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ESG CLUB CONFERENCE 2023
DRIVING CHANGE IN CHALLENGING TIMES

These are challenging times for investors. They are facing uncertainty surrounding inflation, geopolitics and economic growth, but still have to earn a minimum financial return while trying to make the world more sustainable and equal.

portfolio institutional's second annual ESG Club Conference sought to tackle these issues by bringing experts together to discuss themes as diverse as the energy transition and biodiversity.

We also put the quality of ESG data under the microscope to see how investors can overcome inconsistences in non-financial corporate reporting to make better decisions, while a group of asset owners and investment managers explained how they are making positive social impacts through their portfolios.

The following pages of this supplement review the conference and highlight our panellists' insights into the world of ESG-led investing.

We hope to see you at our third annual ESG Club Conference on 3 July 2024.

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ESG CLUB CONFERENCE: TRANSITION ASSETS – A PATHWAY TO NET ZERO

Fossil fuels power our homes and businesses, enable us to travel the world and build products that improve our lives. But time has proved that they are also a threat to life on Earth. Breaking our reliance on them means finding reliable alternatives, and not just wind farms and solar parks. The panel in this year's ESG Club Conference started with a look at how institutional investors can reduce our reliance on oil and gas.

This year's conference opened with BlackRock's Ewa Jackson describing the transition to a low carbon economy as "a mega force that is shaping the global economy".

And there are three drivers that she believes are influencing the shape, speed and size of how the transition will unfold.

The first is policy stimulus in Europe and the US. Then there are the technological advances we are seeing across a variety of renewables. Finally, there is consumer sentiment.

To help implement net zero into its products, BlackRock has developed scenarios of how they believe the transition will unfold. These scenarios start with the endpoint – say, a 1.5-degree temperature rise in 2050 – and then work backwards from sector and energy perspectives to see how we can achieve it.

Predicting the future is not easy, so BlackRock has defined tipping points within technological advances. For example, what are the "tipping points" that will make electric vehicles mainstream? One is if the car is cheaper than the fossil fuel-powered equivalent, while there is alleviating range anxiety in the consumer.

In this transition scenario, sectors and regions BlackRock believes are in the "fast lane" to decarbonise include property, energy and light transport, predominantly in developed markets. It also identifies heavy transport and predominantly emerging market assets as being in the slow lane.

"We are starting to use this scenario in our product development," Ewa Jackson said.

Powering up

Picking up the theme that cleantech is not limited to wind and solar, Newton Investment Management's Therese Niklasson said that cleantech can be found in the transport, infrastructure and manufacturing industries. "If we just take the energy transition, whether it's meat replacements or electrification, there are lots of areas to look at," she said. But it is not just about cleantech exposure, investment teams are looking at how the companies in their portfolios are being powered.

This is an approach adopted by pension pool London CIV, Jacqueline Jackson said. "We have funds that wouldn't be described as sustainable but give us an opportunity to engage with organisations to support the transition."

Almost a quarter of London CIV's infrastructure investments are renewables, which will play a part in helping the pool achieve its ambitious 2040 net-zero target. "Looking to the future, we will be focusing on not only how we fund decarbonisation, but how we invest in clean energy," Jacqueline Jackson said, adding that reforestation and carbon capture technology could potentially play a role in the pool achieving carbon neutrality.

WELCOME
DRIVING CHANGE IN CHALLENGING TIMES

BNP Paribas Asset Management understands how influential it and organisations such as London CIV are in creating a regenerative economy. "We have long believed that asset owners and asset managers have a key role to play in financing the energy transition and helping to achieve net zero," Thibaud Clisson said.

BNP Paribas AM is committed to slashing its carbon footprint by 30% in 2025, from 2019's levels, and increasing this to 50% five years later.

It also has a framework that classifies companies depending on how credible they believe their decarbonisation strategy is. "Our goal is to have 60% of our assets under management in companies which are either achieving net zero or will be aligned by 2030," Clisson said.

Going forward, the intention is to invest in more climate solutions. But while stewardship will be crucial in shaping corporate climate strategies, the asset manager will also work with policymakers to ensure that regulation is going in the right direction.

Gold standard

It is clear that the energy transition offers several opportunities to institutional investors, but they are more bullish in some areas than others.

Eva Jackson says that investors are particularly excited by real assets such as infrastructure and real estate. A lot of capex is required to unlock and scale some of these technologies and much of that will be upfront financing and through different structures. More broadly, in infrastructure, this means hydrogen pipelines into the grid and investment in transport.

And with regard to real estate, by 2030 all commercial buildings will need energy performance certificates graded A or B. Ewa Jackson believes that around 85% of buildings will need to address their rating in order to get to that standard. "So a huge amount of capex is required in real estate," she said.

"From a thematic perspective, climate resilience is a theme which emerged strongly from the transition scenario," Ewa Jackson added. "By 2050, we estimate there to be around a 5% impact to global GDP due to climate damage. So once again, requiring significant investment to address that."

However, Newton's Therese Niklasson pointed out how difficult it is to achieve consensus on where capital is most needed in the transition. "If four economists were sitting on this panel, they would probably not agree on where it's most needed."

She added that a lot of capital needs to be deployed globally, but in the UK there are 13 million buildings that need to be reworked for installation and heating purposes. "EV needs to have an infrastructure around it to make it work.

"The elephant in the room, however, is emerging markets," she added. "Yes, we need investments in Europe and the UK, but we won't achieve the energy transition if we leave emerging markets behind," Niklasson said. "That's where most of our emissions will come from in the future."

Thibaud Clisson sounded an even louder note of caution. "It is fair to say that we are not necessarily on the right path," he said. "We are consuming fossil fuels like never before. The effects of climate change are more and more visible."

He added that the industry needs to act where it has the power to. This means bringing greener practices into private markets and engagement with policymakers to force through more regulation.

"We also need to address topics which are linked to climate change, but not necessarily perceived as being so. I'm referring to natural capital.

"Industry treats climate change and biodiversity as a silo, but we should try to treat it collectively," Clisson said, pointing to BNP Paribas AM buying a Dutch sustainable forest and agriculture company.

"It's a great opportunity to help our clients contribute to ecosystem restoration but also a natural carbon storage. This is how we can address the issue and make a difference."

Keeping your enemies close

So, does this mean that to solve the problem, investors should embrace problem industries?

"Investing in oil and gas on the path to net zero is a complex and potentially contentious issue, but there is an opportunity for that sector to have a real impact through targeted engagements," Jacqueline Jackson says.

London CIV has voted against Shell and BP for winding back on their transition targets and supported shareholder resolutions which requested financial institutions to stop funding new oil and gas exploration.

"But not all oil and gas companies are necessarily created equal," she said. London CIV looks for extractive companies which have strong transition ambitions with robust decarbonisation strategies.

"We cannot consume our way out of a crisis by simply decoupling emissions against revenues," she added. "What we look for is are our oil and gas companies reinvesting into greener technologies."

Jacqueline Jackson described carbon offsets as a "red herring", but pointed out that there are genuine opportunities to look at credible and robust carbon offsets and invest in industries that potentially offset portfolio emissions.

Short-term thinking, long-term gains

But what asset managers want you to do around climate risk is not uniform, Niklasson said. "There are many clients who might want you to focus more short term and are not willing to give up performance," she added.

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BlackRock

Therese Niklasson
Global head of sustainable investment
Newton Investment Management

Jacqueline Jackson
Head of responsible investment
London CIV

Thibaud Clisson
Climate change lead
BNP Paribas Asset Management

This varies across the world, with the US and Europe taking divergent routes. "This is important to asset managers, because we are not investing our own capital. So that is a big challenge we are working on," Niklasson said.

Then there are the conversations with portfolio managers. "You won't get the attention from the investment team if you keep talking about 2050," she added. "We have to make this a much more short-term conversation, looking at the timeframe through which they are investing. So we need to roll back the dialogue to make it more relevant for the investment teams to be incentivized to get involved."

The other issue is policy and regulation. "It hasn't gone far enough or fast enough for there to be a level playing field," Niklasson said. "Public markets are not going to solve this on its own. That is a little bit the frustration at times that it is almost like everyone's looking to us as investors to solve all of this, and for the markets to do its bit to solve the energy transition and climate issues. And it is not going to happen on its own. We need much more clear, uniform policy and regulation developments."

Going underground

However, we appear to be in something of a Catch-22 situation. Building wind turbines, solar panels and electric batteries requires minerals, we need more houses, which have to be extracted from the ground beneath us, which is far from kind to our planet.

"We are talking about quite traditional industries that potentially have quite antiquated technologies," Jacqueline Jackson said.

But there are emerging opportunities in these sectors, including using scrap materials in steel production, or fly ash in the production of concrete. "One thing that is often overlooked is the siloing of these technological advancements in these types of sectors," Jacqueline Jackson said. "When you look at some of the opportunities that are emerging, they are interlinked."

