak accurately and precisely about what they are trying to achieve.

"Sometimes ESG is used out of laziness: 'I know there is something that I should be talking about, but I'm just going to substitute it with "ESG" and hope that the person who is listening understands what I mean'," Manuel says.

We hope there will be more action on methane next year.

Peter Mennie, Manulife Investment Management

Regulation hasn't created an impetus for action.

Tim Manuel, Aon

He uses water as an example. It is a finite natural resource that supports life on Earth and which all businesses need a clean, constant and secure supply of. Semi-conductor makers, for example, are massive consumers of water. So not only is it a sustainability issue, but it is a financial risk for investors.

"Why not just talk about water being a business risk and an investment risk, rather than about it being an ESG risk," Manuel says. "There is often no need to label things as ESG. Using the term in a lazy way can sow confusion.

"A trend will be everyone starting to talk more precisely about what they mean in this space," he adds.

30 by 30

Biodiversity has become part of investment conversations for a couple of years now, and in 2024 the theme will continue to evolve, says Peter Mennie, chief sustainable investment officer of public markets at Manulife Investment Management.

"It has been a year since we were in chilly Montreal for COP15," he adds. "One of the key outcomes from that was the 30 by 30 target, which gives us evidence of where public policy is going and the angle we need to take when engaging with companies to promote nature-positive action."

In the year ahead, Mennie expects the 30 by 30 target to be a priority that drives decision-making on engagement targets alongside Nature Action 100 and the PRI's Spring initiative.

"When we talk to asset owners, they are thinking about their dependencies and impacts on nature," he adds. "So we are expecting to see an increase in reporting on nature."

So 2024 is the year that will see asset owners beginning to work towards putting that into practice, says Eric Nietsch, head of sustainable investing for Asia at Manulife Investment Management. "There are other pieces of regulation and pledges that are being made, which will come up next year at COP16, which is the first time that countries will begin to show their progress."

He adds that there are things happening on the regulatory side in Malaysia, the Philippines, Indonesia and Vietnam, while changes in Europe will also have an effect on Asia, specifically the EU Deforestation Regulation. "It comes into effect at the end of 2024 and covers supply chains, so that any product that goes on a shelf in Europe will have to show that it has not contributed to deforestation.

"Palm oil, for example, has been heavily scrutinised," Nietsch says. "Deforestation related to palm oil has decreased by about 80% over the last 10 years, but this new regulation will also cover rubber, coffee, cocoa cattle, wood and soy.

"We expect a lot of companies to be working on that through their supply chain next year," he adds. "If everything has to be clear by the end of December, then that means they have to do the work in 2024. That is just another example of regulation off the back of COP15."

Mennie says that nature and biodiversity should matter to everyone. A third of the world's medicine comes from nature, a third of our food supply is dependent on pollinators and with studies showing the potential job creation linked to addressing biodiversity loss, this is something we should all care about. As we move towards COP16 we are expecting to see a real focus on how we address it.

"The 30 by 30 target provides a framework and focal point for everyone to work towards: but we need to make sure it works and we need to harness the power of the markets and set the right incentives to make sure that targets are met," he adds.

Moving out of the shadows

It is becoming widely understood that climate change and biodiversity are linked. "If we just build an economy that doesn't emit carbon dioxide, there is a big risk that we will still destroy the planet," Newton's Aspinall warns. "Indeed, a good way to absorb carbon dioxide is to maintain our forests and oceans.

"Biodiversity has become a topic on its own," he adds. "The Taskforce on Nature-related Financial Disclosures is fresh out and clients are namechecking it more and more, so there is definitely an increasing client awareness of the topic."

Aspinall expects more and more of Newton's clients to be discussing natural capital going forward, as they try to understand how this systemic risk might affect returns.

"More of the investment process will be dedicated to natural capital as more and more people are thinking about these risks and more data is becoming available," he says.

Aspinall explains that when it comes to biodiversity, the investment world is not at the same stage as it is with climate change, but collectively responsible investment teams are pushing that agenda and there could soon be change. "In 2024, we could see positive change in internal philosophies around biodiversity," he says.

Natural risks

Many of the trustees Manuel speaks with are more engaged with nature risk than climate. "You can't take the person out of the decision-maker," he says. "People are more deeply affected at a personal level by issues connected with nature than they are with issues connected with the climate."

