# pi ESG CLUB

***With the West suffering from low productivity, tackling the rise in lifestyle-related conditions such as obesity and depression is a priority for cash-strapped governments to ease pressure on their health services and get people back into work. This month's ESG Club looks at the innovations institutional investors are supporting to help.***

## APRIL 2024

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# BIODIVERSITY: THE CHALLENGES AND OPPORTUNITIES

**The challenge of biodiversity is greater for investors than that of climate change, finds *Andrew Holt*.**

The numerous challenges facing investors when it comes to addressing biodiversity risk were explored at the PLSA's investment conference in February, with asset owners and investors discussing their experiences.

Faith Ward, chief responsible investment officer at Brunel Pension Partnership, warned that the investment industry does not yet fully understand the issue of biodiversity. "I don't think anybody has got a total grip of all the complexities that need to go on when dealing with biodiversity and nature. The impact matters, on the where, the when and the what. So there is a lot of complexity," she said.

Ward also highlighted how biodiversity was made a responsible investment priority by Brunel back in 2022. "That is not to say we weren't doing anything on it before, we had been looking at deforestation and supply-chain risks, but we felt looking at the evidence and the enormous impact it has and the potential risks on our portfolio brought it through as a risk in its own right," she said.

It was then that Brunel applied it in the same way as other risks, which led to several questions being asked, Ward said. Such as: how does Brunel integrate this into its decision making? How does Brunel collaborate with others? Which is the best way of bringing about change? And how can Brunel be transparent in tackling that change? As well as: what are the expectations of Brunel's asset managers? And what are the expectations on companies and the assets Brunel invests in?

Picking one topic out of those, Ward addressed the issue of expectations on asset managers. "It is about the risk. So identifying where those risks might be, as well the opportunity in terms of capital deployment in those opportunities."

But, she added, not just in terms of managing the risks and opportunities in more overt assets that tackle nature loss. "But actually the everyday, the natural assets we have, and this is particularly pertinent in the real asset space and where we are directly investing and how we can maximise the opportunities within those. So it is not necessarily an asset allocation thing, it could be just how you go about your day-to-day investment risk opportunity analysis."

## Bigger than climate change

Offering another warning, David Russell, chair of the Transition Pathway Initiative, said the biodiversity challenge facing asset owners and investors is bigger than the challenges addressing climate change.

"Nature and biodiversity are much more complex to deal with than climate change. And climate change itself isn't easy," he said.

"We have been looking at climate change for 20 years and thinking in more detail about it in the last five, six and seven years post the Paris agreement."

Russell then revealed another challenge. "We have a track record of looking at the [climate] issue. We can collect climate data, we can do carbon footprints, we can do scenarios because there is something you can anchor that on.

"You can measure emissions and the reductions in emissions for climate change. With biodiversity there are so many different measures, that it is going to be highly complex for the pension fund community, and active managers, to deal with."

When addressing the issue of what nature is and why investors should care, Josephine Quint, finance sector advocacy manager at WWF UK, gave a compelling account of the situation.

"Nature is all the systems on earth, including land, water and biodiversity, which provide us with food, clean air and fresh water and so much more. Unfortunately nature is in freefall," she said.

## Two sides

Globally we have lost 59% of our nature since 1970, Quint added. That matters to the finance and investment sector for a few reasons. "One is that climate and nature are two sides of the same coin. So for financial institutions that have targets it won't be able to meet those without looking at nature," she said.

"The other reason why it is important to the financial sector is that nature underpins our economy and by extension the finance sector."

Quint added that 55% of global GDP is dependent on nature. "So translating that into financial risk, the loss of those services nature provides us with will translate into losses for the economy and the finance sector," she said.

Another type of risk comes from the transition of the economy, regulation and consumer behavior in the face of nature loss, Quint said. "Which means those businesses and financial institutions that do not integrate nature alongside in their financial and business decisions will be left behind," she said.