So mining and technology companies need to come together to understand where there can be cross-sector efficiencies, such as using waste from one production process in another. "That is often an area that gets overlooked because with competition and innovation needed, it can be quite difficult," Jacqueline Jackson said.

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

TRACKING THE LOW-CARBON TRANSITION

Thematic investing is about looking towards the long-term and orienting portfolios towards the big structural changes that will define our era. With that in mind, our BlackRock Investment Institute has named the transition to a low-carbon economy as one of 5 mega forces that we see as structural shifts bringing significant changes in profitability across economies and sectors. The transition to a low-carbon economy is driving an economic transformation spurred by government policy, technological innovation, and consumer preferences.[1]

In 2022 alone, **$1.1trn of global capital** was committed to low-carbon energy supply investment solutions, crucial to bringing us closer to the transition to a low-carbon economy.[2]

Investors looking to align their portfolio to the transition to a low-carbon economy can choose from a range of iShares thematic ETFs, that are designed to benefit from or contribute to the transition. Let's take a closer look at the themes shaping this range.

Clean energy – towards a renewables-powered economy

A key focus of the transition to a low-carbon economy is on the highest-emission segment: power generation.[3] Industrial advances are driving energy independence and reduced-emissions targets, which combine to boost investment in clean-energy infrastructure and technology. In 2022, 86% of all newly contracted renewable capacity had lower costs than fossil-fuel-fired electricity, indicating how production costs associated with renewable energy now rival those of traditional power sources.[4]

Essential metals – needed for a low-carbon transition

Minerals such as copper, lithium, nickel and rare earth have unique characteristics that are useful for constructing the technology required to transition to a low-carbon economy, including renewable energy systems, wind turbines, solar panels and electric vehicles. The acceleration of the low-carbon transition, coupled with supply-chain challenges, could present growth opportunities for miners and producers of these essential metals.

Lithium – charging ahead

Lithium is an important metal for electric vehicles and energy storage. Companies involved in the production of lithium and lithium-battery producers could benefit from increasing demand for these technologies, with annual lithium demand expected to increase 22x between 2022 and 2050 in the Net Zero Scenario by BloombergNEF.[5]

Copper – wiring the present to the future

Copper plays a role in all things linked to electrification, so copper miners are one of the main groups likely to benefit from the low-carbon transition. For instance, in power production, copper is used intensively in manufacturing wind turbines and solar cells. And in transportation, electric vehicles use 2.5x more copper than non-electric cars.[2] By 2035, it's estimated that copper demand will nearly double from 2021 levels, with most of this growth coming from transition-related demands.[6]

Index funds, including ETFs, can provide exposure to strategies with a focus on preparing for, being aligned to, benefiting from and/or contributing to the transition to a low-carbon economy.

To learn more about transition thematic ETFs, visit: www.iShares.com.

1) BlackRock Investment Institute (BII), *2023 Global Outlook:* New Regime, New opportunities, as at 31/07/2023
2) Bloomberg NEF Global Low-Carbon Energy Technology Investment Surges Past $1 Trillion for the First Time, as at 26 January 2023
3) IEA CO2 emissions in 2022, as at 30/03/2023
4) IRENA, Renewable Power Generation Costs in 2022, as at 30/08/2023
5) Bloomberg NEF Electric Vehicle Outlook 2023
6) S&P Global, 'The Future of Copper - Will the looming supply gap short-circuit the energy transition?', as at 31/07/2022

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THE RACE TO SECURE A GREEN FUTURE: LEGISLATION, CHALLENGES, COMPETITION

Policymakers across the world are committing billions of dollars to support efforts towards a green future. But the lack of an organised approach could set off fierce competition for people, power and resources, hampering the realisation of global green objectives.

We have seen plans to bolster greener forms of economic growth announced in the US, the EU, China and India.

Countries have stepped up efforts to gain a green competitive edge. This will entail transitioning to green products and processes, driving green innovation, and safeguarding critical mineral supply chains needed for the clean energy transition.

The 'race to green' began a new phase in August 2022 with the Inflation Reduction Act (IRA), which seeks to bolster US energy security and decarbonise energy production. It includes $500bn (£409bn) of spending and tax incentives for renewable energy to strengthen the domestic supply of critical minerals and production of clean technologies within the US.

Other economies have enacted their own green policies:

– The EU's REPowerEU Plan aims to reduce reliance on Russian fossil fuels with an investment package totalling almost €300bn (£259bn). It will be spent on clean energy infrastructure projects, with the goal of securing the bloc's supply of critical minerals and reaching a 45% renewable energy mix by 2030.

– China's 14th five-year plan totals $4trn (£3.2trn) in government expenditure. Low-carbon development and innovation are a priority: the plan targets 30% renewable power, 1,200GW of wind and solar capacity and peak emissions – all by 2030.

– India's 2023-34 Budget pledged $4.27bn ($3.5bn) towards green energy projects focusing on hydrogen and solar. India is looking to use green bonds to decarbonise its vast transport system.

Research on the IRA's impact found that economy-wide emissions should fall by 43%-48% below 2005 levels by 2035 if clean energy deployment accelerates. Electricity-specific emissions would drop by just 27% without IRA regulations, but by 59% with sped-up clean energy deployment and a high uptake of IRA regulations between 2022 and 2035.

The legislation has had other positive effects, for example, spurring a big push for US-based electric vehicle and battery production.

Foreign companies have too been notable beneficiaries of the legislation; projects include Vietnam's VinFast's $4bn (£3.2bn) EV factory in North Carolina and South Korea's Hyundai's $5bn (£4bn) battery plant in Georgia.

As is the US, the EU, China and India are focusing policies on renewables in order to keep up with increasing energy demand without boosting carbon emissions.

Efforts are centred on securing – and where possible onshoring – supply chains. One contentious area is that of critical minerals, essential components in many rapidly growing clean energy technologies, from wind turbines and power grids to electric vehicles.

Demand for these minerals is expected to rise quickly as the clean energy transition gathers pace.

There are growing concerns, though, about the emergence of critical mineral monopolies, resource nationalism and frayed international relations as economies strive to secure supplies and provide subsidies to domestic producers.

One of the IRA's tenets is increasing the domestic supply of critical minerals such as lithium and manganese. However, more local mining may fan environmental concerns over water withdrawals, greenhouse gas emissions and biodiversity.

The EU is also striving to safeguard supplies of critical minerals and manufacturing capacity. Under the Critical Raw Materials Act, the bloc looks to bolster production of vital net-zero technology components to enable a speedy transition to a clean economy.

The US, EU, India and China's plans will accelerate the eventual and inevitable transition to a lower emissions economy, creating a multitude of opportunities for stakeholders including investors.

There are considerable challenges, however. A 'race to the bottom' could see more local subsidies and incentives for local players, fanning resource nationalism, triggering further protectionist onshoring and increasing geopolitical tensions.

Nonetheless, we believe there is an upside given the vast sums economies are setting aside: when it comes to climate mitigation and adaption, every effort helps.

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BNP PARIBAS
ASSET MANAGEMENT

Therese Niklasson is global head of sustainable investment at Newton Investment Management.

NET ZERO: ADVOCATING FOR CHANGE AND A HOLISTIC APPROACH

Evidence of the direct link between the human burning of fossil fuels and climate change is all around us, yet despite the increasingly unequivocal science there is a long way to go in the fight to limit the impact of rising temperatures and increasingly frequent volatile weather events on our planet.

From an investment perspective, we know the current environment is one of significant uncertainty for net-zero efforts, with economies still recovering from pandemic lockdowns, the continuing Russia/Ukraine conflict, and capital discipline by heavy emitters providing a good short-to-medium term environment for carbon-intensive securities, albeit with a long-term overhang around the potential steamroller of regulation.

As asset managers, we believe our advocacy efforts must call for government and industry regulation with genuine 'teeth', as voluntary efforts alone are unlikely to be enough to create the level playing field to deal with the complexities of issues such as carbon taxes, border taxes or offsetting green premiums. For us, this is the crucial mechanism by which net zero will be achieved; we believe that voluntary action from consumers and asset owners will struggle to realise the desired outcomes on their own.

At an asset-manager level, we still get a sense that the thorny issues are being broadly dealt with within responsible investment and environmental, social and governance (ESG) team silos, but it needs a more holistic approach across companies, harnessing the risk function and the critical role that investment teams need to play. To create that internal ecosystem to deliver on our net-zero pledges, it requires a standardised and multi-disciplinary approach with ESG teams, analysts, portfolio managers and senior management all pulling together.

We are facing some stark realities: fossil-fuel substitution with cleaner counterparts needs to happen more quickly. Energy security and affordability must be balanced with climate considerations. Crucially, we believe that government regulation must be strengthened to correct the market failure to price emissions, which will create the right market considerations to incentivise the transition.

