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INTERVIEW

'From an investor's perspective, green bonds perform better'

As chief architect of the Climate Bonds Initiative, **Sean Kidney** is heartened by the recent upsurge in sustainable investment, but he stresses that it's a race against time

Mark Hillsdon

"In every investment call I have, people say: 'Give me more green bonds,'" says Professor Sean Kidney, co-founder and CEO of the Climate Bonds Initiative. "That makes me hopeful. Green bonds have grown up."

His organisation is a not-for-profit body working to mobilise international capital for climate action. It works in more than 30 countries with investment partners including Credit Suisse, BlackRock and Allianz Global Investors, as well as advising several national governments.

The first ever green bond, designed specifically to raise money for environmental projects, was issued in 2007 by the EU's European Investment Bank (EIB). Having grown steadily since then, this market is now valued at nearly £1.1tn.

"It's no longer a small concern," notes Kidney, who adds that there is still plenty of growth potential, given that the overall bond market is worth about £100tn.

Having served as an adviser to the United Nations' secretary-general and as a member of the People's Bank of China's task force on green finance, Kidney has been a key player in the field of sustainable investment for more than a decade, winning accolades as a champion of climate finance. He is currently a member of both the UK government's green gilt advisory committee and the European Commission's Platform on Sustainable Finance.

Kidney launched the Climate Bonds Initiative during the UN's "depressing" COP15 climate conference at Copenhagen in 2009. The politics of that event were all wrong, he explains. China was largely ignored while those seeking change wasted their energy berating President Obama when the US Congress was actually blocking progress.

So what has changed over the intervening 12 years? "We have established that, from an investor's perspective, green bonds perform better," Kidney says. "This is about risk management, tied to the fact that governments are starting to act."

Initiatives allied to combating climate change are less likely to be affected by policy changes, he explains. This makes them a much lower-risk option for investors than they once were.

"If something is green, there isn't much chance that someone would kick it over," Kidney says. "There's a lot of money around that needs to go somewhere at the moment. In essence, if you've got a fossil-fuel bond, it's hard to get a good price. If you've got a green one, you're going to get more investors and a better price."

While the initial price of a green bond may be higher, investors know that they will also sell at higher prices. "Suddenly, every sustainability manager of an investment fund around the world has become popular. It's an amazing situation: investors are doing better and issuers are doing better too – it's booming."

Governments that understand the need to act urgently on climate change have picked up on this and started introducing their own green bonds. When, for instance, the UK government issued its first green sovereign bond in September, investors placed more than £100bn in orders, setting a new record for debt sales by Westminster.

> "The truth is that the climate figures are not going our way

Kidney notes that other factors have been whetting the market's appetite for sustainable investment. Joe Biden's arrival in the White House has been particularly useful. "You now have a US president who is treating climate change as his number-one challenge," he says.

Biden held a climate summit in April at which many big economies committed to tough new 2030 targets, notes Kidney, who adds: "You've got all the world's power blocs going green and suddenly people are asking: 'How do I make money from this?'"

New taxonomies are being developed around the language of climate change, which helps to clarify how green bonds can be used. The US, China and the EU are among those to have provided stronger definitions as to what can be called 'green', according to Kidney. "This is no longer the Wild West. We're starting to see some pretty robust governance mechanisms."

Kidney sees a central role for development banks in maintaining the momentum. "They're public-sector pools of capital that can be the buffer between private-sector risk challenges and what's got to happen," he says. "They have just got to be reoriented for a greener mission" by ensuring that money is being put into sustainable infrastructure projects that will help to achieve the climate goals set by the UN's 2015 Paris accord.

Appropriate investments could include green transport systems, energy-efficient houses, offshore wind farms and projects to improve climate adaptation, such as flood defences and regenerative agriculture.

Kidney notes that the greening of many emerging economies will soak up a lot of capex. There are opportunities for investors such as pension funds to make a lot of money here, but "development needs to be integrated with climate initiatives", he stresses, referring to the new wave of African mega-cities, where billions of pounds have already been poured into building roads, rather than railways. He also cites the decades that some emerging economies have spent building inefficient "glass towers" that rely on air conditioning to render them usable. Over the past 20 years, just as much has been spent on air-con systems in tropical countries as it has on renewable energy.

Kidney says that he would like development banks to be rebranded as climate banks, pointing to the EIB as an excellent example of what can be achieved. Half of the bank's annual €80bn (£68bn) investments are going towards climate initiatives, while it ensures that none of its other investments works against the Paris agreement. "Every bank, not only development banks, should be doing that," he argues.

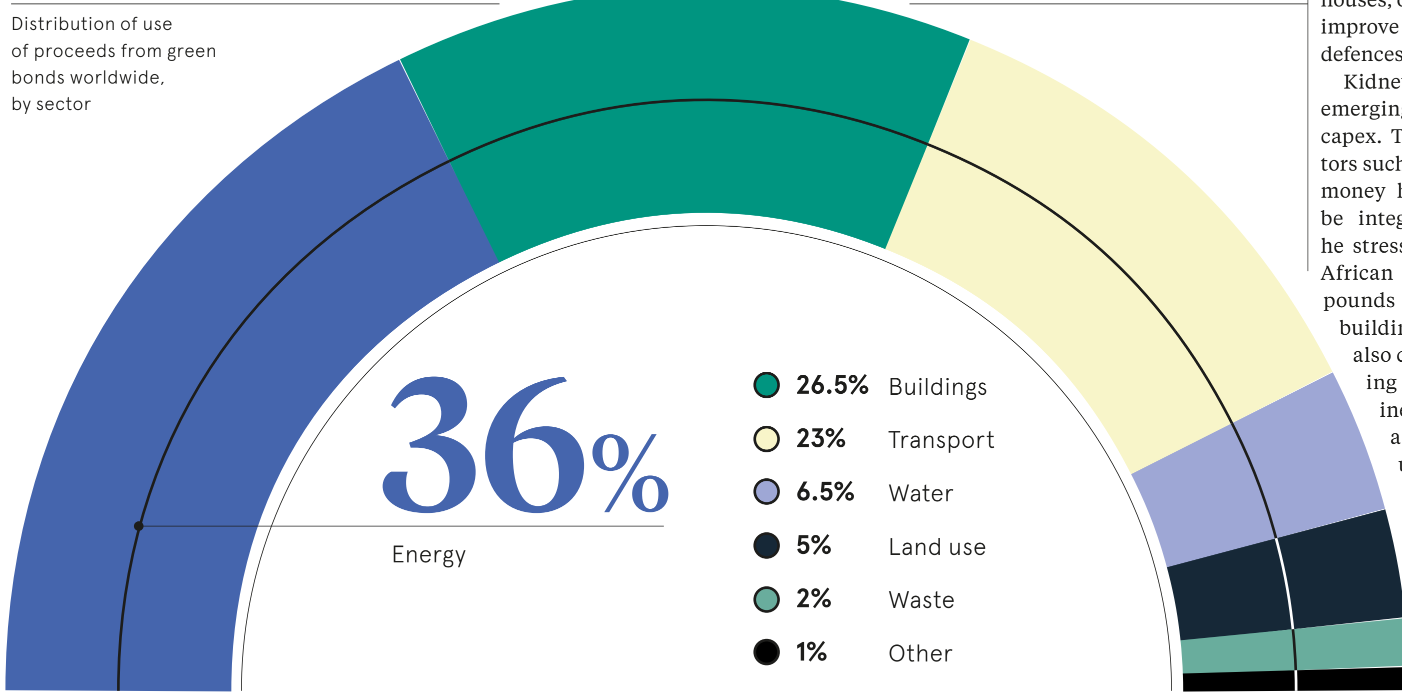
Ultimately, Kidney's experience of sustainable investment has left him with a curious mix of optimism and scepticism. With a year-on-year increase of 16% in global CO_2 emissions expected for 2021 at a time when they should be dropping by 8%, "the truth is that the climate figures are not going our way", he says.

But Kidney adds that "green bonds give me hope – I do think that we're making progress. Yet we are so late to this party. There's no doubt about where we're going – the shape of the future is decided – the problem now is our speed. We've got to get there really fast."

WHAT DO GREEN BONDS FINANCE?

Climate Bonds Initiative, 2021

Distribution of use of proceeds from green bonds worldwide, by sector



90%

the value share of sovereign green bonds attributed to issuances by European countries

edie, 2021

£95bn

the amount raised by sovereign green bonds globally

Linklaters, 2021

Investors act to capture resilient opportunities

Sustainability has moved into the mainstream for consumers, societies and businesses. As investors assertively pursue sustainable and purposeful growth opportunities, having the right priorities and partnerships can help unlock success

Over the last decade, there has been a transformation around sustainability. An increasingly urgent climate crisis, and rising global awareness of wealth inequality, are prompting consumers to spend differently and leading regulators to mandate change.

With societies and governments alike demanding more environmentally friendly and socially responsible business practices, investors too are reallocating their capital with those considerations in mind. From high-net-worth individuals, to family offices and institutional funds, investors are moving their money where they perceive less risk and greater long-term opportunity, with returns often comparable to traditional investments.[1]

"There is clearly less tolerance to invest in companies that harm the environment or society, and this is a natural evolution as fewer people want to buy from heavy polluters or those that compromise on issues such as labour standards," notes Michael Baldinger, chief sustainability officer at UBS, the global financial services firm.

A growing emphasis on the measurability of sustainable outcomes has been a critical part of this change. Improved insights into company behaviour are helping investors to better understand and interpret performance on environmental, social and governance (ESG) issues. This can prompt them to either exert pressure to change on companies in their portfolios, or even reassign their capital.

"Today, investors know that they can use these more transparent insights into companies and the ways they do business to make decisions about where they place their money," Baldinger explains. "This enables them to take a long-term view around the sustainability of their investments."

Investors' push for transparency means companies must take note. It is clear that over time, businesses will need to proactively demonstrate ever more measurable, comprehensible progress on reducing long-term sustainability risks, and create future-proof plans for resilient growth.

> It's important to view a business' direction of travel, in order to improve the resilience of portfolios without compromising long-term risk-adjusted returns

Alongside pressure from financial regulators - a number of which are considering clearer disclosure mandates - industry bodies such as the Taskforce on Climate-related Financial Disclosures (TCFD) are creating frameworks that are helping to standardise aspects of company reporting around crucial topics such as climate. "That in turn helps investors make more informed decisions because they can compare apples with apples, and ask whether one is doing better than another in managing the sustainability transition," notes Baldinger.

Beyond this, investors must rigorously examine the future sustainability strategy of each company in their portfolio. Such an approach requires solid working partnerships with institutions investing their money, which can unearth the hidden details and investigate the likely outcomes of steps being taken by those companies to meet their ESG priorities.

"It's important to take a forward-looking view of a business' direction of travel, in order to improve the resilience of portfolios without compromising long-term risk-adjusted returns," says Baldinger.

These discussions are held to analyse the risks and understand the opportunities, while pushing for deeper change with "very clear" expectations, Baldinger notes. If progress is not achieved in any company it can lead to the withdrawal of capital and reallocation into other businesses.

Such collective investor pressure is already catalysing significant progress among many businesses, which are keen to meet these expectations in order to retain both custom and essential access to investor capital. "We're seeing a growing number of businesses engage closely with their investors in this regard," says Baldinger. Many such businesses are committing to net-zero carbon emission targets and addressing issues such as poor working conditions among suppliers, while also tightening the governance of their own operations with stronger policies and ESG-linked executive remuneration.

Since September 2020, UBS has made sustainable investments its preferred solution for wealth management clients wishing to invest globally. "We've taken the decision to focus our activities on planet, people and partnerships - these are areas where we can help mobilise capital to make the most significant difference. This means prioritising climate change, tackling wealth inequality through health and education, and then working with our network of partners to drive global change," Baldinger explains.

As investors pursue long term growth opportunities that are both purposeful and resilient, joining forces with the right financial institutions helps them to place their money in companies that are truly sustainable. Equally, these partnerships also help ensure that portfolio companies make the depth of progress needed by customers and societies around the world.

To find out more visit ubs.com/sustainability

UBS

[1] *Journal of Sustainable Finance and Investment, Global Impact Investing Network and Cambridge Associates*

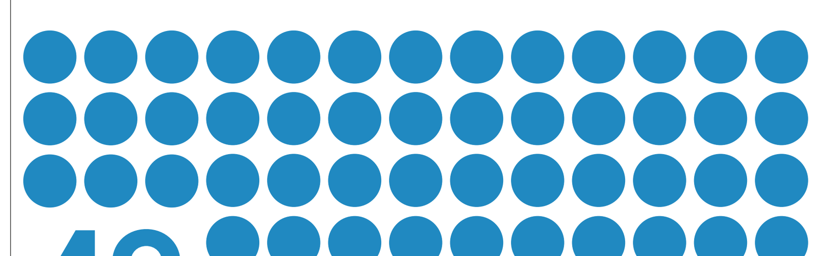
$793bn

in UBS core sustainable investment assets* in 2020, representing an increase of...