Maria Nazarova-Doyle, who leads the global sustainable investment team at IFM Investors, also said there is a necessity in addressing biodiversity from an investor perspective. "Biodiversity is not just a new shiny thing.

"It is something we have to do. Especially when you think of larger infrastructure projects: they have always had to have a biodiversity assessment, it is part of how we do risk management," she added.

## ESG INTERVIEW – JAMES ALEXANDER

# “We have to make sure that any incoming government sees the magnitude of what they need to do.”

UKSIF’s chief executive talks to *Andrew Holt* about playing the political game, breaking down barriers, why sustainability has been something of a game of two halves, the importance of macro stewardship and the sustainability challenges that lie ahead after a general election.

**What ESG and sustainable investment initiatives are you undertaking?**

There is a huge amount going on at the moment. Not least, we will be having an election in the UK this year. So for us it is vitally important to make sure all parties – as we engage with all of them – understand the importance of sustainable finance, what they need to do, and what we would like them to do.

But also, make sure a core priority is getting private capital into the sustainable transition. What we hear from our members all the time is this huge amount of capital they have and a willingness to invest in sustainability issues. So whether that is through companies creating sustainable products or how infrastructure relates to the UK’s transition, there is a huge amount of capital out there looking for a home.

**So what then is your biggest challenge here?**

The challenge is that the UK has to be a good place to invest. So, over the coming months, we will be working with all the parties to build investor confidence.

We will offer specific policy proposals that need to be put in place to make sure the UK becomes a top priority investment destination. We have to be the home of the latest innovative companies.

On the energy side, it will wean us off Russian oil and gas, and create home grown renewable energy.

It is also about tackling the barriers to investing in the UK, such as the planning system, which is slow, and the energy grid, which sometimes takes 15 years for a project to get connected to.

If we can start to address some of those, which are more regulatory issues, then we can start unlocking some of that private capital into the UK.

**How many marks out of 10 would you give the government in terms of their pursuit of pushing sustainable investment and finance?**

It has been a game of two halves. The first half was quite positive. We saw the UK become the first major economy in the world to commit to net zero, which was an incredible achievement under Teresa May.

We saw Boris Johnson host COP26 in Glasgow [in 2021] with a host of important commitments made by the UK. That was the high-water mark of the UK’s commitment to sustainability.

Unfortunately, in the last year or so we have seen the UK backtracking on its sustainability commitments. That has been a real disappointment to investors. It has had a corresponding impact on the number of people buying electric vehicles, which has fallen, and will see less private capital going into creating the infrastructure for those vehicles.

So it is a mixed scorecard. What we want to see is the next government, whoever it is, to be considerably better than we are right now. We have a huge distance to travel just to keep up with where we need to be. And if we want to be a world leader, we have a long way to travel.

We could, and should, be a world leader. Although, we cannot be a leader in everything: we have to think about the top four or five industry areas that we will lead the world in as it transitions to a sustainable future.
Where we have the opportunity to be that leader is in financial services. We should be aspiring to lead the world in financing the transition.

**You mentioned Rishi Sunak reneging on the government's climate change policy and its targets, which must be particularly disappointing.**
It was a huge disappointment. It left many investors and corporates feeling let down. It felt like we had been marched on a journey and then let down at the last minute.
In order for government policy to have the effect of driving capital and attracting businesses to the UK there has to be a deep sense of trust that when it says it will do something it will happen. Where we have got to is disappointing. Government and investors should be partners in the transition.

**ESG and sustainability have become something of a hot political potato and there seems to be a backlash against it – where is this coming from and is it a problem going forward?**
It is worse than that. The government is trying to engineer a backlash against sustainability as a wedge and dividing line among the parties leading up to the next election.
There are problems with that: it is an extremely short-term tactic and very disappointing.
And in the long term, we know we will have to decarbonise our economy – that is not just the best for the future of the economy, it is what we need to do for the world.