In the near term, we know that the Russia/Ukraine conflict may continue to create headwinds for the net-zero journey. We view it as a short-term 'speed bump' to the energy transition in that we will see a near-term increased reliance on coal and gas, but over the longer term we view it as an accelerant of the energy transition as a number of countries seek to bring forward their clean-energy transition plans.

While there is a huge amount of jargon used by asset managers, broader business and governments seeking to quantify how to achieve net zero, at a fundamental level climate change represents a series of risks and opportunities for all businesses that must be managed. Burying heads in the sand and using the past as an indicator of the future will not only cause severe damage to our planet, but also result in permanent destruction of capital and the missing out on the opportunities as new industries emerge.

At Newton, we know there are a concentrated number of stocks that produce most of our financed emissions. We will continue to work closely with them even if they do not achieve initial target-emission reductions. We must also act as advocates to influence the wider system which includes government and trade bodies to ensure that the right regulatory framework is put in place.

If we are to succeed in our aim of becoming a truly effective net-zero organisation, we will need to harness our active engagement approach and a truly company-wide buy-in to ensure that all our financed emissions have credible transition plans. By setting interim targets towards our end goal, we will be accountable to our clients, via transparent and timely reporting, to mark our progress along the way.

Find out more at:
www.newtonim.com/uk-institutional

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ESG CLUB CONFERENCE: BIODIVERSITY – PARADISE LOST?

Biodiversity supports life on Earth. It feeds us, purifies our air, provides us with medicines, fights climate change and could protect us from natural disasters such as flooding. Yet pollution, construction and overfishing are not only putting half of the world's GDP at risk but our lives, too. The second panel at the ESG Club Conference 2023 sought to discover what institutional investors are doing to stop the destruction of our ecosystem.

The WWF's Josephine Quint opened the conference's biodiversity panel with a few sobering thoughts: "Nature is in a pretty awful state," she said. "We estimate that we have lost 69% of our natural world since 1970."

The figure jumps to as high as 94% in some regions, such as Latin America. Yet the situation in the UK is not much better with it sitting among the world's most nature-depleted countries.

This is important for the financial institutions and corporates working to keep average temperatures low. "We have to be clear: we can't achieve net zero without nature," Quint said. "Nature loss and climate crises are two sides of the same coin.

"If we look at greenhouse gas emissions globally, 23% come from deforestation and land use change," she added. "If we are to achieve net zero by 2050, 37% of the emission reductions needed will come from nature, so this is important."

The natural world underpins our economy with 55% of global GDP either highly or moderately dependent on nature, PwC has found. This, Quint pointed out, has an impact on companies in all sectors, which to some degree are dependent on nature. "If there is no nature, there is no supply chain," she added.

Nature loss is, therefore, a financial risk. But it is also an opportunity. The UN estimates that $11trn (£9trn) needs to be invested in nature for the world to achieve its biodiversity goals by 2050.

How to identify and reduce nature risk in portfolios was a theme picked up by Lee Backhouse, senior responsible investment manager at Scottish Widows, who described the task as "difficult". "We are all looking at it with a fair degree of trepidation."

But he added that the first step is to reflect on what nature is and to understand the "wacky and wonderful characteristics of it". Then investors can spot any pressure points in their portfolio and how the impact arising from them could interact with their risk/return profile.

Not perfect

There is data available to help assess nature risk, but investors have to decide what methodologies to use and how they fit in with their aims. "It's not an easy task," Backhouse said.

This is due to there not being a single methodology to identify and reduce nature risk that suits everybody. "There is no one-glove-fits-all [approach]. There isn't a silver bullet," Backhouse said.

"But the data is there," he added. "It might not be packaged up in the way in which we as an industry like data to be packaged, it might not be in the bottles we like, but it is there and it can be used."

Yet there are issues over the quality of the data available, as there can be gaps. Backhouse, therefore, warned investors to manage

their expectations. "I would encourage anybody looking at nature right now to not get dragged into the perception for a need for absolute perfection before you start looking at this."

What could improve the quality of assessments in this area are any potential crossovers with addressing climate change. For example, the reporting infrastructure for the Task Force on Climate-related Financial Disclosures (TCFD) could serve as a base to assess and manage biodiversity risk.

The same could be true if you monitor deforestation, given the negative impact land use change has on biodiversity. "There are lessons that can be learned from previous work, so you are not going into this from a completely new foundation," Backhouse said.

For Mette Charles, Aon's ESG research lead and associate partner, the key challenges trustees and investors face when thinking about biodiversity are time and expertise.

"This is another elephant in the room because trustees are already pushed," she said. "Agendas are crowded. They already have to take on the huge subject of climate change and transition planning. Then there is stewardship and their implementation statements. They have a lot on their plate.

"Now biodiversity comes along. It is highly complex; the issues are difficult to understand and it's difficult to know where to start.

"So time and more expertise is needed," Charles added. "Trustees need frameworks and guidance, which are still being built and defined. It is going to take time and the challenges are enormous."

Mapping it out

There are many aspects to nature risk and its impacts are locally specific, so where to start managing such risks?

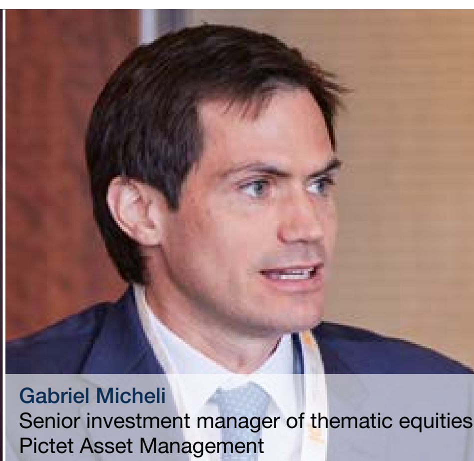
Lucian Peppelenbos, Robeco's climate and biodiversity strategist, said that the first step is to make a heat map of your sector exposures. "The good news is that the science data is pretty solid," he said.

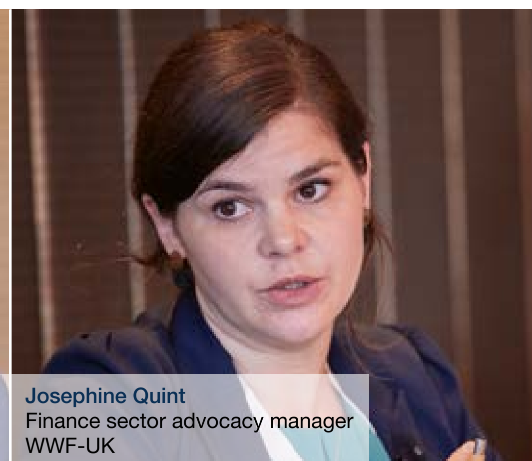
Replicating official research, for example, could help find your sector hotspots – the areas where you have the most nature-related risks. "You will find, just like with carbon footprints, that most of the impacts and risks are concentrated in a few sectors," Peppelenbos said, explaining that consumer staples, materials and financials carry 75% of the nature risk in some of Robeco's portfolios.

"It gives you focus," he added. "You can zoom into those three sectors and reach out to your portfolio managers and ask: how are we addressing those risks in these sectors? Can you show it in your investment analysis and in your valuations?

"Then it is a matter of pulling up your sleeves and working your way through it," Peppelenbos said.

Claudia Gray
Head of financial sector research
ShareAction


Gabriel Micheli
Senior investment manager of thematic equities
Pictet Asset Management


Josephine Quint
Finance sector advocacy manager
WWF-UK

Packing it up

Pictet has tackled nature-related risk in their environmental funds for some time, while its ReGeneration strategy, which was launched in February, specifically engages on the issue.

Examples of the impact Pictet is having in this area include at packaging companies. They work mostly with paper, which is recyclable, but sometimes a layer of aluminium is used. "90% of biodiversity loss comes from resource extraction and the use of those resources," said Gabriel Micheli, Pictet's senior investment manager of thematic equities.

"The more you can reduce that, the more you get towards a circular economy, the less impact you will have on biodiversity," he added.

Pictet works with companies to encourage the use of mono materials, such as if they use plastic, for example, it is only one kind of plastic which can be re-used.

Another company in its portfolio now uses forest-positive packaging meaning that they are replanting trees in biodiversity hotspots like Mexico.

Micheli said that more companies and investors are becoming aware of their biodiversity risks. "We have seen the re-rating of companies strongly over the past decade [due to climate change]. The same is going to happen with biodiversity, as companies understand their risk."

He added that investors are becoming aware of this given that consumer preferences are changing, while regulation is moving in the right direction.

Case by case

This comes back to the same issue: if investors are becoming more aware of the need to manage their nature-related risks, how should they do it?

When Aon interviews investment managers, how they approach biodiversity is an important part of that conversation. "It is interesting, because all of them come back to specific materiality on a case-by-case basis," Charles said.