62%

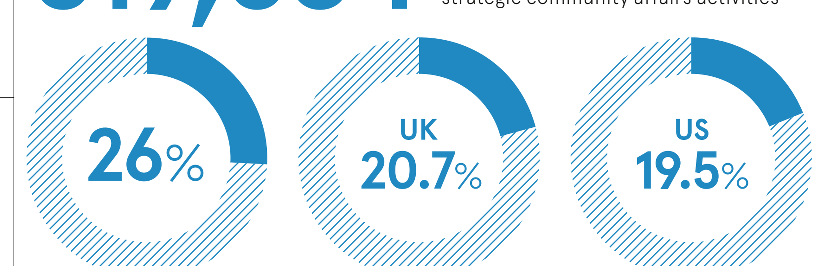
$168m

donations raised by UBS Optimus Foundation



49 oil and gas, and utilities companies actively engaged in 2020 on climate topics

519,534 beneficiaries reached through strategic community affairs activities



26% of UBS employees at director level or above are women

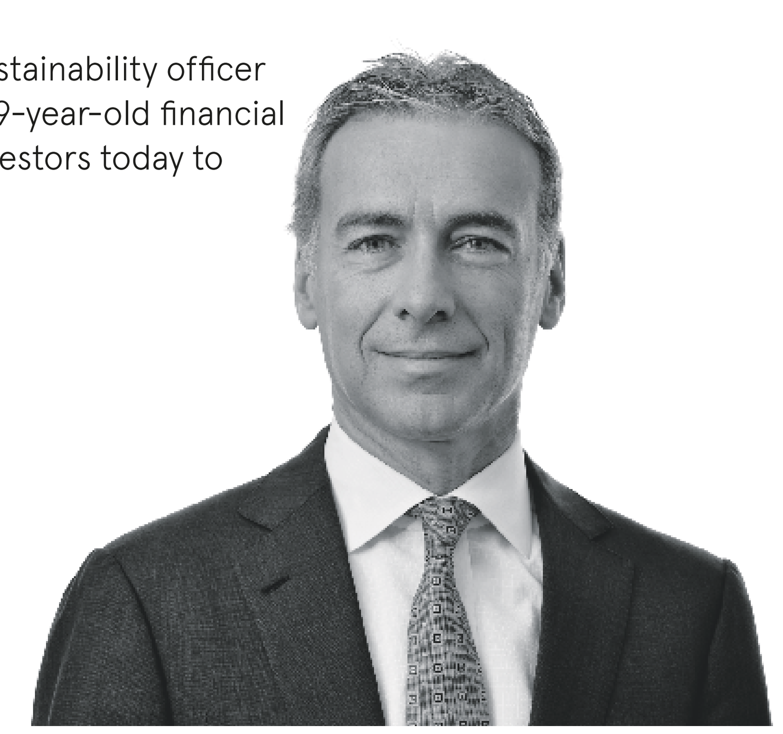
UK 20.7%, US 19.5% of UBS employees at director level or above are from underrepresented ethnicities

UBS, 2021

*Core SI are SI products that involve a strict and diligent asset selection process through either exclusions (of companies / sectors from the portfolio where the companies are not aligned to an investor's values) or positive selections (such as best-in-class, thematic or ESG integration and impact investing)

Q&A

Michael Baldinger, chief sustainability officer at UBS, explains how the 159-year-old financial services firm is enabling investors today to achieve portfolio resilience



Q From your observations, what does sustainability mean to most investors?

A In recent years we have seen a paradigm shift – with the move of sustainability into the mainstream, for business, for finance and for society. In my mind, that shift has been driven by one thing: transparency. It affects what individuals buy and how we travel, and now how we invest money. Yet it's very clear to me that sustainability means different things to different people; you only need to look at the United Nations' 17 Sustainable Development Goals, which set out a broad range of essential areas to improve – right from tackling poverty, hunger and educational barriers to improving consumption habits and environmental impact.

Q What does this mean for how they approach investments?

A Many investors start by identifying their particular priorities. Do they want to see emissions cut in their portfolio companies, or exclusive use of renewable energy? Do they want better use of water and resources, and improved recycling? Do they want elimination of bad practices throughout the supply chain, stopping of corruption, better diversity and fairer executive pay? Driving these priorities means that businesses will focus on thinking and acting in all these areas and beyond with the long term in mind. For me it is those two words - long term - which are critical.

> We spend a lot of time talking to managers to unearth the risks and opportunities in their businesses, and to support them in making deeper changes

Q How can investors ensure they are succeeding on sustainability?

A When it comes to sustainable investing, there's been a tendency for investors to look backwards and rely on ESG scores and ratings from the very many providers out there in the market. These can be useful as a starting point, but we think it's much more important to take a forward looking view of where the business is going in order to improve the resilience of portfolios without compromising long-term risk-adjusted returns.

Q How does UBS ensure its clients have resilient portfolios?

A We spend a lot of time talking to portfolio companies' managers, firstly to unearth where the risks and opportunities lie in their businesses, but then equally to support them in making deeper changes. We partner with them to transition their business models. One example is the work of our asset management division. It has engaged extensively with major energy firms, because while these businesses have clearly been a big part of the climate problem, we know that with their innovation skills they can also build the solutions.

Q Can you characterise a typical discussion between UBS and a portfolio company?

A When we engage with companies, we are very clear: we explain that we'll work with them and support them as they transition their business models, but if insufficient progress is made then we'll no longer continue to invest. We're not alone in this endeavour; many of the largest investors in the world are also taking the same approach, as are growing numbers of private investors.

Q What's the impact of this stance on business practices?

A We've started to see more companies set ambitious net-zero targets, for example, and agreeing to align executive pay to them. Companies are recognising the need for transparency, to show investors that their business models reflect not only long-term risks, but also the durable opportunities. In the market today, we can see that the companies successfully attracting capital are those able to show a clear and long-term plan that is being well executed.

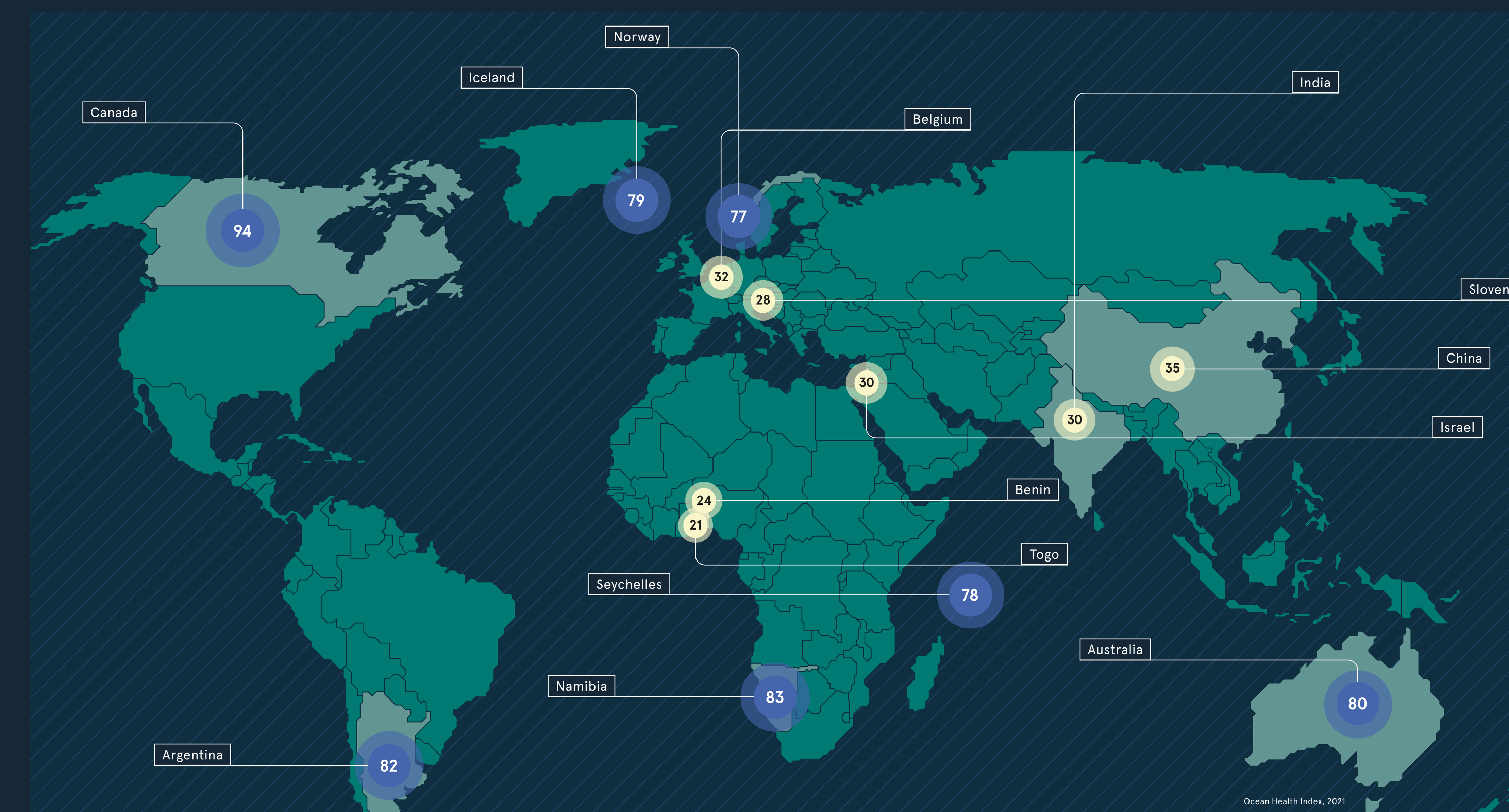
The value of investments may fall as well as rise and you may not get back the amount originally invested

EXPANDING THE INVESTMENT COLOUR PALETTE

The ocean economy can be defined as the sum of the economic activities of ocean-based industries, together with the assets, goods and services provided by marine ecosystems. The Organisation for Economic Co-operation and Development expects the value generated by ocean-based industries to reach $3tn (£2.2tn) a year by 2030. But, despite the centrality of water to both our lives and the global economy, ocean and water sustainability is chronically underfunded. Private investors must recognise that sustainability requires not only green investments but also blue ones

WATER QUALITY COMPARED

Ranks of the world's clean water scores, on a 100-point scale

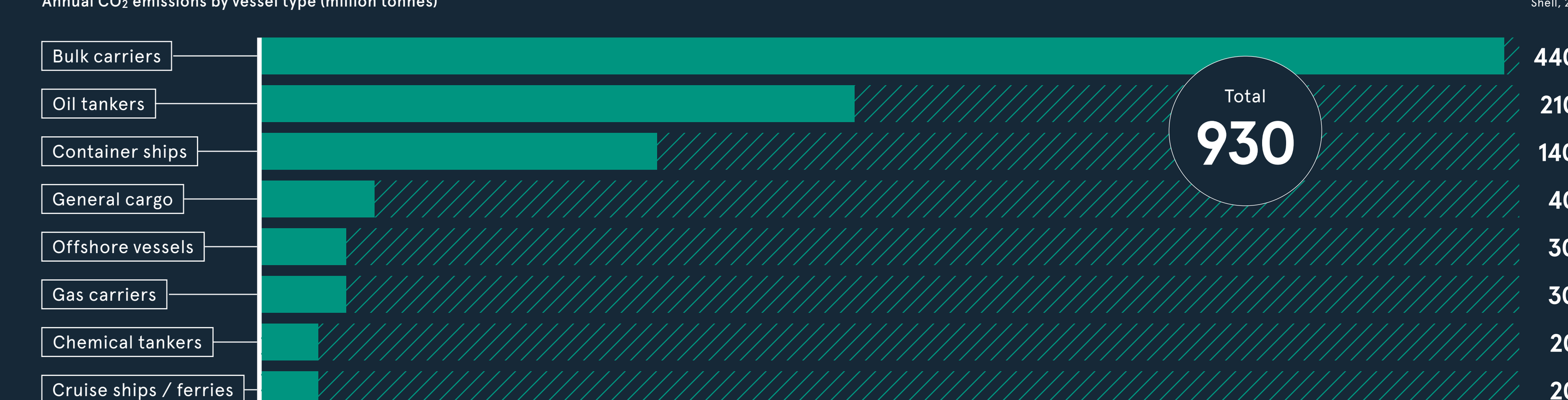


Ocean Health Index, 2021

INTERNATIONAL SHIPPING: A DECARBONISATION CHALLENGE

Annual CO_2 emissions by vessel type (million tonnes)

Shell, 2020



$300bn

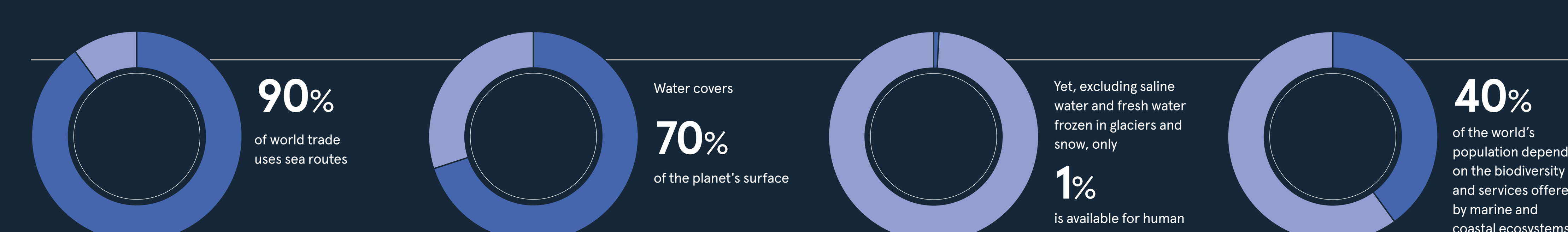
The business costs associated with climate-related water incidents