**Do you get a sense from the government that they are listening?**
Our frustration is that it feels like policy-making is geared only towards a general election. That is not the way to handle a long-term economic transition that will have profound consequences for the country and take decades.
We want to work with whoever wins the next election over the duration of the next Parliament to make a serious dent in achieving our sustainability ambitions and targets.

**What do you make of how asset owners have tackled the ESG and sustainable investment challenges?**
We are seeing a lot more focus on sustainability as part of investment decision making. That is important. Focusing on ESG risks is a key part of building a portfolio.
One interesting example is the IPO of Deliveroo. Our investor members were quite nervous about that. This is predominantly because its profitability depends on a core ESG risk: the ability to pay drivers low

sums of money for delivering pizzas and other takeaways to people's houses.

That is the S within ESG. And you then look at the long-term trajectory for this and other such companies. So it is here that we need to start looking more closely and effectively.

**So do you think the social element of ESG has been overlooked?**

The focus for a long time has been on the E, and more importantly the climate change part within the E. The whole cycle of approaching net zero and climate change from an investment angle is now well established.

What we need to start thinking about is how do we extend a lot of that thinking to other areas, which includes the E: nature, biodiversity and other things, and the S: working conditions, human rights, slavery and other key topics.

**What advice would you give to asset owners to improve their approach to these issues?**

What asset owners need to start thinking through is where they get their advice from and how their advisers are giving them good insights on sustainability issues. In particular, the scenario modeling they are doing. And then take a critical look at these scenarios and what they actually mean.

Also take a long-term perspective. Think through the time horizons on which your investments need to work, not just thinking about quarter to quarter.

There needs to be a lot more consideration given to stewardship. We need to raise it to another level. This could be called macro stewardship: engaging on a more economic level. So engaging with governments and national policymakers that have an influence over things at that level.

**Do you think institutional investors' net-zero objectives are stringent enough?**

We saw a huge number of net-zero commitments being made at COP26 in Glasgow. It is not just asset managers and investors that need to have the commitments, it is the corporates themselves who investors are investing in.

What we need to think about is how transitioning is a risk compared to not transitioning being a bigger risk. We need government, policymakers and corporates to work together.

The challenge is also creating investment opportunities for net-zero committed capital to move into. How we are going to structure transactions to invest in is a core challenge.

> **"The challenge is that the UK has to be a good place to invest.**

**What do you make of the Cop meetings? Do you believe they will achieve anything?**

The Paris agreement is a phenomenal achievement of global diplomacy. It shifted the focus and had a huge impact. All of this means individual countries themselves need to take the agreements seriously, and that is the challenge we are seeing now.

**What have you observed as the biggest issue investors have suffered from when it comes to ESG and sustainable investment?**

One of the issues we have had is how we talk about it with clients and policymakers and how it relates to what we are doing. We are on a transition journey. Investors have a role as stewards of assets to help shape the economy.

**Is greenwashing being dealt with?**

The new Financial Conduct Authority (FCA) anti-greenwashing rule will go a long way in addressing that. We are on the edge of our seats for the FCA to publish the final guidance so we can help embed that.

**You are highly committed to this area: what attracted you to the role and what spurs you on?**

What is exciting for me is that financial services have such an enormous ability to make change happen. What excites me is seeing how much we can do and make happen. Also, what motivates me is working with the amazing team at UKSIF and its members, who have £90trn of assets under management and who are committed to moving the agenda forward.

**What has been the biggest change within ESG and sustainable investment you have witnessed?**

It has been the speed of change, the acceleration, we are now talking about how do we do this. That is one of the most fundamental pieces.

The next stage is where are those misaligned policies. And how can we go about addressing them.

**What are the biggest challenges ahead?**

The big challenge is post-election: where does the UK's political environment go. We have to make sure that any incoming government sees the magnitude of what they need to do.

We are in a critical decade. We need to make sure that the government and the financial services industry work together as collaborators and partners to drive things forward and help to shape the economy, while growing the economy.

**What has been the biggest lesson you have learnt during your career?**

Work with amazing people and then you can make things happen.