And that is one of the problems with biodiversity. "There are no systematic, applied processes to demonstrate," She added.

There are, however, online tools that score the materiality of ecosystem services. Aon used the MSCI World to discover which ecosystem service was the most impactful or risky. The answer was water security.

"So that is a thematic way to start, but then you need to drill down in terms of locality," Charles said. "This is just the beginning of a journey.

"There is no silver bullet like with carbon emissions," she added. "It is early days, but there is data and there are starting points to get on with."

The right framework

Understanding the complexity of nature is crucial in managing its risks. "Nature is multi-dimensional," Backhouse said. "There are many interconnections, it is just far too complex for one metric to even get anywhere near giving you an indication of what is happening.

"If you were to attempt to use a single metric, then you are pretty much abandoning that complexity and wonder of nature. And you are going to get little information from it," he added.

It could take a basket of metrics to understand any particular impact across a portfolio, but along with that comes a suite of methodologies, because different methodologies rely on different metrics.

In response to that, Scottish Widows work closely with the Zoological Society of London in order to bring in a level of understanding that can support their use of metrics and methodologies.

Backhouse also likes the EU's Biodiversity and Business Platform, a biodiversity measurement navigation wheel that enables investors to identify which metrics, which approaches and which methodologies are going to suit their specific needs. "That wheel is essentially a performance decision framework,"

Lee Backhouse
Senior responsible investment manager
Scottish Widows

Lucian Peppelenbos
Climate and biodiversity strategist
Robeco

Mette Charles
ESG research lead, associate partner
Aon

he added. "And by systematically working through the criteria that make up that framework, that enables you to home in on what you need."

Frameworks will be increasingly important in managing nature-related risks. Indeed, Pictet launched a strategy 10 years ago using the framework of the planetary boundaries as a starting point. One of the framework's nine environmental dimensions is biodiversity.

Looking at how much value a company has created, relative to the resources it uses shows how efficient a company is. "Biodiversity is usually the combination of land use, climate change, water use and pollution. But if you look at how much value a company is creating relative to what it uses, you see a clear impact on financial performance over time," Micheli said.

For Peppelenbos, the Taskforce on Nature-related Financial Disclosures (TNFD) framework will be highly useful. "It is, of course, building on six years of experience of TCFD, replicating its structure.

"Now the key challenge is going to be: will it generate data that is investment relevant, that is comparable and that we can aggregate in portfolios? Indeed, there is no single metric, it's case by case. That's the big challenge.

"Sector is the key here. We need sector by sector guidance on what are the key impacts, the key underlying drivers of biodiversity loss and the key mitigating actions in a sector to mitigate those drivers.

"For nature, we need the same pathways as we have for climate change," he added. "We have sector decarbonisation pathways, it gives the timelines, the thresholds and the technologies that need to come into place. We need that for nature as well."

Food for thought

Another issue that is damaging our ecosystem is how we put food on our table. Quint said that our food system is extremely damaging for the natural environment.

"It is the biggest cause of deforestation," she added. "It is the biggest driver of freshwater stress. It is the biggest cause of destruction of wildlife and aquatic life in oceans and rivers."

Quint called for a rethink on how we tackle the "triple challenge" of feeding a growing population while maintaining average global temperatures below 1.5-degrees and reversing nature loss. "In order to achieve that transformation, we will need all stakeholders within the food value chain to work together," Quint said, adding that such co-operation will have to push for much less use of artificial fertilizer, reducing food waste and better management of livestock.

Good COP, bad COP

The conversation then turned from investors to politicians, especially concerning the COP15 meeting in Canada last December, where Peppelenbos was philosophical. "COP15 is nice, but what really drives politics here is the law of physics. We are in the Anthropocene, a new geological period after billions of years where the human footprint is now shaping the Earth's system.

"Nature's cracking and it's knocking on the doors of politicians, but they don't really like it because nature doesn't vote. It doesn't win elections," he added.

So politicians reluctantly take it on board through COP15 and other frameworks, which have their benefits. "COP15 doesn't have any legal status, but it creates a peer pressure process," Peppelenbos said. "Diplomats are forced together in a room where they pursue each other and review their plans.

"That will help to accelerate this inevitable policy response, but it is not going to be a piece of paper that does all of this. It's the laws of physics," he added.

But COP15 did produce a biodiversity agreement among most of the world's governments. Indeed, 188 countries agreed to protect a third of our planet for nature by 2030, which will see more support for the world's rainforests and wetlands. "A deal is only as good as its implementation," Quint said. "We need ambitious national plans that will show how countries will deliver against the goals and targets set in this framework."

Stephen Freedman is head of research and sustainability for thematic equities at Pictet Asset Management.

BIODIVERSITY LOSS IS BECOMING A MATERIAL FINANCIAL RISK

Biodiversity loss has long concerned scientists and conservationists, but new research shows it has now become a material financial risk. Several studies in 2023 have found that biodiversity-related risks are beginning to affect valuations.

Listed businesses that contribute most to biodiversity loss have seen their shares penalised, while firms with more sound ecological credentials enjoy more favourable financing costs.

A Swiss Finance Institute study showed that the risk premium investors demand on companies with larger biodiversity footprints has risen in the past two years.[1] These stocks experienced an additional monthly rise in risk premium of 23bps, or an annualised increase of 2.8%, for a one-standard deviation increase in the value of their corporate biodiversity footprint.[2]

This increase occurred between the last two COP biodiversity summits, where governments agreed the Global Biodiversity Framework (GBF), which researchers say has increased awareness about biodiversity loss and future regulations.

Emergence of a risk premium

Other research suggests the biodiversity risk premium may have existed as far back as 2010.

A paper published by the National Bureau of Economic Research analysed financial statements and annual reports from 2010-2020. It found that companies more exposed to biodiversity risk saw their stock prices underperform compared with others when biodiversity risk increased.[3]

To determine the extent to which biodiversity risks are incorporated into equity prices, researchers made a two-part study. First, they constructed a news-based measure of biodiversity risk using a natural language processing model.

Secondly, they built model equity portfolios along sector lines, grouping them according to their exposures.

The portfolios held long positions in industries with low biodiversity risk exposure – and short positions in industries with high biodiversity risk exposures.

Researchers assumed that if biodiversity risk is priced, the return on these biodiversity-risk-sorted portfolios should move together with their aggregate biodiversity news index, effectively behaving like a hedging portfolio for biodiversity risk.

The correlations between the return of this hedging portfolio and their biodiversity-risk index were positive at up to 0.2 – a pattern researchers said was large and comparable to those obtained by climate hedging portfolios when evaluated against aggregate climate news.

Negative return expectations

A separate group of researchers examined companies in industries that have a large biodiversity footprint. They found that investors require higher compensation for holding biodiversity-impacting firms.

Another study showed the emergence of biodiversity risk in fixed income markets. Researchers compared the Credit Default Swaps (CDS), or the cost of insuring debt against default, for a term between one and 10 years.[4] They focused on the infrastructure industry, a sector that is crucial in the tackling of the triple planetary crisis of climate, biodiversity loss and pollution and responsible for nearly 90% of all climate adaptation costs.[5]

They found that companies with better biodiversity risk management had up to 93bps better relative long-term financing conditions than the worst ones with results showing greater difference over longer lending periods. This flattening of the CDS curve, the researchers concluded, indicates that investors perceive those risks as long-term issues.

Biodiversity: not business as usual

Yet this doesn't mean businesses and investors can afford to disregard biodiversity loss as a risk factor. On the contrary.

The Taskforce for Nature-Related Financial Disclosures (TNFD) has just launched a set of 14 disclosure recommendations that are aligned with the GBF. More regulatory changes are sure to follow.

All of which means biodiversity will be a major topic for debate across corporate boardrooms. It is, in any case, already a material financial variable, affecting the way firms conduct their businesses and how investors allocate their capital.

1) Garel, A. et al, Do Investors Care About Biodiversity? (May 26, 2023). Swiss Finance Institute Research Paper No. 23-24, European Corporate Governance Institute – Finance Working Paper No. 905/2023 https://ssrn.com/abstract=4398110
2) The biodiversity footprint was calculated using a metric based on a species-based indicator of biodiversity intactness
3) Giglio, S. et al, Biodiversity Risk (April 4, 2023). https://www.nber.org/papers/w31137
4) Hoepner, A. et al, Beyond Climate: The Impact of Biodiversity, Water, and Pollution on the CDS Term Structure (February 8, 2023). Swiss Finance Institute Research Paper No. 23-10, Michael J. Brennan Irish Finance Working Paper Series Research Paper No. 23-4 https://ssrn.com/abstract=4351633
5) https://www.unep.org/resources/report/infrastructure-climate-action

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Building Responsible Partnerships

Lucian Peppelenbos is a climate and biodiversity strategist at Robeco.