You look up at the sky and know there are emissions up there because scientists tell you that they are, but you can't see them. The destruction and abuse of the natural world is more tangible and visceral. "There is a personal drive that sits behind the decision-maker to want to do something about it, because there is something they can do."

The development in biodiversity during 2024 will be, Manuel believes, the realisation that if you think climate is complicated, then nature is a whole another level. "Not least because with climate there is a generality to it," he says. "Rising temperatures are a huge global problem, there is a similarity about it everywhere. The same solutions are going to solve that problem.

In 2024, we could see positive change in internal philosophies around biodiversity.

Nico Aspinall, Newton Investment Management

"But nature is location specific," Manuel adds. "The nature issue in the UK is completely different than the nature issue in the Amazon, which is completely different to the nature issue in Southeast Asia. And the solutions to those issues are different, too."

Evolving frameworks

Nature risk is also a hot topic for LGIM. "Over the last few months, we have received a big increase in questions about what it all means for investors," Brown says, who puts a lot of this down to The Taskforce on Nature-related Financial Disclosures (TNFD) coming onto the agenda for institutions.

"It's not an obligation, but having experienced TCFD, I guess people would like to get ahead of the game," she adds.

To helps its clients get ahead of the game, LGIM has been adapting its ESG scoring frameworks to incorporate nature-related metrics and are looking at strategies in this space, such as, for example, debt-for-nature swaps where it has experienced a jump in enquiries.

Biodiversity has a connection to climate change and so the firm is making sure that strategies evolve to account for nature risks. "I expect to see more and more interesting discussions on that side of things," Brown says.

To include it in their frameworks, LGIM have broken the issue down into its underlying component parts. Deforestation and water management are the two areas they have decided to start with, given that there is data available. "I would expect to see more and more in that space as more data is available," Brown says.

All that gas

Finally, governments are working to achieve the Paris agreement through investing in renewables and scaling up decarbonisation technologies, but there are other issues they need to tackle.

"We hope there will be more action on methane next year," Mennie says. "There seems to be an increasing alignment on action on methane and potentially more countries joining the Global Methane Pledge."

Methane is a potent greenhouse gas, which has a warming potential 84 to 87 times that of Co2 over a 20-year period. The IEA identifies cutting levels of this gas as a crucial part of hitting the 1.5-degree target.

"The next 20 years are a critical time for addressing climate change," Nietsch says. "Watching what happens out of the next COP will be interesting."

COP will certainly influence institutional investment portfolios in the coming year, with making a positive impact on the natural world and fighting climate change high on the agenda in what promises to be a year where ESG continues to evolve.

Inaction is NOT an OPTION

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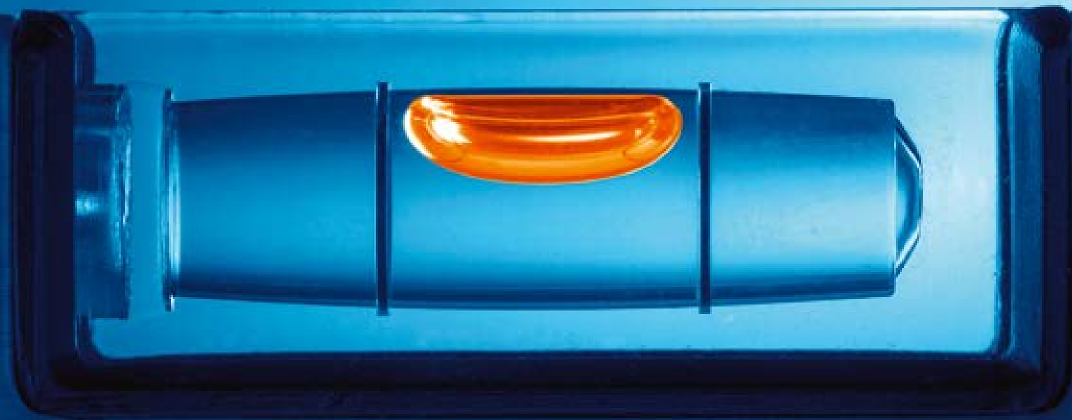

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