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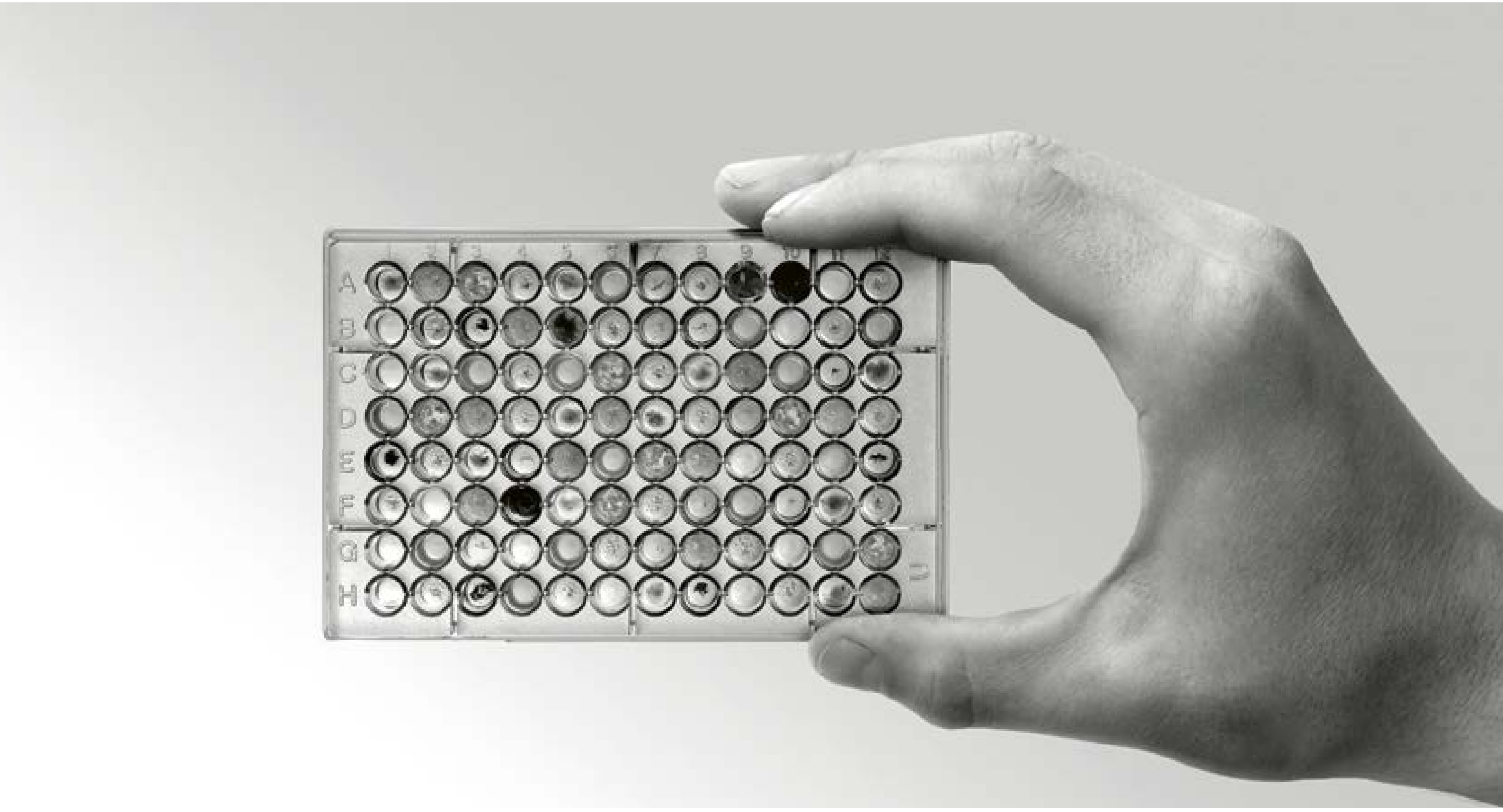