IS IT (IM)POSSIBLE TO INVEST IN BIODIVERSITY?

The financial sector has been showing a growing interest in investing in biodiversity-related financial instruments. In Robeco's annual climate survey of 300 global investors, nearly half (48%) indicated that biodiversity is 'significant' or 'central' to their investment policy, up from only 19% two years ago. Moreover, the respondents shared that they are actively seeking to invest in biodiversity-orientated strategies within the next year.

At the same time, we have seen various launches of thematic biodiversity equities investment products in the market. This raises questions about the criteria and metrics applied. How is biodiversity measured, and when can we speak of a positive contribution to biodiversity?

The simple fact is that most businesses have an inevitable negative environmental impact from consuming natural resources, emitting carbon dioxide, and releasing substances. Economic activities that improve the quality or quantity of nature are, in principle, quite limited. So, is it possible to invest in biodiversity in the first place? The answer generally is no.

Fundamentally, forests, wetlands, rivers and oceans do not provide direct returns for a company and therefore are hard to invest in. A European Investment Bank study showed that only 3% of nature-based solutions projects in the European market have a significant private sector investor behind it; the rest is funded by governments.

What companies should focus on

Although we do not want to dismiss the opportunity of nature-positive investments for the private sector, and certainly not in the medium and long term, the risk remains that it can distract companies from what they should be focusing on now.

We think companies should concentrate on reducing and eliminating the key pressures behind biodiversity loss, such as deforestation, draining wetlands, burning fossil fuels or ocean pollution. If these pressures on nature stop, or no longer reach excessive levels, nature will be able to take care of itself.

We know this can work, as evidenced by the recovery of the ozone layer. In 1987 governments worldwide agreed to ban nearly 100 ozone-depleting substances. This removed the key pressure, and as a result the ozone layer has now recovered almost fully.

Bending the curve

The focus of companies and investors must be on bending the curve of biodiversity loss. In line with the Global Biodiversity Agreement agreed upon in Montreal, they must drive a transition to reduce the environmental footprint of production and consumption, reach a point of no further nature loss in 2030, and from there onward realise a pattern of economic growth that goes hand in hand with the growth of nature.

To achieve this systemic change, we need to rethink what companies are part of the transition toward a nature positive economy. What companies have business models that help reduce the pressure on biodiversity and hence assist nature in its recovery?

A small but decent universe

Some listed companies provide solutions contributing toward a nature-positive world, measured in terms of reduced deforestation, water use and their impact on other pressures. Think, for example, about alternative proteins, green infrastructure or water technology companies. There is a decent investment universe for these solution providers, but it is relatively small.

In the private equity space, there are start-ups and scale-ups who are operating in biodiversity-rich locations around the globe – often in emerging markets.

But this is not enough. We can't rely on only financing totally green companies. To bend the curve of biodiversity loss, we need to address the unsustainable value chains that are responsible for biodiversity loss and their underlying pressures.

That requires scaling up and speeding up systemic change at the larger companies to help them achieve nature-positive status. Engagement can help with this, and if biodiversity does indeed prove to be uninvestible, it may well be our best way forward.

If you'd like more information about biodiversity investing, please contact: *ukinstitutional@robeco.com*

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*Broadridge Market Analysis, 2022. Broadridge Distribution Achievement Award – ESG/SRI - 2018, 2019, 2020, 2021, 2022

ESG CLUB CONFERENCE:
ESG RATINGS – WHAT'S THE SCORE?

Non-financial disclosures are inconsistent, making it difficult to build an accurate ESG profile of assets. Rating providers claim they can bring clarity, but rarely reach the same conclusion on individual companies. Is this because there are too many factors to consider or are these ratings simply not fit for purpose?

ESG scores are one of the most debated topics within the sustainable investment arena. The issues surrounding the topic were central to the third session of *portfolio institutional's* ESG Club Conference, appropriately titled: *ESG ratings – What's the score?*

Starting the discussion, MSCI's Elchin Mammadov said that investors using MSCI's ESG scores fall into one of two "investor buckets". The first is traditional investing, where the focus is on maximising returns. Here ESG data is used with their financial analysis to help identify risk within a company's valuation, profitability and competitive position.

The second bucket is a smaller and more diverse group of investors who analyse the impact assets have on society and the environment. "They avoid companies which are making a negative impact to focus on those generating a positive impact," Mammadov said.

There is also a methodology that uses a mixture of the two approaches. "This is what we call double materiality, where investors think about maximising their risk-adjusted returns, but also try to avoid companies that do not make a positive impact," Mammadov said.

Buyer beware

Addressing the criticism voiced by some investors that ESG scores are often too simplistic to be useful, the PLSA's Joe Dabrowski said: "There is a lot of tension between what pension schemes need in practice and what is in the underlying data."

He also noted that trustees are reliant on advisers and consultants to interpret the data, for which there are different needs across the pensions sector based on issues such as the size of the scheme. "As a trustee you are looking for information that you can trust and readily use, as well as being reliable and comparable. But in the ratings space, we don't have that," Dabrowski said.

"It is emerging but is a bit of a buyer beware situation presently."

This poses obvious challenges for investors, especially pension funds, when addressing the ratings situation.

Dabrowski was keen to qualify his thoughts that investors, including pension funds, do have accessible data, but he stressed a more fundamental point. "How robust it is? How comparable it is?" he said.

Questions also surround ratings being unregulated, as well as issues concerning governance and system controls. "Investors are in a slightly difficult space," Dabrowski added. "It is a real pickle at the moment, and we need to resolve all of that."

Are you serious?

Moving the discussion on, Shai Hill, chief executive of data provider Integrum ESG, tackled the issue of whether investors

can take ratings seriously when there is such divergence among providers.

First, he questioned if there is, in fact, a big divergence. "I suppose the answer is, yes." Hill cited research from the Massachusetts Institute of Technology, which compared the ratings of ESG providers and concluded that they are more likely to disagree than agree on a score. Hardly a reliable starting point for investors. "That does lead to a lot of frustration," he added.

Hill then started unpicking some of the flawed perceptions about ESG scoring. "People want ESG ratings to be like credit ratings," he said. "In my view, that is a foolish expectation, because it took decades to reach a consensus of what makes credit worthiness."

In comparison, Hill said, ESG is an enormous range of topics, from the composition of the remuneration committee to the amount of air pollutants emitted per annum.

He, therefore, suggested that investors should not be frustrated, as ESG is too wide ranging to be boxed into a single score.

Material world

That said, there is, he highlighted, a consensus on what the material issues are for a company based on its sector, but not how material those different issues are. "And what affects ratings is the weighting you put on something," Hill added.

"The balance between quantitative and qualitative: how you measure that is a huge issue. Do you reward a company for having a strong [ESG] policy, or do you ignore it?"

Hill's central point being the logic behind ESG scoring is never clear. "Why are asset owners and trustees relying on ratings they cannot understand?" he asked.

Then the other Hill on the panel, Mark Hill from The Pensions Regulator, highlighted the importance of effective ESG scores. "The credibility of ESG ratings has a role to play for corporate disclosures to be effective," he said. "So we are looking at that credibility for them to be useful.

"As a regulator, we are very much aware of all this and is why we are looking at how to increase that coverage and credibility," he added.

As a result, The Pensions Regulator is undergoing a major regulatory initiative which looks at the statement of investment principles and the implementation statements. "What we are doing is looking at ESG and climate-related disclosures in relation to the financial and non-financial considerations. Hopefully, the results of that will be published in early 2024," Mark Hill said.

"That will hopefully help drive that expansion and credibility," he added. "The integrity of disclosures is very important."

Private problem

When it comes to corporate bonds and listed equities, the climate-related data is pretty good, Mark Hill said, but he added that private markets are a challenge. "From a regulatory perspective, we want to see an improvement in invested data and disclosures made available to trustees, service providers, investment managers and advisers in order to give them a better understanding of the risks and opportunities and how to manage that," Hill said. So how can the industry improve the quality of non-corporate disclosures? "There is a lot we can do for ourselves," Dabrowski said.

Thinking about what can and is being done as an industry, he cited: guidance on the issue of disclosure, shared experiences, looking at implementation statements, case study work, engagement with the regulators, setting out the industry's stewardship expectations and uniformly pushing those as hard as possible.

Dabrowski, therefore, put a strong emphasis on investors, like pension funds, playing their part. "That will be driven by getting amongst ourselves some form of consensus on what matters to us. You hear a lot on that about corporate disclosure, or disclosure from asset managers," Dabrowski added.

But putting the issue into context, he said that climate-change reporting has taken an "incredibly long time" to be part of corporate reports. "You need in some cases the hard rod of legislation to hold people to account."

Nevertheless, there are discussions taking place about ratings, which left Dabrowski reasonably optimistic that it will feed through to benefit investors. "We need to be able to use all of that at any level of [pension] scheme," he added.