Bloomberg Green, 2021

3.5%

The share of sustainable investment addressing the conservation and sustainable use of the ocean – the joint-lowest share attracted by any of the UN's 17 sustainable development goals

Reuters Events, 2020



90% of world trade uses sea routes

OECD, 2020

Water covers **70%** of the planet's surface

BNP Paribas Wealth Management, 2019

Yet, excluding saline water and fresh water frozen in glaciers and snow, only **1%** is available for human consumption

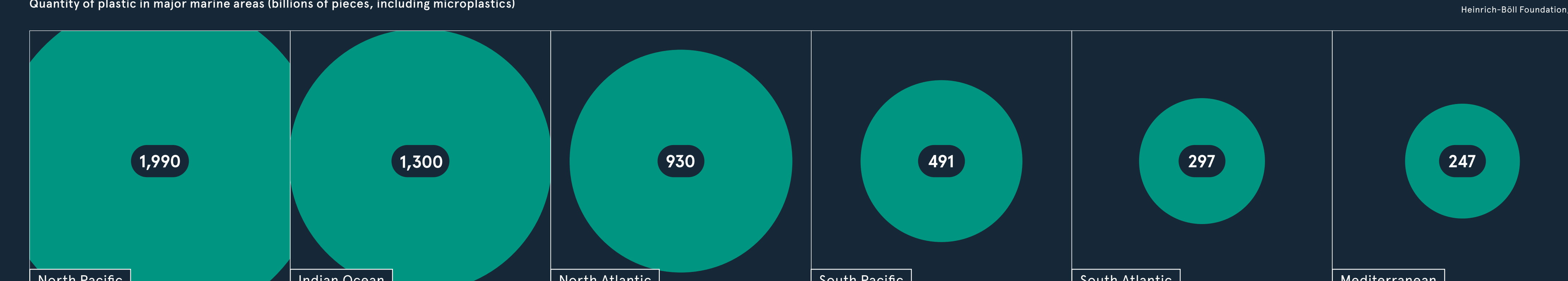
40% of the world's population depends on the biodiversity and services offered by marine and coastal ecosystems

Reuters Events, 2020

THE PLASTIC PROBLEM

Quantity of plastic in major marine areas (billions of pieces, including microplastics)

Heinrich-Böll Foundation, 2020



LEGISLATION

Muscle from Brussels: EU law retains its reach

Although Westminster chose not to implement the Sustainable Finance Disclosure Regulation, the new rules are set to have an impact on many asset management companies in the UK

Megan Tatum

Michele Spatari/NurPhoto via Getty Images

The Sustainable Finance Disclosure Regulation (SFDR), which came into force in all EU member states in March, is part of a new wave of legislation designed to strengthen the financial sector's role in making business more environmentally sustainable.

It's likely to be a disruptive force across the EU, obliging a broad range of organisations participating in the financial markets to publish more information about their environmental, social and corporate governance (ESG) performance. But the regulation also has significant implications for players in the UK, as its requirements apply to any non-EU-based asset manager that deals with EU investors.

Under what scenarios might operators in this country be affected by its provisions – and how? How best can they prepare for such changes? And should we expect a version of the SFDR to make its way into the UK statute book too?

The overriding aim of the SFDR is to crack down on greenwashing and protect investors by creating a clear framework under which products can be compared. In simple terms, the regulation requires asset managers and financial advisers to demonstrate their ambitions towards, and engagement in, ESG, putting the onus on them to collect ESG data and report on this. They must also share how they plan to integrate the associated risks into the investment decisions they make.

The obligation to publish this information isn't restricted to ESG funds either, although those funds that promote environmental and social characteristics (article-eight funds) and those that have sustainable investment as their key objective (article-nine funds) may be required to make additional disclosures.

"While fund managers have been quick to communicate externally about their ESG credentials, the SFDR brings in stricter standards about what counts as sustainable and what does not, putting them in front of their responsibilities and making them accountable." So says Georgia Stewart, CEO of Tumelo, a fintech firm that works with asset managers such as Aviva Investors and Legal and General Investment Management to help them meet their ESG commitments.

"Pension and retail investors hold trillions of dollars in funds. As a result, fund managers control majority stakes in many of the world's most influential companies," she adds. "Investors want these companies to change, but they have no voice. Fixing this breakdown of shareholder democracy would create massive opportunities."

> UK managers marketing funds to EU-based investors and those that provide portfolio management services to EU managed funds will be affected to some degree

Victoria Gillespie is responsible for sustainability and ESG services at JTC Group, a provider of fund management services based in Jersey. She warns that, although the SFDR came into force after the end of the Brexit transition period, there are still plenty of circumstances in which UK organisations could be subject to its obligations.

"UK managers marketing funds to EU-based investors and those that provide portfolio management services to EU managed funds will be affected to some degree," says Gillespie, but she adds that the regulation is "complex", with the more detailed technical requirements set to be implemented in a further phase next year. In other words, "there will be a learning and adjustment period for those making the first disclosures".

32

The number of "adverse sustainability indicators" that large entities are obliged to report under the EU's Sustainable Finance Disclosure Regulation. There are a further 18 voluntary indicators

PwC, 2020

How well prepared are UK asset managers and financial advisers for the new requirements? "The picture is very mixed," says Richard Burrett, chief sustainability officer at Earth Capital, a London-based fund specialising in cleantech investments. "Some larger players are already collecting data that will enable them to make selected funds comply with SFDR. But many others are unready – and the reporting obligations are not trivial."

He continues: "Some asset managers are reportedly staying away from the article-nine fund declaration because they want to avoid the reputational damage of a potential downgrade later, as some of the standard's definitions remain imprecise."

Iain Ramsay, chief investment officer at AHR Private Wealth, notes that a "key hurdle for investment firms will be creating the necessary framework and management processes to comply with the chosen level of the regulation. For some, this may require investment in resources and infrastructure to demonstrate selection criteria, as well as monitoring and adoption of the chosen ESG focus. There is, of course, a significant time and cost to this process. Firms will need to develop a clear implementation strategy to achieve a smooth transition."

Alongside all these considerations is the possibility that the UK government may write its own version of the SFDR. After all, as well as signalling their intent to make the requirements of the Task Force on Climate-Related Financial Disclosures mandatory for all large companies by 2025, ministers have created an independent Green Technical Advisory Group in an effort to curb greenwashing. The Financial Conduct Authority has even published a consultation paper on climate-related financial disclosures for asset managers.

These are all "indicators that the UK is pushing environmental factors to the forefront of its agenda", Gillespie says.

Stewart agrees. "There has certainly been momentum in the run-up to the United Nations' COP26 climate change conference. I hope that this will serve as an opportunity for policy-makers and the financial services community to meet and find a way to work together to deliver a positive impact," she says, adding that the UK could even go a step further than the EU and require asset managers labelling their funds as article eight or article nine to "commit to full transparency".

There is undoubtedly scope for the UK to adopt its own version of the SFDR or come up with a "better-defined disclosure standard", according to Burrett. "But that might add to the administrative burden of British firms wishing to meet both standards."

He may well be proved right. What is abundantly clear right now is that the SFDR will have a sizeable impact on the UK's asset management industry – one for which all fund managers and financial advisers must prepare.

THE ROAD TO COMPLIANCE

BIQH, 2021

Timeline of important dates for the Sustainable Finance Disclosure Regulation

- **10 March 2021** – SFDR effective date. Requires all level-one obligations to be in place
- **1 July 2022** – First reference period starts (delayed from 1 January)
- **1 January 2023** – Second reference period starts
- **30 June 2023** – Final date by which financial market participants need to report for the first time
- **30 June 2024** – Final date by which financial market participants need to report for the second time, including a comparison between the first and second report

Commercial feature

ESG ETF investors: always take a closer look at the 'recipe'

The diversity of sustainability priorities means there can be no one-size-fits-all approach to ESG ETF products, says Qontigo's **Anna Georgieva** and **Saumya Mehrotra**

Mounting attention on sustainability and climate issues has prompted a surge of interest in ESG-related exchange-traded funds (ETFs), with net new asset growth hitting 140% last year, compared with just 8% for non-ESG ETFs, according to Qontigo, provider of well-known European indices including the STOXX Europe 600, EURO STOXX 50 and Germany's DAX. Yet with the vast array of ESG ETFs available on the market, finding the one that is best suited for a particular investor can often be a challenge.

"Sustainability means different things to different people and ESG ETFs don't all target similar sustainable concepts or investment objectives," says Anna Georgieva, senior sustainable investment specialist at Qontigo. "A quick glance at fund names or the indices out there can often be confusing, even for the most experienced investor."

For Georgieva, the investment theme and the index methodology—essentially the rules or "recipe" for how to create the index—are areas where investors should take a closer look when selecting an ETF. For example, one popular theme might be climate, though not all climate-related ETFs are created the same. One approach could be to exclude certain sectors, such as fossil fuel-related companies, to reduce carbon footprint.

> Quality ESG data is more important than quantity at this stage and meaningful product design is paramount

Another approach could be to overweight companies that are performing better on certain climate indicators, and underweight those that are underperforming.

The methodologies behind these ETFs can have important implications for investors as it shapes the ETF's exposure and thus its behaviour, including risk and return, says Saumya Mehrotra, senior sustainable investment specialist at Qontigo.

Given the range of products available, investors must start by deciding on their own sustainable investment objectives and then selecting a portfolio that is built in alignment, Mehrotra says. For example, are they looking to align their investments with their personal values, such as not profiting from industries and practices they disagree with? Or are they looking for better risk-adjusted returns through exposures to companies that are adapting their business practices to keep up with the sustainable transition? Or perhaps they want to use their capital to make the world a better place through a more specific impact investment?

For now, ETFs that adopt a broad approach using an overall ESG measure make up the bulk of the market, yet the fastest growing approaches are more impact-oriented or thematic, such as a focus on the United Nations Sustainable Development Goals or standalone social or environmental themes, says Georgieva. The market has also started to move away from pure exclusion-based approaches towards more optimised strategies that can better achieve sustainability goals without deviating too much from the broad market.

An additional point to bear in mind is the inherent divergence in the calculation of ESG metrics from different data providers that are used for index design. These differences in calculations can lead to entirely different outcomes, even if those ETFs have the same goals, says Georgieva. Continuing with our climate example, to measure climate risk or exposure, you need a proxy. One ESG metric underpinning a fund might use a company's commitment to science-based climate targets (SBTs) for emissions reduction as its proxy, while another might measure the quality of the company's reporting according to the Task Force on Climate-related Financial Disclosures (TCFD), a framework intended to unify corporate disclosures on climate-related financial risk.

"Fundamentally, both are trying to measure the same things, but come out with different exposures because of different proxies," says Mehrotra.

Given the diversity of ETFs, it's no surprise investors face challenges when trying to invest sustainably. There is a strong need for transparency, greater flexibility in approach and more precision in accessing specific investment objectives.

"Quality data is more important than quantity at this stage and meaningful product design is paramount," says Georgieva.

Qontigo is heeding the call to provide sustainability-minded investors with those explainable investment solutions. By collaborating with ETF issuers, leading data providers, stakeholders from academia and the global not-for-profit sector, Qontigo aims to be a catalyst for the shift to the next generation of transparent, effective and highly-targeted ESG ETFs.

For more information please visit qontigo.com

QONTIGO
AXIOMA | DAX | STOXX

Kiyoshi Ota/Bloomberg via Getty Images

ESG REPORTING

The heat is on

The government is intent on making all reporting recommendations by the Task Force on Climate-Related Financial Disclosures mandatory before 2025. Companies would be well advised to start preparing for this now

Megan Tatum

Within two years, companies in the UK could be legally obliged to disclose the risks (and opportunities) presented to their business by climate change. In November 2020, the chancellor, Rishi Sunak, announced a package of policies aimed at boosting the sustainability of the financial markets. This included a plan to make some of the measures recommended by the Task Force on Climate-Related Financial Disclosures (TCFD) mandatory as soon as 2023.

The TCFD has produced a voluntary protocol that encourages enterprises to publish a range of climate-related information, covering aspects such as their greenhouse gas emissions, energy consumption and waste management practices, within an agreed set of reporting guidelines.

If the government presses ahead with its plan, the UK would become the first country to impose such a regime. Sunak has described the move as necessary to "bolster the dynamism, openness and competitiveness" of the nation's financial services sector after Brexit.

What effects would this have on businesses? And how can they best prepare?

Rich Hall is head of sustainability and stakeholder assurance at MHA MacIntyre Hudson, a firm of accountants and business advisers. He believes that "the introduction of the TCFD's reporting requirements will be a game-changer for organisations, in terms of both the level of information required and the work they'll need to do to make their disclosures compelling".