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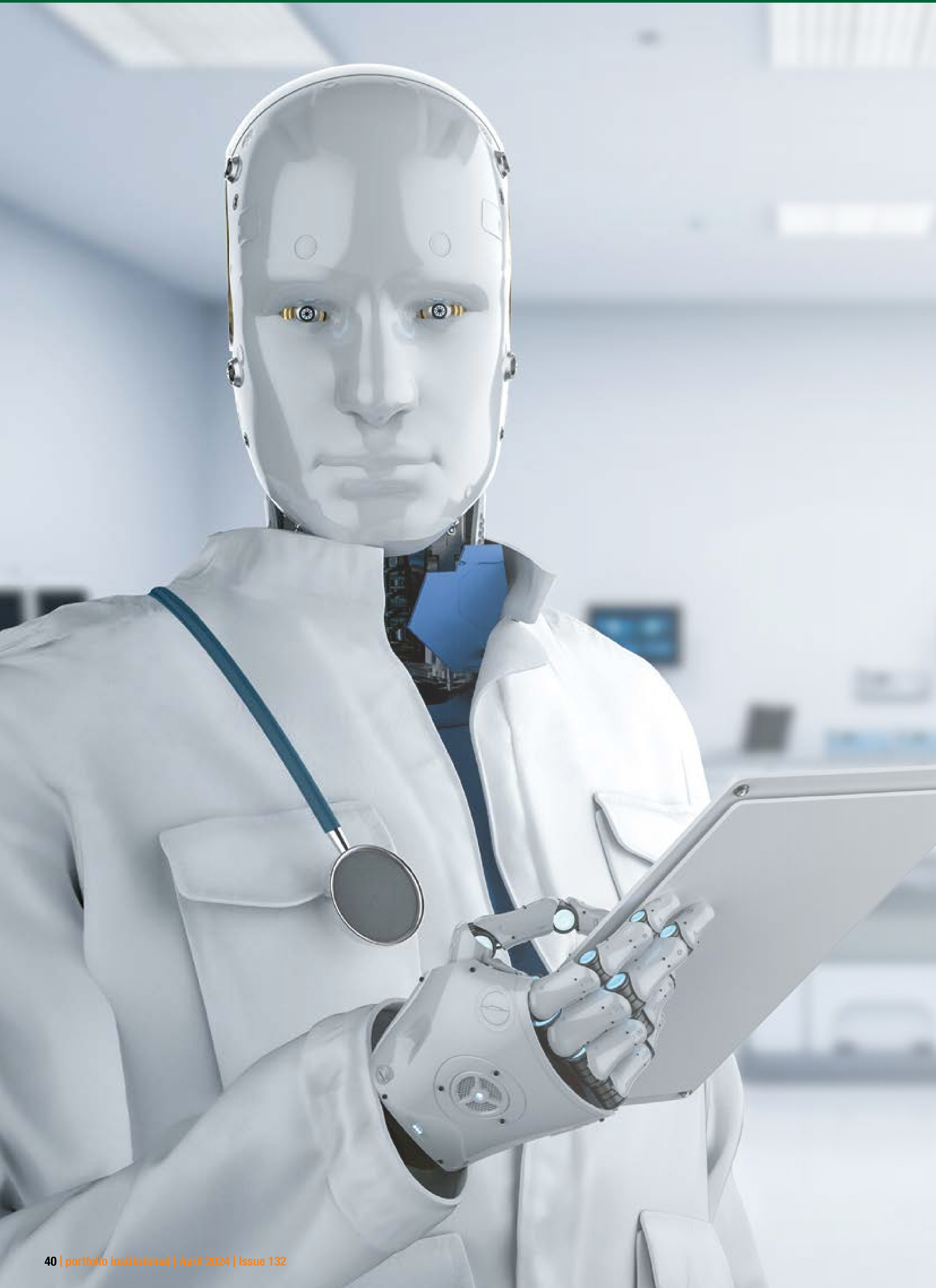

# ESG: THE ROBOT WILL SEE YOU NOW

With rising diagnosis of chronic conditions putting pressure on developed world economies, how can investors get people off the sick list? *Mark Dunne* reports.