An alternative view

Returning to the scoring methodology, dealing with the challenges in MSCI profiling a company and setting an accurate score, Mammadov admitted: "It's not easy."

But he added that the way MSCI approaches ratings is through collecting a great deal of data. "We take time standardising and structuring that data. We have over 400 analysts doing that," Mammadov said.

"But the issue we have is a lot of data reported by companies, whether voluntary or mandatory, is not standardised, it is cherry picked," he added.

MSCI, therefore, utilises alternative data sources, which includes regulatory data, such as has a company had any recalls or fines, as well as data from non-governmental organisations like the World Bank. "More than a third of our ratings are derived from using that third-party data," Mammadov said.

He added that there is always a methodology behind everything MSCI does. "The way we think about the ratings is: what risks and opportunities is the company exposed to? And what is the company doing in managing those risks?" Mammadov said.

He added that MSCI focuses on six to eight financially material risks for a company, with a weighting for each one of them. "A lot of our clients are smart and don't take the ratings at face value. What they tend to use is the underlying data. Then they can adjust the weight of the rating on the key issues they think are relevant," Mammadov said.

Shai Hill added that materiality is important. "If you have a tight materiality framework you are looking at the seven things that are material for that company," he said.

Mind the gaps

But what is evident is that there are big gaps in the available data. So how can these be filled? For Shai Hill, it comes back to there being transparency issues in the data. Although, he added: "We have a phrase which is: no disclosure is valuable data. As in, don't try to fill it with some type of estimate or proxy. Estimates are dangerous."

And he wondered if asset owners know how much estimated data they are using. "It is a real concern, one the regulator should be concerned about," Hill said.

Offered to come back on this, Mark Hill from TPR, retorted: "Where do you start?" He noted there is an issue of the professionalisation of trustees, in that they need to have the right tools to look at such issues and say: "That doesn't look right."

Comparing matters on a geographical basis, how do corporate disclosures in the UK versus the US and emerging markets shape up? "Europe is leading the way globally in terms of disclosures on ESG and climate," Mammadov said.

However, he also said it depends on if you are in developed or emerging markets, with disclosure better in the former.

"Compared to Europe – the US, China and Canada lag," he added. "In China there is an ESG standard, but it is voluntary. And in the US, SEC proposals are still not final."

Different strokes

Although there can be regional differences on different types of disclosure. "In the US there is good disclosure on governance and business ethics. In other parts of the world there is better disclosure on diversity, but in some markets it is illegal to report that data," Mammadov added.

The good news is that many emerging markets are looking to adopt frameworks like the Task Force on Climate-related Financial Disclosures (TCFD), which could go a long way in helping to standardise reporting globally.

So how far are we from having a compulsory framework on disclosure? "It is fair to say it is a while off," Mark Hill said.

Joe Dabrowski
Deputy director
Pensions and Lifetime Savings Association

Mark Hill
Climate & sustainability – business lead
The Pensions Regulator

Shai Hill
CEO
Integrum ESG

Elchin Mammadov
EMEA co-head of ESG and climate research
MSCI

But there are positives. He listed a number of initiatives that have paved the way for a possible all-embracing disclosure framework. "The then chancellor in 2021 talked about a disclosure requirement regime, which was reiterated in a revamp of the green finance strategy in March, so the direction of travel in that regard has been set," he said.

Mark Hill then added: "We have TCFD forming the framework, the Taskforce on Nature-related Financial Disclosures is based on the foundations of TCFD, we also have the Transition Plan Taskforce soon releasing its framework and sector specific guidance due out in early 2024, which includes asset owners and asset managers. We also have the green taxonomy for the UK. "The building blocks are most definitely there to deliver it."

Mark Hill continued to note other matters that could get in the way – at least in the immediate future. "We have an election coming up, so I don't think we are going to see anything before 2025 in terms of an integrated, holistic and sustainable disclosure requirement regime."

Shai Hill is the chief executive of Integrum ESG.

DON'T TAKE ESG RATINGS AT FACE VALUE

In the ever-evolving landscape of sustainable investing, a disparity has emerged, one that raises questions about the credibility of the field.

In contrast to credit rating agencies, which showcase a level of alignment in their ratings exceeding 90%, ESG ratings providers instead find themselves in a state of discord.

Various academic studies and analysis from the CFA Institute have estimated correlations between providers in the range of 30% to 50%. Analysis on our data at Integrum ESG against MSCI shows a correlation as low as 29%.

Whilst some view this as a significant problem, calling into question the credibility of ESG ratings, others perceive it as a safeguard against groupthink, highlighting the past shortcomings of uniformity in credit rating agencies.

Despite differing perspectives on the issue's gravity, there's a widespread consensus on the necessity for transparency in scoring methodologies and data sources among rating providers. This transparency is vital for investors seeking reliability when utilising these ratings in their decision-making processes.

The most widely used provider of ESG scores, MSCI, makes available a public methodology document, but is opaque in terms of how scores and weights are generated. It does name several 'key issues' that it has considered and present whether it believes a company is an 'ESG leader', 'ESG laggard', or 'ESG average' for that industry. It is not made public how these issues are weighted or what underlying data is used to evaluate them. In contrast, Integrum ESG equally weights every issue deemed material by the International Sustainability Standards Board (ISSB) and applies a transparent 0-4 scoring logic.

Let us look at an example – Automatic Data Processing (ADP) is an American provider of human resources management software and services with a market cap of more than $100bn (£81.8bn) and a workforce of more 60,000. It has been awarded the coveted 'AAA' by MSCI every year since 2020. In contrast, Integrum ESG score ADP the average grade – a mediocre C.

Identified as an 'ESG leader' for issues such as 'privacy and data security' by MSCI, Integrum ESG have scored them poorly for these metrics as the company does not disclose data breaches and instances of customer data being breached – a significant problem in the industry.

Although it does not align with the key issues deemed material by ISSB, MSCI considers 'climate emissions' for ADP and views them as 'ESG average'.

This comes as a surprise to the research team at Integrum ESG who find that ADP have not calculated and published their emissions since 2020. ADP further scored poorly on two issues deemed material by ISSB but not mentioned as key issues by MSCI – water consumption and management of competitive behaviour. For these material issues, ADP failed to disclose relevant data or outline any policies in place to avoid their risks.

We discovered a theme of multiple large software companies and companies responsible for highly sensitive information scoring highly by MSCI but failing to disclose data relating to data breaches or loss of customer private information, including Microsoft and American Express.

More generally, there were instances of companies being labelled an 'ESG leader' for issues which the company did not actually publish data on.

Integrum ESG evaluate material issues by applying an objective, publicly available, rules-based scoring methodology to assess a company's own ESG disclosures to provide an overall ESG rating. This approach ensures that there is no room for analyst subjectivity to influence our ESG ratings. Importantly, this allows investors to understand why certain issues have been deemed material for a specific industry and the precise rationale for assigning a particular score to a company by showcasing the underlying data.

Whilst opinions regarding the most important ESG risks for a company will often differ, it is imperative to provide a detailed explanation for the selected issues and the information and data evaluated in the assessment.

Without this, investors will struggle to gain a true understanding of an ESG score leading to inefficient, if not dangerous, asymmetric information in the market.

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Integrum ESG provides data related services / financial research, capturing ESG data that is material to any company (and its sector) or country and providing ratings/scores. The analysis is driven by a blend of Human and Artificial Intelligence and uses a simple and transparent scoring logic to assign a grade that their clients can unpack for any company or country.

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ESG CLUB CONFERENCE:
THE BIG S: MAKING A SOCIAL IMPACT

Using institutional capital to build a better world is not just about cutting harmful gas emissions and improving access to fresh water. It also involves tackling social challenges, such as providing adequate housing, education and healthcare. The final panel of our ESG Club Conference looked at how institutional investors are using their capital to reduce inequality.

"Most investment impact is not achieved through impact investing," said Dan Neale of the Church Commissioners for England as he opened the discussion.

"Most of us can't be impact-first investors, we can't take concessionary returns," he added, explaining that when people talk about making an impact, they usually mean that "some positive stuff happens" in their investments where the potential return was the main driver for investing.

As proof, he pointed to less than 1% of assets under management globally are allocated to making an impact, based on The Global Impact Investing Network's claim that the market is worth $1.1trn (£900bn). The main problem is that it is harder to make a positive social impact than a positive environmental outcome, where an investment causing less harm to the climate is acceptable. "You can't have that equal narrative with social," Neale said. "With social we can't say this is an investment with less slaves. It doesn't have that same ring as having less harm on the environment."

Another issue with the social pilar of ESG is the lack of offsets. "You can't say that the good we are doing over here makes up for the bad over here," Neale said. "There are positive impacts and there are negative impacts with every investment, but they do not exist on a balanced scale."