Given that the investment community and the wider public are becoming increasingly interested in companies' environmental records, such disclosures "may prove key for a brand's reputation and its access to finance", Hall adds.

For those firms that are ahead of the curve on sustainability reporting, it may merely be business as usual. According to the TCFD, 384 companies in the UK are following its guidelines, with the likes of Barclays, BP and AON already committed to making climate-related disclosures.

But Westminster's planned move is likely to prove a wake-up call for those firms that have failed to consider climate change in their reporting so far, particularly given the tight implementation schedule.

In its 2019 *Green Finance Strategy* policy paper, the government stated an expectation that all listed companies and large asset owners would be disclosing in line with the TCFD protocol by 2022. And, in a 'roadmap' published last year, it revealed its plan for most other affected businesses to be making disclosures by 2023, with the following two years set aside for making refinements to the measures.

> Unless you know how a company is exposed to climate change and how it is managing that exposure, you cannot properly assess its long-term financial resilience

Changes planned within this timeframe will probably apply only to large companies, according to Hall, who explains: "To be deemed 'large', a company has to meet two out of three of the following criteria: an annual turnover of at least £36m, balance-sheet assets totalling at least £18m and a workforce of at least 250 employees."

All large UK companies will be affected by the TCFD requirements within the next 18 months, says Vanessa Havard-Williams, partner and global head of environment and climate change at law firm Linklaters.

"The net effect is to require the reporting entity to provide emissions data and also explain the financial impacts of climate change on its strategy, risk management and governance," she says.

Under those four broad headings, the TCFD guidelines set out 11 more detailed reporting requirements. These cover aspects ranging from the resilience of the company's strategies in various climate-change scenarios to its board's oversight of climate-related risks.

"That might all sound pretty dull, but it is a cornerstone of effective climate policy. Over time, it will be transformational," Havard-Williams predicts. "Unless you know how a company is exposed to climate change and how it is managing that exposure, you cannot properly assess its long-term financial resilience."

But it could create significant burdens. For instance, it will entail understanding risks and opportunities throughout the value chain, notes Stuart Lemmon, MD (northern Europe) at climate consultancy EcoAct. That includes a firm's scope-three greenhouse gas emissions. The scope-three emissions of a food retailer, say, would encompass the carbon footprints of ingredients and products sourced, as well as their use by customers. Emissions in this category, which can account for up to 90% of a company's total carbon footprint, present the biggest data-collection challenge.

Lemmon adds that affected businesses will need to use complex analysis methods to model long-term changes under various climate scenarios. Such techniques, he says, "were not initially designed to be used by companies, many of which will lack the right data, tools and experience. What's more, they typically don't know how to link scenarios to business needs."

Nonetheless, the TCFD itself has said that "it's important to get started", given the government's clear signals of intent. But how? A spokesman for the task force recommends that firms "read our publications and evaluate the areas where they already make disclosures, which ones they want to improve and where new reporting is needed".

He continues: "Based on their analysis, they can consider how best to address each area and which groups to engage with, internally and externally. We recommend accessing the online TCFD Knowledge Hub for additional resources, including free courses in how to make disclosures."

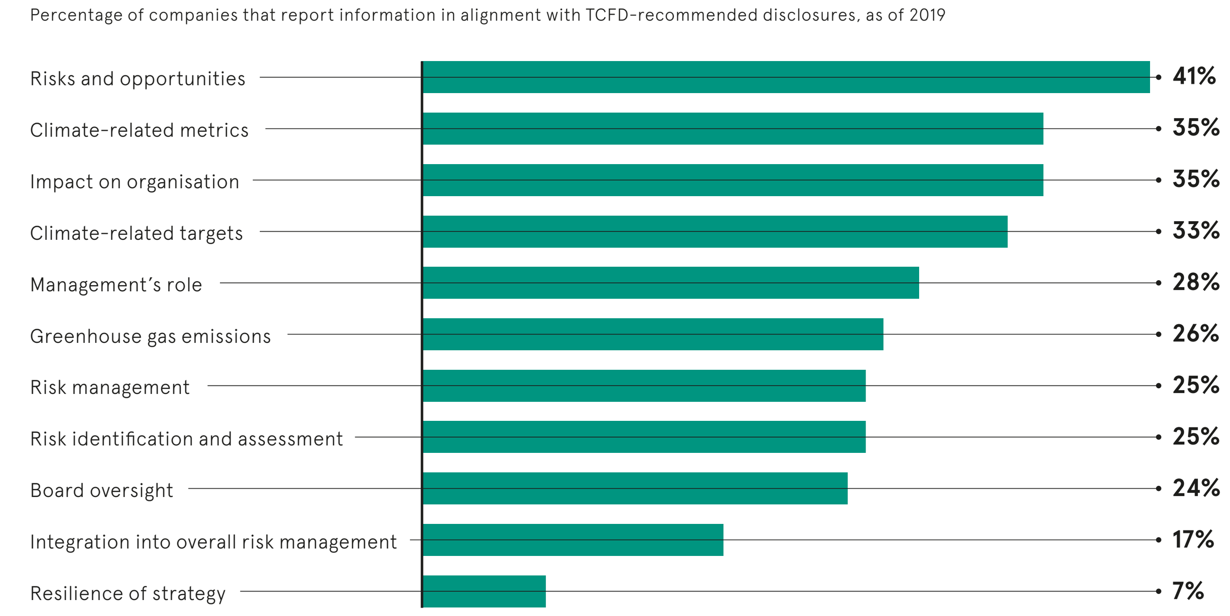
It's important to remember that, for all the extra work and cost involved, there are significant benefits to be gained from compliance. Companies that already disclose their climate-related risks obtain "better access to capital by increasing investor and lender confidence", according to the TCFD, which has "also heard from companies that found the reporting process helped them to capitalise on opportunities that could come from the transition to a low-carbon economy".

In other words, although it may seem a daunting task, the disclosure of climate-related risks is good for business and, ultimately, good for the planet.

THE STATE OF CLIMATE-RELATED REPORTING

Task Force on Climate-Related Financial Disclosures, 2020

Percentage of companies that report information in alignment with TCFD-recommended disclosures, as of 2019



Commercial feature

Mobilising green capital to meet net zero

Private capital is instrumental to achieving a net zero economy. As calls for sustainable private finance grow louder, firms like CBRE Investment Management are prioritising the private sector's focus on ESG and, in doing so, are leading the charge toward net-zero

If the world is to achieve its global climate goals, it's essential to unlock trillions in private finance. This has the potential to rapidly shift the dial on the progress to a net-zero carbon economy. The United Nations is now holding its 26th annual climate summit, COP26, with over 190 countries charting a path to combat climate change. While developed countries are committing to mobilise $100bn annually, the private sector will also need to play a substantial role. Investors are already investing billions into sustainable finance, including: green bonds; environmental, social and governance (ESG) funds; green ETFs; public companies with environmentally friendly track records; and sustainable real assets.

The disruption caused by the Covid-19 pandemic has brought many issues into focus around community, social equity and the climate, driving investors to care more about ESG-focused mandates. Combined assets for funds focused on ESG-related topics climbed to $2.3tn recently, while inflows doubled in 2020 over 2019. Many firms are reporting a three-fold increase in investor enquiries for sustainable investments over the last three years alone. Around the world, new sustainable funds are launched on an almost daily basis in order to meet demand, as more businesses promote better sustainable practices. It is a virtuous circle.

While nearly all industries will need to make progress to reduce the impact of climate change, the building sector has a particularly important role to play. Buildings account for nearly 40% of greenhouse gas emissions attributable to climate change. This is fuelling the drive to net-zero by many leading companies in this sector.

"In October we issued a €500m green bond, the third ever issuance executed directly from a fund-level entity. The bond raised funds from a diversified pool of global investors and was significantly oversubscribed. This is a great example of how the real asset industry can help mobilise green finance," explains Helen Gurfel, head of global sustainability and innovation at CBRE Investment Management, which has $133.1bn assets under management and 30 offices within 20 countries worldwide .

> Eventually scale is what's needed. We can pilot, improve and adopt new technologies to help innovative companies grow and to advance our collective goals

"Our definition of sustainability is holistic, jointly considering our planet, people and long-term investment returns. We believe that we have both an opportunity and responsibility to improve the sustainability of our investments for all our stakeholders including investors, clients, shareholders and employees. Everyone needs to be as fluent in ESG as they are in asset investing. We need to elevate knowledge today, for climate gains tomorrow," added Gurfel.

CBRE Investment Management is working to embed ESG throughout the investment process, from asset acquisition to disposition. Before acquiring assets, real-estate companies are increasingly assessing ESG risks including climate change and the impact it might have on the asset's long term financial performance. Throughout asset ownership, tracking and improving environmental performance is becoming an industry standard. Turning data into information becomes vital.

"Data is always key to this process," says Robbie Epsom, EMEA head of ESG at CBRE Investment Management. "The question is how sustainable is the project you are investing in and what is possible to achieve? Right now, there are fifty shades of green. Often businesses don't think through what it takes to get ESG really integrated and then implemented. That's because these are often technical problems, which require scientific or engineering expertise and understanding," Epsom explains.

"In fact, an array of STEM skills - science, technology, engineering and math -- are all needed for effective decision making. That's why STEM skills are so important and why our growing ESG team consists of scientists and engineers. If you're going to really tackle climate change you need the right technical people to design and implement the right strategies and tools and to upskill the wider investment teams so that ESG is integrated across the whole business in an impactful way."

So, how can we do this? CBRE Investment Management believes that there's a clear process. "If we can do this starting with our own operations and direct investment assets, we can pioneer and then generate the expertise across different investment strategies," says Epsom.

Calculating climate risk is fast becoming a necessity in the investment process. Many tools that try to quantify risk on assets require greater transparency. It helps that financial markets are starting to speak with a common language around ESG. The EU and UK Taxonomy, which provides a classification system listing environmentally sustainable economic activities and providing an exact definition of these, could be critical.

"Investment managers need to be cohesive in how they talk about these issues. There are various local and regional standards, policies and regulations, but one thing that is global is finance. Everyone speaks the language of finance so if we can get capital working in a consistent way, we can make a difference," says Gurfel.

> As an investor-operator, and with assets that are equivalent to the size of an average city, we can use our global scale to bring about change

Today we live in a period of transition. Many of the solutions and technologies needed to help solve climate change challenges have yet to be developed. Over the coming years many more innovations will come online, whether it's green hydrogen, new construction techniques, circular economy solutions, credible global offsetting exchanges or energy storage technologies. Robust product assessment and adoption will be important for the industry to reach climate mitigation goals.

"Eventually scale is what's needed. We can pilot, improve and adopt new technologies to help innovative companies grow and to advance our collective goals. As an investor-operator, and with assets that are equivalent to the size of an average city, we can use our global scale to bring about change," concluded Gurfel.

For more information please visit cbreim.com

CBRE Investment Management

Shopping City Galati, Romania. Certified BREEAM International In-Use 2015 'Excellent' in 2018, 2019 and 2020. Owned and operated by NEPI Rockcastle, achieved green bonds as a result of BREEAM Certification

Unlocking the built environment's gateway to green finance

Third-party certification schemes such as BREEAM can give ESG investors and lenders more confidence that real estate projects are as sustainable as they claim

As governments around the world sketch out their commitments to cutting carbon emissions and tackling climate change, one sector that accounts for roughly 40% of all emissions has a vital role to play in helping governments meet their targets: the built environment.

"With heightened unease following the recent spike in gas prices, real estate investors and lenders are increasingly scrutinising the resiliency of their portfolios to the potential impacts of climate change", says Dr Shamir Ghumra, head of building performance services at BRE Group, which runs the BREEAM sustainability assessment method.

"That has been a stark reminder of the social dimension of this: are we really preparing ourselves such that the infrastructure is ready to cope with changes in the fuel mix?" asks Ghumra. "For example, there has been a lot of talk about when governments will no longer allow traditional boilers to be installed in new homes, but these initiatives continue to be delayed. Unfortunately you can't keep kicking the can down the road—the can is getting quite big and the road is getting shorter."

That backdrop is prompting property owners to look at ways to make their buildings greener, particularly by focusing on resource efficiency - through reducing waste or cutting energy use - and using data and technology to optimise how those buildings are used and occupied.

> As a general rule, if it's easy, it probably means it's greenwashing

"We're starting to see more appreciation of the efficiency measures needed and a lot of drive and behaviour in trying to understand how their buildings are operating," says Ghumra. "BREEAM has different schemes at different asset lifecycle stages, but our in-use programme is our fastest growing scheme and a lot of that activity has come from investors."

This rush to improve the energy efficiency of buildings means property developers and home owners are increasingly turning to green finance to bankroll projects.

"Green finance is going to be vital both for financing net-zero new builds but also for the significantly larger challenge of financing the retrofitting of the UK's existing building stock," says Emma Harvey, programme director at the Green Finance Institute. "The UK Committee on Climate Change has estimated that £250bn of investment is needed to retrofit UK homes, so clearly there is a vital role for private finance to play given that cost can't be met by the public purse alone."

At the same time, investors and lenders require reliable data to verify that the money is being deployed according to the terms agreed. For instance, green bonds and green mortgages are typically used to finance specific projects, whereas sustainability-linked loans can be used for broader purposes on the condition that predetermined sustainability targets are met. This underscores the need for robust data.