Predicting the future is easy. In the year 1900 a group of experts across a range of fields described what they believed life would be like in the year 2000. The rise of women in the workplace, space travel and machines playing a greater role in our lives have proved to be accurate predictions.

However, even experts cannot always be right. One of their more ambitious forecasts was that by now we would all be living in perfect health.

Indeed, diseases that were around at the time of the survey, such as scarlet fever, tuberculosis, typhus and typhoid, are now rarities in the developed world, but they have been replaced by an array of new health conditions as our lifestyles changed dramatically during the last century.

Healthcare systems are struggling under the rising volume of people suffering from cancer and heart disease as well as chronic conditions for which there is an on-going need for treatment and support, such as stroke, diabetes, obesity, arthritis and dementia. All of the above are believed to be linked to bad diets, smoking, alcohol abuse, pollution, a lack of exercise and aging.

They also have a big impact on the economy. Indeed, in January 2023, 28% of the unemployed were not working because they suffered from a long-term illness – up from 23% four years earlier. Illness was the most popular reason for economic inactivity.

At the end of October, 3.2 million people were claiming Personal Independence Payments, which are for those who suffer from illness, disability and mental health conditions, such as depression and anxiety. This was 3% higher than at the end of July.

But the problem stretches beyond this. The government is forecast to spend £90.9bn on illness and disability benefits in 2028-29 up from £65.7bn this year, say the Office for Budget Responsibility.

These payments eclipse the £17bn that is expected to be paid in pensions in 2028-29, according to Paul Johnson, director of the Institute of Fiscal Studies.

These health issues are so complex that developing a new bottle of pills will not fix them. There are wider issues to consider in how they are treated and cared for, so it is clear that the healthcare industry will have to innovate to combat the growing lifestyle-causing healthcare issues.

Technology is at the heart of this search for treatments, and cures to not just reduce taxpayer spending on healthcare and benefits, but to make more people contribute to the economy rather than be dependent on it.

### Feeling good

It is clear that with economies in the developed world suffering from low productivity, healthcare budgets are not going to be expanded to develop the next generation of cures and treatments. So private capital needs to step in and it could be a rewarding move.

"It is important to note that when you are investing in healthcare companies, you are investing in impactful companies, companies that are developing medicines to improve people's overall health," says AJ Ziegler, a sector and thematic product strategist at BlackRock.

But it is not only about little bottles of pills. Such companies are also developing new therapies and healthcare technologies. Then there are those supporting healthcare's infrastructure through building and equipping hospitals and GP surgeries. "There is a lot of inherent good that comes from investing in healthcare companies," he adds.

But the sector also offers a sound long-term investment case. Ziegler says that in the past 10 years healthcare as a whole has outperformed the broader equity market, and with less volatility.

> **What we see in the future of AI is there is going to be different models that can be tailored for different industries, and healthcare is one of them.**
>
> AJ Ziegler, BlackRock

Indeed, the MSCI World Health Care index made an absolute return of 131.11% in the 10 years to the end of February, while the MSCI All Country World index gained 123.49% during the same period.

"I don't like using the phrase: 'doing good makes you feel good', but there is a double benefit for investors of strong risk-adjusted returns and making a positive impact on society," Ziegler says.

### Straight to video

One area where technology is changing healthcare is how it is being accessed. One such innovation is telemedicine where patients connect to a doctor through a screen on their phone rather than visit their office. This is an innovation born of necessity during the Covid pandemic.

"Setting up a video call with your doctor is not super groundbreaking, but it makes everything a lot more efficient," Ziegler says.

From my own experience, using Teams makes it easier to speak to a doctor, but Ziegler sees much greater potential for using such systems. "In emerging markets people might not have access to a doctor on site, so why can't they connect to a medical professional anywhere in the world," he says. "There is no reason why that should not be the direction of travel."