However, Abbie Llewellyn-Waters, who is responsible for global sustainable equities at Jupiter Asset Management, disagrees with Neale, believing that it is not mutually exclusive to have a capital growth objective and a positive impact. "The two can co-exist comfortably. It is not one or the other," she added.

Social mobility

One "exciting" capital growth opportunity and positive social impact multiplier Jupiter is looking at is financial inclusion.

"There are 1 billion unbanked adults in the global economy, so investing in companies that enable the digitalisation of cashflow is an important step forward for inclusive economic growth," Llewellyn-Waters said.

This means investing in digital payment operators, payment networks or digitalisation-enabling software. "It is important, particularly for communities in rural or remote regions where they don't have the infrastructure to facilitate economic inclusion from a financial service provision perspective. That is an exciting aspect that we can look at," she added.

Another social mobility enhancer in Jupiter's portfolio is a company that makes cochlear implants, which synthetically recreate the neural pathways between the brain and the ear.

"The congenital deafness run-rate for babies is one in 1,000 in the developed world. It runs about one in 250 in some other regions," Llewellyn-Waters said.

"The economic isolation of deafness can be detrimental to the child," she added. "Treatment for the first two years of life leads to almost 100% inclusive economic trajectory for that child."

Then there is Valspar, a US social mobility enabling paint manufacturer. When a sole trader comes into one of their retail outlets, they facilitate full invoicing to enable them to operate on a company basis, allowing for decent work and economic growth "yet they are selling paint", Llewellyn-Waters said.

"So it is an interesting way of looking at the effect your capital allocation process and the impact multiplier can have on the economy," she added.

The four Cs

But how easy is it to make a social impact through investing in real assets. In the past 15 years, Legal & General Investment Management (LGIM) has invested more than £30bn in assets such as transport, schools, commercial buildings and housing.

"For us, it is about improving asset value and performance, and that goes hand in hand with positive social and environmental outcomes," LGIM's Shuen Chan said.

There are many reasons why making a social impact is important to LGIM, but there is one fundamental driver. "The infrastructure investments we make and the assets we develop, manage and operate are ultimately for people and communities. Without them, our business model does not work," Chan said.

So LGIM is focused on making place-based impacts. "What we ask ourselves is, how can we as real asset investors contribute, deliver and catalyse change for the communities where our assets are based," she added.

This approach is underpinned by what Chan called the four Cs. The first is the community where the asset is based. "The social challenges facing a coastal town such as Poole in southeast England are different from the challenges faced in Maryland in the US, for example."

Then there is commercial. "There doesn't need to be a trade-off between driving positive outcomes and commercial returns," Chan said. "There is a proven relationship between real assets, building resilient economies and investment returns."

The third C is collaboration: identifying strategic partnerships that help you understand the needs of the local community. Finally, there is being catalytic, in that when you understand how you can drive change, you drive it at scale.

Investing with purpose

Agreeing with Chan that it is possible to earn a return from making a difference to the lives of the most underserved in society, was Anita Bhatia, investment director of the Guy's and St Thomas' Foundation.

The foundation's purpose is to address health inequality. Bhatia and her team approach this by looking at countries which do not have a public health system. "So how do we make investments, direct or indirectly, that can deliver accessible, affordable healthcare to vulnerable people whose needs are not being met?"

But this is not just about access to healthcare. Other themes that are connected to this include what impact is climate changing having on vulnerable populations.

"There is more volatility in the weather, more floods, more heat waves," she said. "And they affect the poorest in society, the people that either end up with severe health conditions or even death. So, how can we make investments using climate as a sleeve in order to be inclusive?"

Bhatia then moved into diversity, equity and inclusion. "One of the trends I'm seeing is the supply of investment opportunities," she said. This typically means litigation funds, which are trying to address social and racial injustice. "[This] is an exciting space if you are investors in private markets.

"What I would say is, focus on your objective, spell it out and then embed it into your investment strategy with either an impact thesis or a theory of change," Bhatia added.

Respect and protect

Setting high standards of human rights is a big part of reducing inequality, but "ensuring" the protection of those rights could be difficult for investors. "Words are to social what numbers are to climate," Neale said. "Ensuring is a tricky word. As soon as you get outside of your own business, it is hard to ensure anything. You can require stuff in your contracts, but then you go into another tier and another tier, and it gets harder and harder.

"Governments have a duty to protect and enable human rights," he added. "Businesses have a responsibility to respect human rights, which means they need to identify where they are linked to such risks. They then need to take action to avoid, mitigate and, if necessary, provide access to remedy for those."

Frameworks such as the UN Guiding Principles set out how you could do that. "But the problem with the supply chain stuff, is that it is an exponential problem," Neale said.

Supply chains are not like little links in a neat line, he explained, but more like a network where each link splits into different tiers. The chances, therefore, of identifying and mitigating against human rights abuses are quite small without having strong systems.

"If your supplier is a tier one family-run farm in Hampshire, you probably have a good chance of being able to use your leverage to figure out and address what the risks are," he said. "If it is tier six in China, you are going to be limited in what you can do. It is not easy."

To improve the chances of success, Llewellyn-Waters recommends that investors commit to the UN Global Compact,

which has principles on issues including human rights. "This is forced labour, modern slavery and child labour," she added. "This is the base-level standard of what should be acceptable for companies operating on a global basis."

Another way to improve social mobility in supply chains is to encourage the living wage. Llewellyn-Waters used the example of Unilever, which wants all their tier one suppliers to pay a living wage to their employees by 2030 or find another client. "The social impact multiplier of that is huge," she said. "We are talking about some of the most vulnerable manufacturing and agricultural workers in Brazil, China, India, Indonesia, Vietnam and the Philippines."

The right structure

Equity gives investors influence over companies, but it is a different story with debt, where lenders do not get a vote.

LGIM are long-term debt investors, typically lending between 10 and 25 years. "That long-term element allows us to build relationships and engage with the borrowers," Chan said. "But as lenders there is only so much we can influence once we have invested.

"So it is important that we take into consideration environmental and, in this case, social factors in the pre-investment stage," she added.

One example is housing. With many of the world's homes expected to still be inhabited in 2050, there is a huge retrofit challenge to decarbonise that stock. LGIM has invested more than £300m in social and affordable housing and linked the loans to the borrower's decarbonisation objectives.

"This not only meets low-carbon economy objectives, but also addresses fuel poverty, because high energy bills are a fundamental challenge that the affordable housing sector faces," Chan said.

Dan Neale
Responsible investment social themes lead, investment division
Church Commissioners for England

Shuen Chan
Head of responsible investment & sustainability
LGIM Real Assets

Community engagement

Measuring the impact of your investments is not easy. LGIM has created a place-based impact framework around the core pillars of inclusive economy, quality of life and climate and nature. Beneath that are the key performance indicators.

"Impact, especially social impact, means different things to different people," Chan said. "Although measurement is important and a rigorous and consistent approach is critical, I want to stress that when it comes to social impact, measuring someone's quality of life should not be distilled into a number or monetary value.

"This is why we approach it by understanding what the needs are for the community based on where the asset is," she added.

An example of this is that LGIM owns a shopping centre in Poole, which is connected to a high street that Chan described as "dated and unloved". "The first thing we did was provide free rates for two years for the local businesses on the high street.

"That not only created jobs but generated over £2m of revenue for the shopping centre. That comes back to the commercial element."

On community and collaboration, LGIM has developed and nurtured organisations to tackle serious local social and environmental challenges, including homelessness and patient waiting times. One example is its partnership with the NHS by building a diagnostic centre in the shopping centre. "As a result, it has driven footfall and, therefore, rental income,"

Anita Bhatia
Investment director
Guy's and St Thomas' Foundation

Abbie Llewellyn-Waters
Investment manager, global sustainable equities
Jupiter Asset Management

Chan said. "It has treated 4,000 to 5,000 people for ailments such as cataract and screening for breast cancer. It has basically driven commercial returns for us.

"This is one of many examples where we are thinking about the needs of the community and engaging with them."

Leaving no one behind

There is a social aspect to the energy transition in the desire to leave no one behind as new processes emerge.

"People are at the heart of [a just transition]," Neale said. "You have the workers, the community around the workers, the longtail supply chain and the consumers of those products. These stakeholders are what investors should be thinking about when they are looking at those companies.

"We don't want to repeat the 70s and 80s with lots of redundancies, where people are left unskilled and the social unrest that comes with that," he added. "We don't want hollowed out communities and we don't want contagion in the supply chain."

What is needed is decent standards of green jobs coming through, supply chains that don't use forced or child labour and affordable energy. "The problem is that green does not always equal good. There are social risks that go with that, but they are part of the transition that needs to be sorted," Neale said.

Representation

Other societal tailwinds include what Jupiter calls preventative healthcare. This is where companies support early detection of disease, which usually leads to better patient outcome and lower healthcare costs.