"There are quite a few green finance options on the table, so it's about understanding who needs what for what purpose," says Ghumra. "If a bank is going to be lending a green mortgage for, say, a refurbishment project, the bank will need a way of assessing if that outcome has been realised, so one of the conversations we are having with quite a few financial institutions is about using an assurance process like BREEAM as a certification methodology."

Take Lloyds Bank. In September it launched a green commercial mortgage product for its large real estate clients. This complements its existing sustainable development loan programme, both of which offer cheaper loan rates if the borrower's buildings or developments meet certain environmental, social and governance (ESG) criteria.

"In terms of what is 'green' or 'sustainable', certification such as BREEAM plays a central role in ensuring that funded real estate assets under these propositions meet the right standards," says David Willock, a managing director and head of ESG finance, corporate and institutional coverage at Lloyds Bank.

In other words, using a certification scheme like BREEAM can help borrowers unlock access to a greater range of green financing options, while giving investors the confidence that the underlying data is sound. In addition, using a certification scheme like BREEAM can help to bolster investor returns.

According to a recent Knight Frank report, buildings with stronger green credentials are able to collect higher rents. For example, prime office buildings in Central London with 'very good', 'excellent' and 'outstanding' BREEAM ratings are able to generate rents with premiums ranging from 3.7% to 12.3%.

The rapid growth of the wider ESG market is also making it harder for investors to make sense of the abundance of green products that are now available. "There is quite a lot of noise in the marketplace now around ESG finance and data, the terminology has become so broad that what constitutes ESG has become more open to interpretation," says Ghumra.

To that end, the UK Green Building Council's net zero definition and the development of the UK's taxonomy on green activities should help ensure there is more consistency in the market, says Harvey.

"That will ensure people are not comparing apples with oranges, and that everybody is crystal clear on what constitutes green," she says.

Investors need to be wary of certification schemes where standards are relatively frictionless to meet, while also avoiding multiple schemes to cover different aspects of sustainability.

> In terms of what is 'green' or 'sustainable', certification such as BREEAM plays a central role in ensuring that funded real estate assets under these propositions meet the right standards

"As a general rule, if it's easy, it probably means it's greenwashing," says Derk Welling, senior responsible investment and governance specialist at APG Asset Management. "But at the other end of the spectrum, too much time-consuming data collection to demonstrate sustainability is not the solution either.

"This is where a holistic scheme like BREEAM proves its worth. It covers a broad range of environmental, social and governance issues at individual building level and, as it is monitored by a third party, it helps to make assessments credible and to verify sustainability claims made by others."

Ultimately, that third-party verification is a critical component of maintaining the integrity of the green finance market.

"Some lenders are looking at referencing other metrics, which is fine, but there is an increasing risk of the proliferation of proprietary systems that could undermine investor confidence because they lack third-party assurance," says Ghumra. "What we're providing is assurance, credibility, and a robust system and framework that has been evolving for the past 30 years. It's a tried and tested approach that is coherent and easy to understand."

For more information please visit breeam.com

BREEAM®

CONSTRUCTION

Built without guilt

Infrastructure and real estate present varying ESG risks to institutional investors, but there are still opportunities to fund environmentally and socially responsible projects that offer acceptable returns

Carlina Teteris via Getty Images

Pádraig Floyd

Long-term infrastructure investments lie at the heart of the government's latest plan to boost the nation's economy. Indeed, in his foreword to the *Build Back Better* policy document, Boris Johnson pledges: "We will redress Britain's historic underinvestment in infrastructure, with £600bn of gross public-sector investment over the next five years, so our United Kingdom becomes a truly connected kingdom."

Infrastructure projects are not simply about building roads, bridges, ports and airports. They also deliver public institutions such as schools and hospitals. Social housing is also being targeted for investment. This is one of the main reasons why Westminster has been engaging with other big investors, such as pension funds, insurance companies and local authorities.

Investment is all about risk and reward. The bigger the risk you take, the more you should expect to receive in return. Infrastructure investments tend to tie up capital for longer periods. The so-called illiquidity premium they pay to compensate for this is what makes them attractive to investors.

Pension managers, insurers and sovereign wealth funds – for instance, the Public Investment Fund of Saudi Arabia that recently bought Newcastle United Football Club – all take a long view when it comes to investment. Bonds – usually government-issued gilts – are a key component of their highly diversified portfolios, as these provide a relatively reliable income over the medium to long term with little risk. But the exceedingly low interest rates that have persisted since the global financial crisis of 2007-08 have depressed bond yields, prompting investors to seek comparable returns elsewhere. This in turn is leading to an increase in allocations to asset classes offering a comparable risk/return balance.

Many institutional investors have historically considered infrastructure projects too risky for the effort these tend to require. Their argument has been that you need specialist advice and the ability to negotiate the right price on the way in, or you'll never achieve the returns you're seeking. By contrast, they have seen real estate as a stalwart option for decades. Yet neither of those characterisations is accurate. The two sectors have experienced very different fortunes in recent years.

The financial crisis exposed some structural problems with property that have only become clearer since then. In commercial real estate, demand for high-street retail space has fallen as we do more of our shopping online. Anything but premium office space in the big city centres has been on the slide for years. There simply isn't the demand for secondary (on back streets) and tertiary (on ring roads) space that there used to be. Some of these properties have been turned into housing in recent years. If they are near good transport links, they are likely to become prime development sites for local authorities with affordable-housing quotas to fill.

40%
The real-estate sector's annual share of global energy consumption

36%
The reduction of CO_2 emissions needed in the real-estate sector by 2030 to keep global warming within the UN Paris accord's 2°C threshold

20%
The share of global greenhouse gas emissions originated by buildings

RICS, 2019

This shows that, however much we might think that real estate is as safe as houses, certain parts of the market are not necessarily a sound long-term punt. What's more, there are newer risks to consider. For instance, achieving the UK's goal of carbon neutrality by 2050 has fast become the main environmental, social and governance (ESG) commitment of businesses and their investors.

A recent report by Carbon Intelligence identifies the risk posed by the real-estate sector to investors' net-zero aspirations. Although any property under construction today should meet environmental specifications, about three-quarters of the buildings that are likely to be in use in 2050 have already been built.

"When investors start lifting the lid on their portfolios, they are probably going to see that they're reliant on outdated technology and ways of operating buildings," says Chris Parrott, an independent pension trustee and former head of pensions and benefits at Heathrow Airport. That leaves this 'safe' asset class with considerable exposure to climate-change risk, creating a lot of work to align the sector with ESG targets. The costs involved will reduce investors' returns.

Infrastructure, so long associated with crucial – but not necessarily ESG-friendly – objectives, has had something of a rebirth as more and more nations chase net-zero targets. As a sector, it's responsible for the many renewable-energy projects that are proliferating around the world. Nonetheless, these all still carry ESG risks. For instance, any investment in battery storage would rely on cobalt mining. Most of the world's cobalt is produced in the Democratic Republic of the Congo, a nation with one of the most consistently poor records for human rights abuses.

Such infrastructure projects are unlikely to interest pension fund managers. Given that they have fiduciary duties to their members and must also meet the expectations of regulators and society at large to invest responsibly, they are cautious by nature.

Sally Bridgeland is chair of the Local Pensions Partnership, which manages the investments of some of the UK's largest council pension schemes. She says that "the important thing is to look at things that other people are not invested in, in both property and infrastructure. The risks associated with infrastructure differ from those involved in real estate. You need to understand these risks and, ideally, have the skills to manage them internally."

> When investors start lifting the lid on their portfolios, they are probably going to see that they're reliant on outdated technology and ways of operating buildings

One growth market that straddles real estate and infrastructure is the development of sustainable cities that include both social and affordable housing. These are termed 'impact investments', as they can be seen to have positive benefits on local communities. The number of social housing units in the UK has plummeted to about 2 million from its peak of 6.6 million in the late 1970s. Parrott thinks that the effort to rebuild the nation's social housing stock could be a "game-changer" for council pension funds.

These funds cannot simply finance house-building for the local authorities they're associated with, because that would breach their fiduciary duties. But there are ways in which they can invest in asset classes that match their principles, according to Karen Shackleton, an independent investment adviser to public-sector pension funds.

"While climate change has been a primary focus for many investors, local government funds have identified sustainable cities as something they're interested in. This is because they satisfy both the environmental and social aspects of their ESG criteria," she says. "Social and affordable housing projects are very much an impact strategy, because these can achieve councils' goals in helping the homeless and other vulnerable people.

Alexander Spatari via Getty Images

SHAREHOLDER ACTIVISM

Votes of confidence

Ethical investors are flexing their collective shareholding muscle to persuade plcs to adopt greener practices. But many environmental activists view their recent high-profile victories as only the start

Tim Cooper

Institutional shareholders investing in accordance with environmental, social and governance (ESG) principles have shown that they can radically influence corporate behaviour, having achieved some notable successes this year. For instance, oil giants Chevron and ExxonMobil have both lost battles with shareholders over their climate strategies. In the latter's case, an activist hedge fund even managed to oust two board members.

But such headline-grabbing triumphs have been rare. Campaigners know that many more such actions are needed for the burgeoning ESG movement to make a lasting difference. They are therefore ramping up the pressure on all parts of the investment ecosystem to encourage big business to adopt sustainable commercial practices.

In theory, each time someone puts money into an ESG investment, it starts a chain reaction. A retail investor with concerns about climate change and other ethical issues raises these with an intermediary such as a financial adviser or wealth manager. The intermediaries adjust their portfolio goals to reflect their client's views, then select fund managers whose ESG investment practices best align with them. Sometimes, their practices entail screening out companies with unsustainable business models, such as oil extraction. But, increasingly, they involve engaging with such firms in a bid to change their behaviour.

James Alexander is CEO of the UK Sustainable Investment and Finance Association (UKSIF), a body representing fund management firms and other investment organisations. He explains this approach by arguing that "you can't divest your way to sustainability. That would simply mean that you've sold those shares to someone who cares less than you. That's why stewardship, also known as engagement, is crucial for our members. They will vote at AGMs and work with companies to push towards sustainability."

Businesses ought to respond to investors' concerns by cooperating with such engagement, Alexander adds. They should, for instance, set ESG performance targets, report on their progress towards these and enable shareholders to vote on issues concerning climate change. Recent research by FTI Consulting indicates that this type of stewardship is effective, given that most of the world's largest investors have adopted climate-related voting guidelines. This has persuaded more companies to give shareholders a "say on climate" – and many others will follow, FTI predicts.

The Chevron and ExxonMobil stories made a splash because of the conflict they involved, but many equally effective interventions by ESG activists attract less media coverage because the boards of the firms involved don't oppose them. Under pressure from a £140bn shareholder coalition in May, Tesco pledged to stock more healthier foods and drinks, for instance, while in the same month HSBC agreed to phase out financing for coal-based industries after lobbying from a £1.74tn investor group.

Therese Niklasson, global head of sustainability at investment management firm Ninety One, notes that pressure groups often start ESG investment trends by engaging with asset managers. Organisations such as the UKSIF and the UN-backed Principles for Responsible Investment (PRI) network then become platforms for further work on these issues.

The recent trend for investing in biodiversity, for instance, came from several sources, including research by environmental scientists, economists and the PRI. This developed quickly into a reporting framework proposed by the new Taskforce on Nature-Related Financial Disclosures – a consortium of financial institutions, companies, governments, regulators and NGOs. The fast development of this initiative shows how the ESG investment infrastructure has developed to accommodate new ideas.

3,826
The number of signatories to the UN-backed Principles for Responsible Investment, which represent a combined £89tn of assets under management

Principles for Responsible Investment, 2021

Louisiana Salge, a senior sustainability specialist at wealth management firm EQ Investors, says that influencing companies to improve their practices can be difficult. One of the most effective ways for fund managers to encourage them to change is to form partnerships with academics and respected think-tanks.

"Say you want to start a biodiversity fund," she says. "All of the best practice is grounded in academia, because investors want to act on research. Your job is then to ensure that everyone you work with integrates that practice. Asset managers are important here, because they have the resources to engage with investee companies."

But the engagement efforts of most institutional investors have generally been "terrible", according to ShareAction, a charity promoting responsible investment. This is because most of them don't file resolutions, vote against boards, set deadlines for firms to take remedial action or react when targets are missed, it says. ShareAction's research indicates that, while some asset managers are showing leadership in the ESG field, managers responsible for £26tn in investment funds are still turning a blind eye to ecological harm caused by their investees.

Given that many fund managers in the latter category are members of both the PRI and Climate Action 100+, an investor coalition aiming to ensure that the largest corporate CO_2 emitters take effective remedial action, this is a concern for ShareAction. It believes that a large number aren't walking the ESG talk.

"It's hard to tell what some Climate Action 100+ participants are doing to advance its goals," says ShareAction's campaigns manager, Michael Kind. "We don't just want a list of collaborative involvements; we want evidence of real outcomes."

Kind would urge other members of the investment ecosystem, such as consultants and even retail investors, to demand higher standards of responsible investment from fund management firms. "This has started, with more asset managers building their ESG stewardship teams and disclosure practices," he says. "It shows that the quality of stewardship is becoming a business issue for them. But there is a long way to go."