There will, of course, be times when you need to physically visit a doctor's office. "But for prescriptions or more basic issues, telemedicine can take on a lot of that," Ziegler says.

So Covid has been a big influence on driving innovation in healthcare. "It sure put the spotlight on healthcare," Ziegler says. "It emphasised the importance of innovation. It emphasised that this sector is critical to our society."

### Starving obesity

One of the biggest innovations in healthcare has been the discovery of GLP-1s, which are anti-obesity drugs that are also used to treat diabetes. "On a global scale, this is a massive, massive market," Ziegler says.

Indeed, in 2021, 537 million adults were living with diabetes, a number which is predicted to reach 643 million by 2030 and 783 million 15 years later, according to the IDF Diabetes Atlas.

"Recent enhancements to GLP-1 technologies by Eli Lilly and Novo Nordisk have made these treatments significantly more impactful, leading to weight loss of 15% to 20%.

"That reduces the risks of cardiovascular disease or kidney disease and just makes people a lot healthier," Ziegler adds.

One of the more niche markets within healthcare is gene therapy, where living cells are altered to treat, prevent or cure disease or medical disorder. "The cost of genome sequencing 16 years ago was $1m per genome; it is about $1,000 today," Ziegler says, quoting figures from the National Human Genome Institute.

The benefits of the cost of genome sequencing drastically falling include incentivising healthcare companies to fund more research into genetic diseases. It also opens the door for new entrants into the market who perhaps would not of had the budget needed more than a decade ago.

### Aging problems

It is clear that within healthcare the opportunities are quite diverse.

"When people think of healthcare, they typically think of giant pharmaceuticals and the more innovative and groundbreaking biotechs," Ziegler says. "But there are two big gaps in there."

> **Setting up a video call with your doctor is not super groundbreaking, but it makes everything a lot more efficient.**
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> AJ Ziegler, BlackRock

The first is the insurance companies, which provide critical services to healthcare's infrastructure. Then there is medical technology. "One of the coolest areas in this segment is robotic-assisted surgery," Ziegler says.

This is not robots operating on people, it is devices that are operated by doctors. "[Robotic-assisted surgery] is proven to reduce the human risk of the procedure and often leads to faster recovery times for patients," Ziegler adds.

Another innovation that will drive average recovery times higher are known as smart bandages. Developed by Stanford University, they have sensors that can increase blood flow to the wound helping it to heal faster.

And it appears that rising longevity will fuel the growth of such procedures to tackle the symptoms of aging that are not fatal, such as knee replacements. "If we are going to live into our 90s or hit the century mark, the chances of us needing elective procedures goes way up," Ziegler adds.

In 2019, around a fifth (19%) of Britain's population, or 12.3 million people, had celebrated their 65th birthday. This was a 23% increase in 10 years, despite the broader population climbing by only 7%.

The older generation in the UK is projected to continue rising, with people aged 65 and over making up almost a quarter (24%) of the population by 2043 (17.4 million people). The proportion of Britain's citizens aged 75 and over is projected to rise from 8% in 2018 to 13% in 2043, while those aged 85 and over are expected to double to 4%.

### AI is OK

One of the more fascinating areas of our lives at the moment, which is the subject of much debate on the influence it is having on the world, is artificial intelligence (AI). The question here is: what role, if any, is it playing in making the medical breakthroughs we need?

Well, algorithms are being used to detect, diagnose and treat diseases, such as cancer. For example, AI can spot breast cancer 30 times faster than through using a biopsy, and speed is crucial in boosting survival rates.

BlackRock is looking at companies that are seeking to use AI for drug discovery. Although, if this is to be achieved, it could be many years until companies can reliably use AI to make medical breakthroughs.

"That is the next level, but it will take some time. Right now, when you think of using AI, it is basic. You cannot type into Chat GPT: 'give me the cure for cancer'. You need a much more sophisticated data set, and a lot more training," Ziegler says.