"We like that as a structural tailwind," Llewellyn-Waters said. This means investing in vaccine manufacturers, diagnostics, microscopes, heart rate monitors and optical scanner makers. "We like that because there is less regulatory risk from a pricing perspective and also the outcomes are typically more positive in the preventative aspects," she added.

It has, for instance, a company in its portfolio that enables 6 billion diagnostic tests each year for the early detection of cancer. "That is a huge social impact multiplier through that product aspect there," Llewellyn-Waters said. "We like those types of companies."

The narrative for female participation has for a long time been about representation at senior level, but Llewellyn-Waters believes that we need to "go a bit deeper into the workforce characteristics".

She pointed to reports from the IMF and World Bank on the trillions of dollars that could be added to the global economy if there were more women on the global workplace. "This feels like an easy, tangible, quantifiable analysis set for us," she added.

One such company in Jupiter's portfolio is an Australian biotech, where half of its employees working to improve the efficacy of vaccines are women.

Llewellyn-Waters closed our conference with a thought that investors should have a greater understanding of the makeup of the companies they invest in "and what that can do on a global inclusive growth participation basis".

"That is also something that you could ask your managers to look at on a portfolio aggregate level: what is the female participation rate of the companies that you invest in?"

Abigail Llewellyn-Waters is lead investment manager of global sustainable equities at Jupiter Asset Management.

GLOBAL SUSTAINABLE EQUITIES: EQUAL FOOTING

Jupiter's global sustainable equities team discusses the benefits of investing in companies which are better enabling equality in the workplace.

Industries around the world are focused on driving greater diversity and inclusion across the breadth of their workforce. While significant progress has been made in recent decades, there is a further opportunity to align capital to companies attracting and retaining women in the workforce. In the developed world, analysis can be focused on gender pay gaps or inclusive working practices, such as attractive parental leave policies; while in the developing world, analysis includes better understanding accessibility and enabling participation of women in the workforce.

The global economy stands to gain from enabling more women to enter and, importantly, to remain in the workforce. An IMF study shows increased female participation in the global economy could increase respective national GDPs by an average of 35% , showing significant economic benefits.

A McKinsey study indicates that companies with greater diversity and support for women's economic empowerment exhibit competitive success, resulting in up to 35% higher returns . Considering the social impact multipliers of female workforce inclusion, there is a link to female employment rates and reduced household poverty.

Given the above findings, there are frameworks and considerations we can embed to better understand the broader alignment of capital allocation decisions, through alignment to the UN Global Compact, a framework built on ten principles focused on human rights, labour, environment and anti-corruption. Aligning our investments to the UN Global Compact helps to achieve the societal goals of the UN Sustainable Development Goals, including SDG 8.5 on "full employment and decent work for all women and men".

Supportive workplace policy and a broader culture focused on providing flexibility are paramount in a decision to return to and remain in employment. Our portfolio companies leading in this area offer paternity leave policies in addition to maternity packages well in excess of statutory requirements, an important step to achieving a more inclusive workforce.

This also requires employees to be empowered and enabled to participate. The gap in income poverty between women and men increases during women's peak productive and reproductive ages. Globally, 42% of working age women are outside the paid labour force, compared with a mere 6% of men . For companies this means that they risk not being able to employ the best people they need. Leading approaches address gender equality through hiring and employment practices, and steps are taken to address barriers and biases to career progression. For some sectors where gender representation has historically been poor, we have found that some leading companies will seek to encourage future employees by engaging in educational programmes and promoting the development of applicable skillsets.

When applying our capital allocation framework, we consider societal norms in the developed and developing world and specific characteristics of sectoral behaviour. Intersectionality with climate change and natural capital also exacerbate these considerations: extreme heat, scarcity of natural resources, such as water, and other environmental challenges are more likely to affect women who depend on natural resources for their livelihoods. Companies looking to maximise the business benefits of gender equality need also to look at the approaches taken within their suppliers, promoting practices that best strengthen supply chains by securing labour rights and economic participation. As well as strengthening their own businesses this can have large impacts for social mobility and economic inclusion.

According to the SDGs, gender equality is a human right and a foundation for a peaceful, prosperous and sustainable world. Currently, the world is not on track to achieve gender equality by 2030.

Given our 10-year investment horizon, aligning to progress in achieving the societal goals embedded in the SDGs, in our view, will not only result in attractive long-term economic return but also in more sustainable businesses which are leading the transition to a more sustainable world.

The value of active minds – independent thinking: A key feature of Jupiter's investment approach is that we eschew the adoption of a house view, instead preferring to allow our specialist fund managers to formulate their own opinions on their asset class. As a result, it should be noted that any views expressed are those of the author(s), and may differ from views held by other Jupiter investment professionals.

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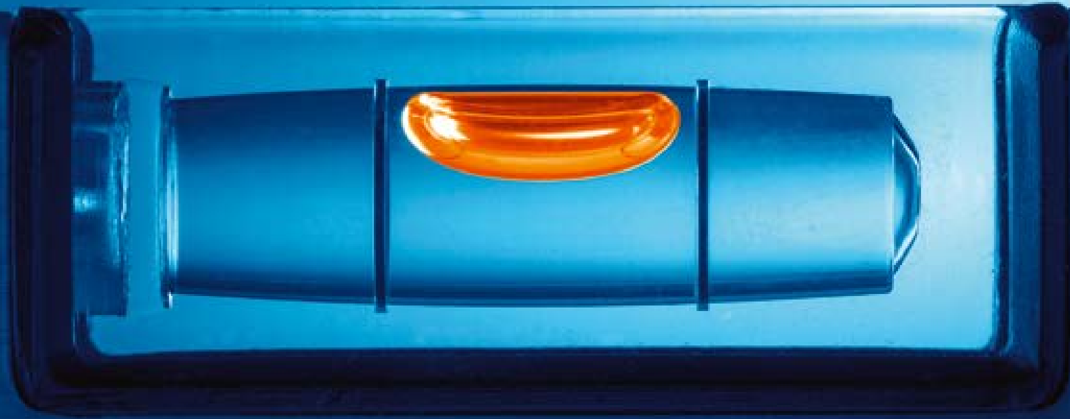

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Shuen Chan is head of responsible investment and sustainability at LGIM Real Assets.

MAKING A SOCIAL IMPACT WITH 'THE BIG S'

Shuen Chan breaks down LGIM's approach and track record on social impact.

Against a backdrop of widening social inequality, we firmly believe that real estate owners and investors have a unique opportunity to play a tangible role in delivering on the 'S' of environmental, social and governance (ESG) considerations.

Real assets are physically embedded within a place, often providing critical infrastructure and have numerous touchpoints with the local community, influencing how people live, work and play. We therefore believe real estate owners are inherently well placed to deliver positive social outcomes for local communities, contribute to levelling up across the UK's towns, cities and regions and aligning with L&G's inclusive capitalism principles.

One way we do this is by considering the long-term impact of our investments on the local communities in which our assets are located. We call this a place-based impact approach.

Delivering social impact should not, in our view, come at the expense of risk-adjusted returns for investors. In fact, we believe social impact can enhance returns over the longer term. There is a compelling argument for real estate owners to consider social impact as an indispensable part of their investment process, in much the same way as environmental considerations are becoming an integral part of the investor toolkit.

We define social impact as the intentional, additional, and attributable economic, social and environmental benefits to communities as a result of our investment. We adopt a place-based approach. This means taking an asset-level view as to how we could intentionally contribute, deliver and catalyse positive outcomes that address local needs.

The communities in which we operate face different challenges, have different wants and needs – some areas are facing an under-supply of good quality, affordable housing, others are facing challenges around ageing demographics.

It's therefore essential that the measurement of impact is adapted and flexed to consider the specific asset, and its context. While delivering positive outcomes for local communities is key, it's also vital that this impact aligns with our commercial objectives, protecting the investments of our investors, many of whom will be pension funds.

We have adopted this approach at The Dolphin Community and Shopping Destination in Poole. In partnership with the NHS, we welcomed the first outpatient assessment clinic in a shopping centre, and the first in Dorset, to help tackle long patient waiting lists. We now know that more than half of patients stay and shop within the asset following their medical appointment. So, alongside delivering positive social outcomes for the community, we're bolstering footfall and revenue for our occupiers, creating a relevant and resilient asset, and therefore, seeking to drive returns for our investors.

Meanwhile, our Kingland initiative, providing 10 shops to independent, Dorset-based businesses rent and rates free for two years, has transformed a once vacant section of the high street into an eclectic mix of independent retailers, selling a range of goods from plants to fish, coffee to restored furniture. Through our intervention, these small businesses have been given the support they need to establish and grow, contributing to an ecosystem at The Dolphin, which also includes a flexible office and co-working facility, wellbeing hub and events space.

We are convictional that adopting a place-based impact approach to real assets investments can deliver strong, long-term risk-adjusted returns while also improving the lives of people living in the communities in which our assets are located.

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