Fiona Reynolds, MD of the PRI, offers the following response: "We're a big-tent organisation. Responsible investment practices are at various stages around the world. So too are our members. We aren't responsible for individual investments in our signatories' portfolios. Investors must monitor this."

For its part, Climate Action 100+ acknowledges that "there is more to be done on companies aligning their capital expenditure with the goals of the UN's Paris agreement on climate change. We remain committed to working with investor signatories to secure these commitments from companies."

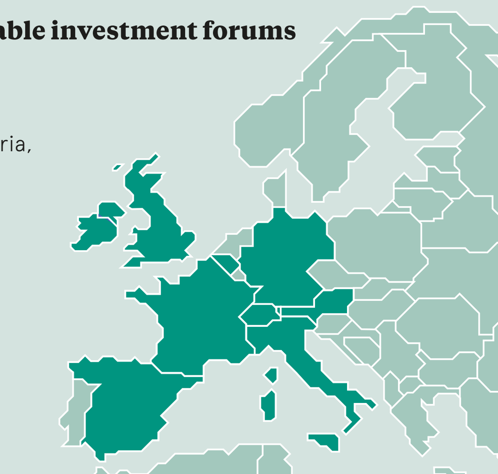
One key challenge that its members face in achieving their goals is a lack of resources. ESG investing is complex – and all the big fund managers are struggling to recruit enough researchers and analysts from a relatively small talent pool.

Another problem is a lack of standardisation in ESG reporting. "As disclosure frameworks become more standardised, the situation will improve," Salge predicts. "For example, requesting exactly the same carbon data reporting has led to real impacts."

If the investment ecosystem can overcome such barriers, it can strengthen its influence, bringing more corporate practices in line with shareholders' views.

Europe's sustainable investment forums

UKSIF – UK
FNG – Germany, Austria, Switzerland and Liechtenstein
ItaSIF – Italy
SIF Ireland – Ireland
SpainSIF – Spain
FIR – France
SSF – Switzerland
KBF – Belgium



Eurosif, 2021

OPINION

Only through a unified approach from the public and private sectors will we achieve our goals

Anthropologist Jane Goodall once said: "We have to make do with planet Earth – and planet Earth has finite natural resources." As events at the UN's annual climate summit unfold in Glasgow, I can't help but keep her words in mind as I reflect on our children's, grandchildren's and, indeed, our own future, in the face of a crisis that no previous generation has met. It is undeniable that the climate and, as a result, humanity have reached a tipping point.

The stark findings from the UN's Intergovernmental Panel on Climate Change report in August rang loud and clear: human-induced climate change is irrefutable. It affects every region on our planet and every investment in our portfolios. Only rapid reductions in greenhouse gas emissions can curb global warming.

That's why the Principles for Responsible Investment (PRI) is driving for increased action and urgency in our pace of change. We are calling on governments, investors and businesses to take tangible steps towards zero-emissions goals.

Net-zero targets by governments and investors are gaining momentum, but we need to step up the ambition of these commitments and push for near-term accountability to get back on track for 1.5°C. Current emission reduction pledges put the world on course for a temperature rise of 3°C to 4°C, which would plunge the planet into chaos. To counter this, governments and businesses need to commit to cutting global emissions in half from their current levels by 2030. It is only through a unified approach from both the public and private sectors that we will achieve our goals.

At and beyond COP26, investors also have a crucial role to play in delivering a global net-zero economy. All investments have outcomes, positive or negative, intentional or unintentional. But a lack of clarity in legal and policy frameworks, and prevailing market theories and practices, have led many investors to consider financial returns as their only goal.

The landmark *Legal Framework for Impact* report – commissioned by the PRI, the UN Environment Programme Finance Initiative and the Generation Foundation, and written by Freshfields – found that across 11 jurisdictions, investors are usually permitted (and sometimes required) to pursue sustainability goals when they are instrumental in achieving financial returns.

We are urging governments to acknowledge the need for a whole-of-government, economy-wide transformation, rather than separate climate workstreams. We need policy reforms designed to support investors and financial institutions in accounting for, and managing the impacts of, their investment and financing choices.

In recognising the power of collaboration and collective action to accelerate the pathway to net zero, we are encouraging PRI signatories – and, in fact, all investors – to join net-zero leadership initiatives. These include the UN-convened Net-Zero Asset Owner Alliance, the Net Zero Asset Managers Initiative, the Net-Zero Insurance Alliance and the Net-Zero Banking Alliance, among others.

In addition to collective ambition, accountability will also be critical. Through public annual reporting on progress, investors can enhance their accountability. Safeguarding against greenwashing will also be increasingly necessary to ensure that sustainability claims are credible.

Public and private finance will need to work together to turn billions into trillions to accelerate the climate transition, with a collective annual target of $100bn of climate finance for the mitigation and adaptation of climate risk. Blended finance – the strategic use of development funding for the mobilisation of additional finance towards sustainable development in developing countries – will play a key role in this.

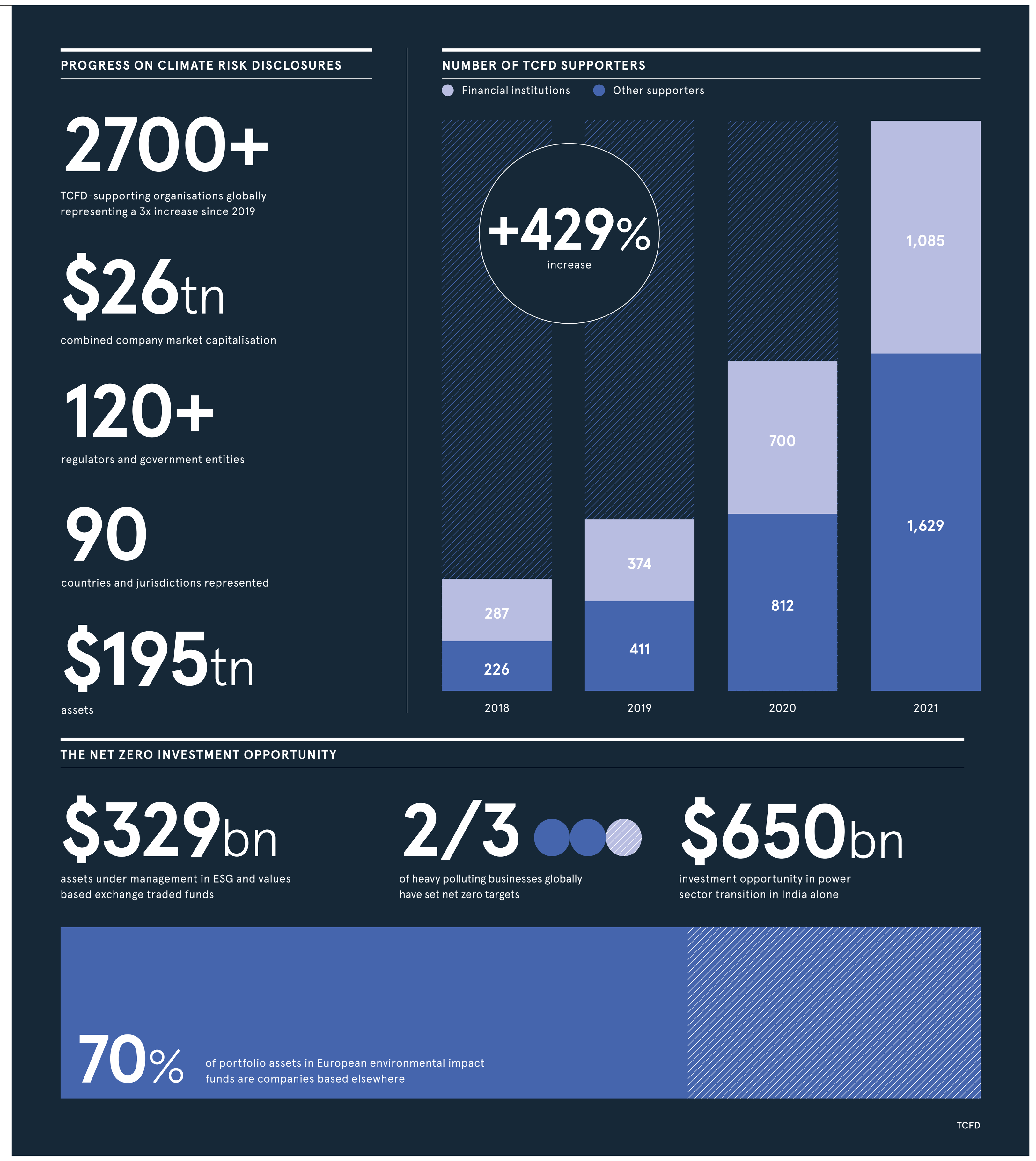
Now is the time for governments and investors to build solutions to tackle one of humanity's greatest challenges. We need to harness the momentum of COP26, working across industries to guarantee the livelihoods of future generations and the prosperity of financial markets. The more we can act in a coordinated way, the further and faster we can go together.

Fiona Reynolds
CEO, Principles for Responsible Investment

COMMERCIAL FEATURE

How green are investment funds? New rules will reveal

Retail and institutional investors increasingly consider sustainability as a key criterion for where they place money. New regulations in the UK and Europe are set to help them decide how green an investment is by providing the first formal, mandated reporting requirements for funds and their chosen assets



As each year passes, many investors expect their allocated cash – including their pensions – to be invested more sustainably and ethically. Increasingly powerful fund activism around environmental, social and governance (ESG) issues is influencing corporate practices, and regulators are now stepping in to support the greening of the economy by requiring corporates and financial firms to report sustainability.

For retail investors, pension fund holders and asset managers to easily compare financial products on a like-for-like basis, investment firms will need to gather and understand masses of reportable corporate information, and provide it using the same methodology. This will help them demonstrate in a clear and consistent way that investments are aligned with environmental or social objectives.

"Investment firms can look to the EU Taxonomy, which is currently the most sophisticated framework," explains Nadia Humphreys, business manager for sustainable finance at Bloomberg. "It functions almost like a dictionary, defining different activities in sustainability terms, such as decarbonising operations in line with the Paris Agreement. Companies use it to assess their current and future sustainability positioning, producing a headline score that investors can scrutinise."

Not only are investors increasingly expecting the types of transparent disclosures listed in the framework, but the Taxonomy itself will become mandatory in the EU from January 2022. The groundbreaking framework is significantly influencing the development of standards globally – including in the UK, where the Green Finance Roadmap includes a future taxonomy, and in Asia, the Americas and beyond. These developments are the direct result of the realisation that substantial private capital is needed to drive a sufficient pace of change to meet existing targets.

Many multinational corporations and funds, located elsewhere, also fall under the scope of the EU Taxonomy. "This is because anyone that sells into the EU needs to comply with it," explains Humphreys. "Funds around the world will rely on the right data to support and evidence their current status in relation to the standards, and how they will be positioned in the future."

So far, the Taxonomy has focused on businesses adapting to environmental concerns and reducing emissions – influencing the more than two-thirds of heavy polluters that BloombergNEF calculates have set net-zero targets. From 2023, it will significantly expand to include water usage, pollution, fostering biodiversity, and the circular economy. By showing a true measure of an organisation's end-to-end sustainability performance, the implications for investors are enormous.

"First of all, banks have to demonstrate what proportions of their assets are represented by Taxonomy-aligned businesses, while investment funds evidence how much of their managed assets are or will be aligned," explains Humphreys. This information needs to be extracted from multiple reports, statements and strategy publications of corporations, which in turn face clear rules around disclosing the sustainability of expenditure and revenue streams.

But investment firms face a long road ahead in trying to demonstrate to clients that their products are truly sustainable. "They need to be able to assess how all their portfolio companies are aligned with the different aspects of the Taxonomy, as well as how much of an improvement they will be able to achieve once certain strategic initiatives have been actioned. Then they need to simply, clearly and transparently communicate this positioning in a standardised and comprehensible manner," says Humphreys. "All of this requires clear capabilities built around the changes, supported by the right information."

While investment firms want to quickly comply with these requirements, many need support to know where to begin, and what data allows them to meet the strict regulatory requirements. "Even explaining their own activity in clear terms is far from straightforward, given the complexity of the regulation and the vast amount of disparate company information," says Humphreys.

It is particularly vital for companies outside the EU to consider adherence to these changes, as they may still need to detail their alignment to the region's Taxonomy. Recent Bloomberg research shows that over 70% of portfolio assets in European environmental impact funds are companies based elsewhere, meaning funds may ask a whole host of non-EU businesses on their books to explain alignment.

> Companies use the EU Taxonomy to assess current and future sustainability, producing a headline score investors can scrutinise

Given the expectations of investors and regulators, financial firms worldwide are turning to Bloomberg to gain the data and analytical capabilities to align sustainable portfolio selection and client communication to these frameworks. "Excelling on this sustainability journey means funds understanding and highlighting not just where they are today but where they are going," Humphreys states. "Bloomberg enables investment firms to assimilate relevant information, actioning and telling this compelling story."