"What we see in the future of AI is there is going to be different models that can be tailored for different industries, and healthcare is one of them."

Julian Mund is the chief executive at the Pensions and Lifetime Savings Association (PLSA).

## PLSA INVESTMENT CONFERENCE ROUND UP: BIG NUMBERS, BIG IDEAS

Pensions is a world of big numbers. Our members and their partners work in the millions, billions and even trillions every day. At this year's investment conference, in our traditional home of the Edinburgh International Conference Centre, we were dealing with big numbers too.

Some 824 delegates – almost 10% more than last year – from 118 funds enjoyed 19 hours of networking time and had access to more than 20 hours of live content, much of which is still available to watch on the conference app and will soon be available in our new online member area.

But, at the Pensions and Lifetime Savings Association, as impressive as the numbers we work with are, we are acutely aware of what they represent and the responsibility they bring to our members.

Liabilities, while seen as an accounting measure to some, are the promises our member schemes owe to individuals who join and pay into them; in many cases, they are also a multi-faceted risk our members have to manage, with trustees taking on the responsibility of getting key decisions right.

We also know that the assets held in schemes are coming under greater scrutiny than ever before. Beyond just meeting the obligations set out for financial returns, investment strategies now must consider where, how and with whom assets are being allocated, with data and justification demands an increasingly heavy burden.

It is with this understanding that we designed the 2024 Investment Conference, aiming to cover as many of the key issues our members are facing and grappling with. We know our events offer our members the opportunity to dig into a range of issues, surrounded by peers that may have a different way of tackling it – or may even have found a solution.

From the UK's economic position and short-term political future, outlined by Paul Johnson, director at the Institute for Fiscal Studies, in the opening plenary session, to the countless other forces shaping our world, expertly condensed into the closing session by the London Business School's Lynda Gratton, we covered much in three days of conference.

Three chief investment officers, drawn from the worlds of open defined benefit (DB), defined contribution (DC) master trusts and the Local Government Pension Scheme, discussed their different approaches to asset allocation, based on their own specific models and expectations. They all agreed that strong governance and having a clear objective for achieving their members' outcomes needed to sit at the heart of all decision-making.

The theme of consolidation also loomed large. From a keynote debate featuring the Pension Protection Fund, Universities Superannuation Scheme and a commercial master trust, to breakout sessions that looked at the practicalities of bringing schemes together, there was no mistaking the direction of travel for many in our industry. News from the chancellor around the future for poorly run DC schemes, which arrived on Friday as we travelled home from Edinburgh, made clear that we need to keep working and debating with members on this.

Another key theme was DB endgame and how, due to a general improvement in solvency levels, the options for schemes, sponsors and trustees looks more varied and achievable than has been the case in recent years.

Megatrends and factors that might at first appear to be non-financial also engaged delegates across breakout sessions and fireside chats. The impact on portfolios of biodiversity loss, climate change and a poor understanding of diversity, equity and inclusion may be greater than you might first think, our members learned at conference.

We were pleased to welcome Paul Maynard MP, minister for pensions, to the conference, despite his warning that 2024 is likely to be "even busier" for our sector than it was in 2023. The "endless consultations" will continue, he said, as government addresses key concerns such as adequacy, dashboards and collective defined contribution (CDC), which are key concerns for the PLSA and our members too.

A fascinating deep data dive by Kelly Beaver MBE, chief executive of IPSOS UK and Ireland, gave delegates an insight into how their members might feel about the state of the nation, politics and their position within it all – and how this might affect their choices going into the upcoming general election.

A thought-provoking conference dinner speech by award-winning filmmaker and triathlete Lesley Paterson made us all reflect on how we can all build resilience within our teams and portfolios.

We thank all our members, partners and delegates for joining us and helping to make our 2024 investment conference such a powerful experience. With the date for next year's conference already in our diaries (11-13 March 2025), we look forward to shaping the agenda with you to deliver another engaging and effective event.

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