After identifying information, Bloomberg uses cutting-edge analytics to examine closely the data's quality and Taxonomy alignment. This information is already allowing portfolio managers to choose the companies that are more suitable, accessing calculations on alignment levels and customisable reports that empower accurate investor communication. "Finance firms rely on our information to help them tell a more holistic sustainability story of their funds," explains Humphreys. "For many, this is essential in deriving competitive edge over their peers and consistently attracting capital."

For investors, the Taxonomy alignment of funds and their selected assets is becoming ever more essential. From a macro perspective, such changes will help ensure countries around the world can rapidly augment their sustainability and meet tough targets.

To find out more about regulatory alignment, data and solutions to take action on climate, visit bloomberg.com/esg

Q&A

The path to reaching net zero

Mary Schapiro, vice chair for public policy at Bloomberg and former chair of the US Securities and Exchange Commission, explains why transparency and global consistency will be key to meeting climate goals

Q What is needed to make net zero commitments a reality?

A Given the number of countries and companies that have made net-zero commitments, every sector will be profoundly affected by the transition to a net-zero economy. To inform financial decision-making and assess the credibility of net-zero pledges, investors, lenders and insurance underwriters increasingly want information on companies' plans and targets for reaching net zero. When investors have the information to accurately price climate change impacts, including transition, capital will shift towards businesses that put resilience and sustainability at the heart of their strategies.

The Task Force on Climate-related Financial Disclosures (TCFD) – which is chaired by Michael Bloomberg – helps companies disclose the financial impacts of climate change, with recommendations structured around governance, strategy, risk management, and metrics and targets. Today, there are 2,714 TCFD supporters, with a combined market capitalisation of more than $26tn. Nine jurisdictions including the EU and UK have announced reporting requirements based on the recommendations, which are also formally endorsed by the G7, G20 and 12 national governments. This is evidence of consensus on the need for disclosures to accelerate the transition.

Q What do investors need to better understand net-zero commitments and take action?

A Investors are demanding information from companies on their plans to transition to net zero. With all eyes on net zero at COP26, the TCFD has released guidance to help companies disclose more consistent metrics, targets and progress, and to assist financial firms in reporting portfolio alignment.

The guidance focuses on disclosure of seven categories, including Scope 1, 2 and 3 greenhouse gas emissions, amount and extent of assets vulnerable to physical and transition risk, capital deployment and others. Companies with a net-zero strategy or those that operate in a jurisdiction committed to net zero, are recommended to disclose key information from their transition plans, anchored in quantitative metrics and annual reporting.

Q Given your regulatory expertise, what do you hope for from policymakers and the financial community?

A I hope we will see more requirements from policymakers around how companies disclose climate risks and opportunities, building upon the TCFD framework, which is helping to unite reporting standards thanks to support from global standard setters, national governments and regulators.

From corporations' senior management and directors, I hope to see commitment to considering climate risk in every aspect of the business, from M&A to strategy, operations, remuneration, and governance, among others. Reaching a net-zero target requires top-down transformation, beginning with the board and C-suite, who can ensure the business is prepared for the long-term effects of climate change and that it is incorporating these considerations in all decision-making. From institutional investors, I look forward to seeing increasing use of this information – they are perhaps the single most impactful group capable of holding corporations accountable, evidenced in recent successful climate campaigns in the oil industry.

> When investors can accurately price climate change impacts, capital will shift towards businesses with resilience and sustainability at the heart of their strategies

Q Where do emerging markets fit in?

A Emerging markets have a critical role. There is a significant gap in investment supporting their energy transition, presenting a significant opportunity for investors.

To tackle this problem, in 2018 Michael Bloomberg established the Climate Finance Leadership Initiative (CFLI) at the request of the UN. CFLI supports a mobilisation of private finance in emerging markets to help accelerate the climate transition, and it has launched the first of a series of country pilots – starting with India. These focus on strengthening local enabling environments and facilitating private capital at scale, bringing together international and domestic financial institutions. In India's case alone, the power-sector transition presents a $650bn opportunity.

Q What excites you for the future in this transition?

A Climate change presents an existential crisis and we have a responsibility to future generations to do all we can to mitigate the worst effects. Global capital markets are powerful tools that can help solve the biggest crisis of our lifetime alongside governments, and policymakers, NGOs, businesses and citizens.

For me personally, it's compelling to be at the front lines of harnessing the power of the capital markets in this fight through Bloomberg's enormous convening power across sectors. The work we have been able to achieve through TCFD and CFLI is driving transparency and mobilising capital in the shift toward a net-zero economy.

CLIMATE CHANGE

A drop in the rising ocean?

The UN's richest members are missing their targets for financing green projects in developing nations. What's more, investment experts believe that far greater – and better-managed – sums are required

Fiona Bond

Saturday 12 December 2015 marked a historic turning point in the global fight against climate change. Members of the United Nations had been in deadlock for decades over how to tackle the problem. But, as France's then foreign minister, Laurent Fabius, triumphantly banged his gavel, a treaty full of hope and promise was sealed that evening: the Paris climate accord.

Scientists have long warned of the catastrophic impact of global warming, with Oxfam estimating that it's responsible for 5 million (more than 9%) of human deaths globally each year. The Paris agreement, achieved after a fortnight of tense wrangling and so many failed negotiations before that, was hailed a breakthrough. For the first time, rich and poor nations alike pledged to restrict global warming to less than 2°C above pre-industrial levels, with a view to keeping it to 1.5°C.

World leaders agreed to submit plans outlining their intentions to reduce their nations' greenhouse gas emissions, incorporating a ratchet mechanism under which they would scale up their ambitions every five years.

Crucially, developed nations promised to jointly mobilise $100bn (£72bn) a year in climate finance between 2020 and 2025 to support the efforts of the UN's poorest member states, many of which had contributed the least to global CO_2 emissions but were already bearing the heaviest burdens of climate change. Funding is a key element of the Paris accord. It's also proving one of the thorniest issues. Developed countries have significantly increased their financial support for emerging economies since 2015, but the money hasn't flowed at anywhere near the speed required.

> Even if developed countries finally deliver the agreed annual sum of $100bn in 2025, vulnerable nations are facing a shortfall for every year they didn't hit that target

The total funds provided in 2019 totalled $79.6bn, according to the Organisation for Economic Co-operation and Development. It takes several months to tally up the numbers, but the latest estimates indicate that the $100bn target was missed in 2020 and it's unlikely to be achieved this year either.

Despite these probable shortfalls, it's likely that more than $400bn will have gone to developing nations over the past six years to help them manage some of the catastrophic impacts of climate change. And huge strides have been made towards a low-carbon economy. Figures from the International Renewable Energy Agency show that more than 80% of all electricity-generation capacity added last year was renewable, for instance.

The Green Climate Fund (GCF), established as one of several financing vehicles under the Paris agreement, increased its portfolio of projects under implementation to 75 in 2019. Its largest schemes included the construction of renewable energy plants in Kazakhstan and affordable green housing in Mongolia.

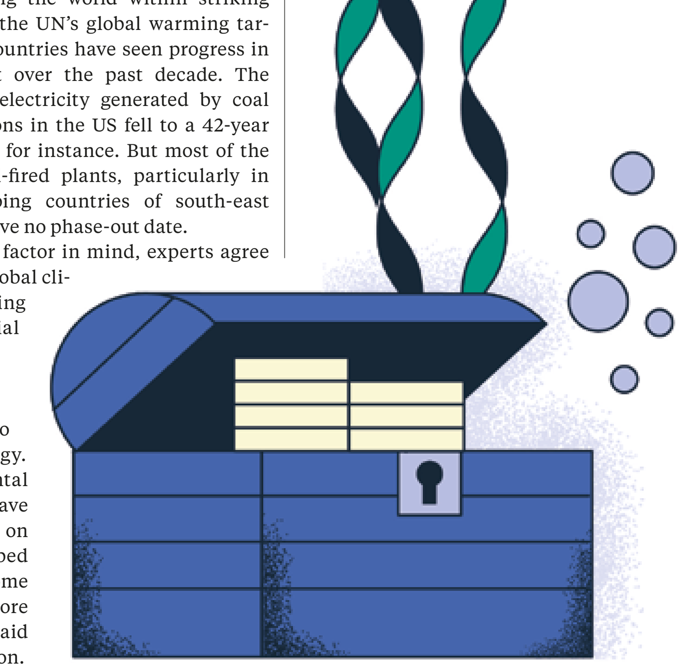
While the Covid crisis wrought havoc across much of the globe last year, efforts to implement more climate-mitigation programmes continued mostly unhampered. In Senegal, the GCF announced its intention to support the government to achieve universal energy access by 2025 through solar-powered mini-grids, for instance. Meanwhile, it's working with the Nordic Environment Finance Corporation to construct 22 solar- and battery-powered mini-grids for rural communities in Haiti where no grid supply exists. Many more similar projects are at various stages of planning around the world.

Although these projects are clearly beneficial in several respects, they have also prompted new thinking about what actions may be needed in future. A report published in May by research consortium Climate Action Tracker has projected that the Paris pledges, if achieved, will result in 2.4°C of global warming by the end of the century – thereby missing the UN's goal by a potentially disastrous margin.

Bill Hare is CEO and senior scientist at Climate Analytics, a co-founder of the Climate Action Tracker. He believes that the Paris accord is "driving change and spurring nations into adopting stronger targets. But there is still some way to go, especially given that most governments don't yet have the policies in place that would meet their pledges."

The abolition of coal-fired energy would help to bring the world within striking distance of the UN's global warming target. Some countries have seen progress in this respect over the past decade. The amount of electricity generated by coal power stations in the US fell to a 42-year low in 2019, for instance. But most of the world's coal-fired plants, particularly in the developing countries of south-east Asia, still have no phase-out date.

With this factor in mind, experts agree that more global climate financing will be crucial in enabling coal-reliant economies to move on to cleaner energy. Environmental activists have also called on the developed world to come up with more funding to aid this transition.



"Even if developed countries finally deliver the agreed annual sum of $100bn in 2025, vulnerable nations are facing a shortfall for every year they didn't hit that target," notes Oxfam Germany's senior policy adviser on climate change, Jan Kowalzig.

In any case, several campaign groups deem $100bn a year to be a fraction of what's actually needed. Estimates by the Climate Policy Initiative think-tank suggest that annual climate funding will need to exceed $4tn by 2030 if there's to be any realistic shot at achieving the Paris target.

Abrdn's chief economist, Jeremy Lawson, explains: "The $100bn was always a drop in the ocean compared with the additional investment necessary to put emerging-market emissions on a trajectory consistent with the aims of the Paris agreement. The fact that actual spending has fallen short of even that meagre commitment is an indictment of the advanced economies' commitments to the accord. An extra $20bn a year wouldn't do much to change this. What's needed at the COP26 summit is a significant increase in the amount of funding."

For developing countries already battling the disastrous consequences of global warming, there is a further complication. The bulk of finance raised has been poured into so-called mitigation projects that reduce CO_2 emissions, such as renewable-energy schemes, rather than into projects that will help them adapt to the current and future problems created by climate change.

Although the UN, the UK government and many climate funds agree that half of all climate finance should go into adaptation projects, only a quarter of the total funding raised in 2019 was so allocated. Mitigation projects are often easier to manage and more profitable, which makes them more attractive to private investors. Adaptation projects are vital in helping vulnerable communities to build resilience, but the return on investment they offer tends to be comparatively low.

"Given that further significant climate change is guaranteed, extra funds should be made available for adaptation," Lawson argues. "This should be focused on the poorest countries that are most vulnerable to its physical effects, most of which are in Africa, central America and the Pacific."

According to the UN Environment Programme, annual adaptation costs in developing countries are expected to increase to $300bn by 2030 and $500bn by 2050. In response to this growing challenge, the GCF has pledged to direct 59% of new funding to adaptation projects. It will allocate more than half of that finance to the "least developed countries, small-island developing states and African states".

Meanwhile, the UK will allocate £3bn of its £11.6bn climate fund to nature-based solutions, including marine conservation, reforestation and protecting habitats such as mangrove swamps, which offer local communities protection from problems such as coastal erosion and tidal surges.

Arguably, the most ambitious of adaptation projects to replace lost vegetation is the Great Green Wall initiative. This mammoth reforestation project, winding 5,000 miles across the Sahel region of northern Africa, is designed to halt the Sahara Desert's growth and improve the quality of life of the millions of people who live in that environmentally sensitive tract. Its supporters say that it's the type of adaptation project to which governments worldwide should be allocating more money.

While policy-makers, financial institutions and environmental campaigners concur that climate funding needs to increase quickly, there remains a question mark over the type of financing that developing countries should be offered. Of the $79.6bn in climate funding raised in 2019 for the developing world, 56% was loan finance. This could leave some of the poorest and most vulnerable nations mired in debt, struggling to honour the capital and interest payments.

"This is about the quality of the finance provided, not just the quantity," Kowalzig argues. "Last year, Oxfam estimated that the true value of climate finance may be just a third of the amount reported, once loan repayments, interest charges and other forms of over-reporting are stripped out. We also believe that only a fifth of funding went to the least developed countries and just 3% went to small-island developing states. This is partly because there are no international reporting standards on what should count as climate finance."

It's clear that, as nations' needs grow, so too must the level of finance from the private sector, which offers by far the biggest, and largely untapped, pool of capital.

Rebecca Craddock-Taylor is director of sustainable investment at Gresham House, a specialist alternative asset manager. She believes there is plenty of potential for the private sector to invest more in "long-term areas of growth, such as renewable energy, biodiversity and critical infrastructure. Another area we should consider is how funding is allocated to developing nations. Projects need to be financed and set up to deliver long-term benefits to local communities so that new investment opportunities and industries can be created."

She continues: "Many developing countries will still be suffering the impacts of the pandemic and will therefore require further funding to encourage economic recovery through the application of environmentally focused initiatives."

Given the sheer scale of the climate challenge, mobilising more money is only one part of the equation. What will become increasingly important is the adoption of a more systematic funding mechanism. To transform how societies and economies operate and move to a more resilient and regenerative world, this needs to shift away from a piecemeal, project-by-project approach and become more holistic, harnessing shared knowledge, new business models and financial innovations.

The new approach would require "much more collaboration and knowledge-sharing among regulators, governments, development banks and the private sector", says Nick Mabey, co-founder and CEO of E3G, a climate-change think-tank. "The preference so far has been towards clean infrastructure projects, but we must now think smarter and invest in driving policy, education and ecosystems to have a far greater, more transformative impact."

Mabey cites the African Risk Capacity (ARC) as an example of the kind of strategic thinking that's required. This agency of the African Union provides insurance services to member states and farming organisations, employing innovative financing mechanisms to pool climate-related risks across the continent and transferring these to international insurance markets. In doing so, the ARC says it improves the continent's response to natural disasters and helps in building resilience.

Mabey also believes that aid payments to developing nations should be allocated with greater consideration. He explains that such funding is "often distributed on an income-per-head level, which is why we see such large flows into Africa. But many nations that would be considered middle-income states, such as tourism-reliant Caribbean islands, can be devastated by the effects of climate change. More must therefore be done to recognise individual countries' specific circumstances."

As COP26 progresses (see panel, above), the need for more innovative, ambitious and effective climate action has never been greater. All nations will need to come together again to mobilise their collective resources if they're to stand any chance of achieving the goals of the Paris accord.

Mobilising funds at COP26

Answering the question of how to finance the net-zero transition is proving one of the top priorities of the UN's COP26 conference in Glasgow.

As this report went to press, Mark Carney, the former governor of the Bank of England, declared that "right now is where private finance draws the line" on tackling climate change, announcing that a new coalition of 450 financial institutions was ready to fund the push for carbon neutrality.

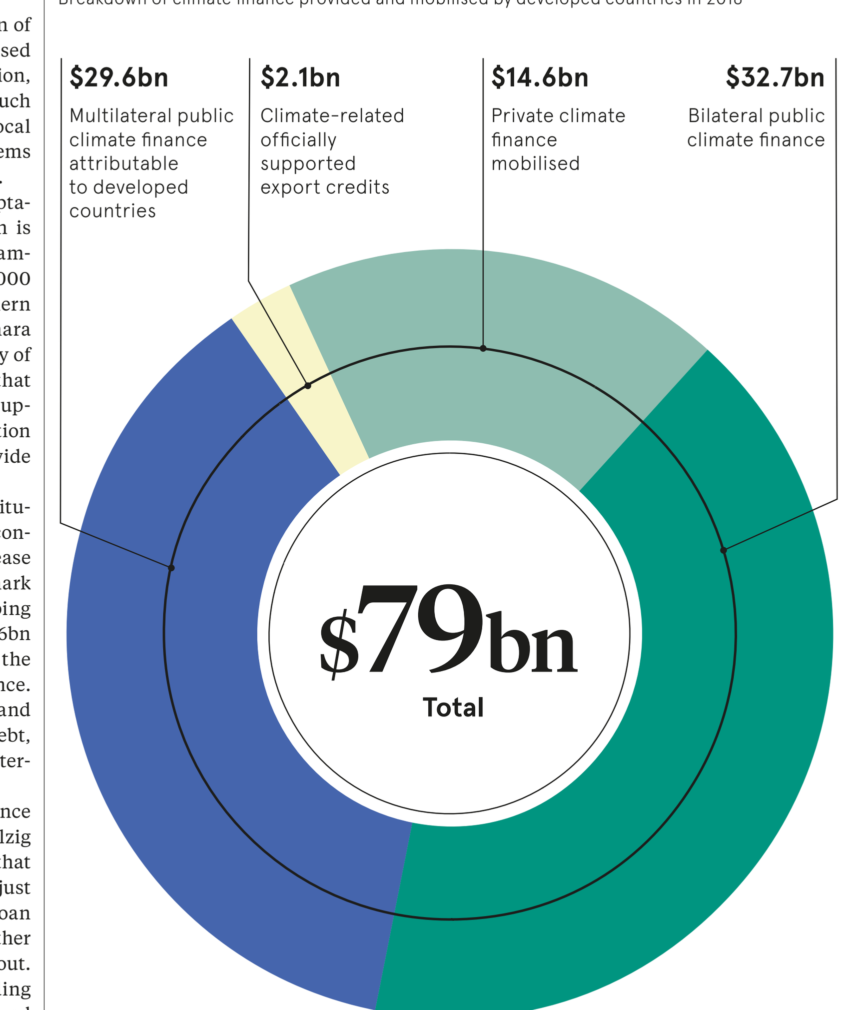
All members of the Glasgow Financial Alliance for Net Zero – which collectively control more than £95tn of assets – have pledged to cut CO_2 emissions from their portfolios in half by 2030.

The chancellor, Rishi Sunak, also used the conference to set out Westminster's plans to make the UK the "first ever net-zero-aligned financial centre".

Under the proposals, financial institutions and listed companies will be required to publish net-zero transition plans that demonstrate how they will decarbonise themselves by 2050.

WHERE DOES CLIMATE FINANCE COME FROM?

Breakdown of climate finance provided and mobilised by developed countries in 2018



Organisation for Economic Co-operation and Development, 2021

Commercial feature

Q&A

Cities must do more to support the environmental and social revolution

Q&A with **Stephanie Hyde**, chief executive, JLL UK; and **Jeremy Kelly**, research director, at real estate services provider JLL

Q Why is decarbonising buildings so important to the climate change agenda?

JK 40% of carbon emissions come from buildings; in cities, it's typically 60% to 70%. That means the world will not achieve its ambitious net-zero carbon targets without addressing emissions from buildings, in operation and construction. As these ambitions get bolder, the pressure to address building decarbonisation intensifies.

SH During the pandemic, people realised what can be achieved with increased attention on the environmental agenda. Our clients and colleagues across the real estate industry have shifted focus over the last year from what we should make happen, to how it should happen.

Q Are cities doing enough to decarbonise buildings?

JK No. Their focus has been on sustainable transport and providing clean energy, which are very important. But buildings must also move up the agenda. City governments have only realised that recently, but the tide will turn rapidly as they start calculating emissions from buildings.

New York, Melbourne, and Copenhagen are at the forefront of building decarbonisation initiatives. New York aims for all new buildings to be carbon zero by 2030, and recognises the need to retrofit existing buildings, which is the bigger issue. They are incentivising owners to deep energy retrofit (DER), which takes a whole building approach.

New York also educates developers and construction companies about how to retrofit for net-zero carbon. Combining regulation and education brings workers and companies with them.

SH Some things investors and occupiers can't do alone or have little control over - such as greening energy grids - so they want bolder decarbonisation actions from city governments.

In this decade, one where we need to move beyond words to delivery, each city needs to develop a comprehensive plan where everyone comes together to realise net zero. The social impact is also essential to consider how we improve lives by addressing social inequality, particularly since that has widened during the pandemic.

> **In this decade, one where we need to move beyond words to delivery, each city needs to develop a comprehensive plan where everyone comes together to realise net-zero**

Q What targets should cities prioritise?

SH Action, not commitments. Without a clear, iterative roadmap to a net-zero built environment, initiatives won't take off. Tangible milestones and deliverables are needed. Businesses and investors will worry about starting without understanding the overall plan. They also need to be incentivised.

New York is a good example of incentivisation, with its finance programme offering long-term low interest rates to fund energy and water efficiency improvements.

Cities also need to target use of onsite renewables, solar energy, and biophilia; and adopt circular practices around water and waste.

There will be a sweet spot when we get the right regulation, incentives and support; with investors, developers, occupiers and city governments all working together.

JK Targets for new buildings are the lower hanging fruit, but cities need rapid, ambitious retrofitting targets to decarbonise. Across mature cities, the refurbishment rate is 1% or 2% a year. They need to ratchet that up. Only a few cities in the UK have taken the lead on retrofitting.

Cities also need to lead by example by setting targets around decarbonising their building stock, and upskilling workers on decarbonisation.

Retrofitting homes is also an opportunity to upgrade inadequate housing stock.

Q JLL's report "Decarbonising cities and real estate" emphasises the importance of partnerships. How can cities, investors, developers and occupiers partner to decarbonise?

SH Collaborations are developing because no single group can achieve decarbonisation alone. We've seen examples of where investors have made leasing terms dependent on whether occupiers meet their green goals. But we need more partnerships and JLL is prioritising this too.

We're collaborating with British Land to deliver our flagship office at Broadgate in London, by 2026. We are both committing publicly to net-zero targets and the highest environmental assessments such as BREEAM and WELL Building certification levels.

Technology and innovation will be pivotal to these sustainability partnerships, and that's happening increasingly through our JLL Spark venture capital investments in property technology. Transparency, data and metrics are also important, so collaborations can measure progress and improve. Ultimately this is about shared values, commitments and prioritisation – finding like-minded partners who realise this goes beyond economic outcomes.

Q What should be the role of regulation?

JK Regulations and penalties will ensure companies are accountable for decarbonisation. However, the real estate industry should help bring together public and private sector stakeholders and communities to define ambitious but achievable regulatory frameworks.

> **Without a clear, iterative roadmap to a net-zero built environment, initiatives won't take off**

Copenhagen is a good example of a collegiate approach, in which the city government works with investors and occupiers to decarbonise and reduce energy use in buildings.

SH The Better Buildings Partnership climate commitment is also a good example of collaboration. Cities should see owners, developers, investors, and occupiers as long-time partners working together on environmental goals. I see a genuine willingness to do this.

Q How is JLL promoting ESG principles in the built environment?

SH We are leading the charge across the sector, and challenging and supporting clients in meeting ambitious targets.

We also want to focus more on social returns in cities and neighbourhoods, and work with community organisations to drive a sense of place. King's Cross in London has been a great recent example, and there are many more.

Our refurbished Manchester office became the first UK Platinum WELL Building certified office outside London. It featured a circular design, with recycled materials; and a focus on air quality, and environment quality.

We have received amazing feedback from our colleagues about how it feels to work there.

We will upgrade all our UK estate using these principles by 2030. It's inspiring to see how excited people get when you show them around. We're sharing what we've learnt and are working closely with clients on the same journey.

Building-specific initiatives will accelerate in the coming months. Many people appreciate getting back together, but they need to do that in positive environments.

We don't have all the answers yet. But we've set ourselves challenging social and environmental targets, with detailed plans. We will hold ourselves accountable and deliver them.

For more information please visit us.jll.com/en/cop26-return-on-sustainability

JLL

Ngampol Thongsai / EyeEm via Getty Images

RETURNS

Positive change brings big profits for ESG funds

Sustainable investments have performed strongly in recent years, highlighting the rewards of focusing on environmental, social and corporate governance

Clare Gascoigne

Sustainable investments are no longer the poor relations of investing. You can do good and still earn good returns – potentially even better than the alternative.

It's a time-honoured axiom of investing that sustainable funds underperform their traditional counterparts. But recently there's been a sea change, with decades of investing wisdom turned on its head by a flurry of recent studies indicating that sustainable funds are outperforming their non-sustainable cousins.

"One of the enduring myths about sustainable investing is that doing good comes at a price," says Maike Currie, investment director at Fidelity International. "But investing in companies that rate highly on environmental, social and governance factors can provide another opportunity to reach your financial goals while aligning with your values."

The data takes some unpicking: one of the key factors in this market is the sheer complexity of the information to hand.

"It becomes complicated very quickly because there are so many different types of sustainable investments," observes James Alexander, CEO of the UK Sustainable Investment and Finance Association (UKSIF). "You cannot put the data into one neat metric. The idea that [measuring green credentials] can be simple and straightforward is not reality."

Matt Christensen, MD and head of sustainable and impact investing at Allianz Global Investors, agrees. "The data is a starting point, but it isn't perfect," he says. "There's a lot of alphabet soup. But the conversation is starting to evolve – we're moving on from ESG, which is now embedded into the valuation of companies. Younger people entering the industry take that as the norm."

Whatever imperfect measure of sustainability you choose, there's pretty universal agreement about the outperformance. A range of sustainable equity indices have done better than standard non-sustainable benchmark stock indices over the past five years, according to BNP Paribas. In June, the French banking group noted that the MSCI World Socially Responsible Investing Index had seen a 14.1% compound annual growth rate (CAGR) in returns since the start of 2016, representing a 1.1 percentagepoint improvement on the standard benchmark, the MSCI World Index. Similarly, the Low Carbon 100 Europe Index had returned a CAGR of 7.1% over the same period, compared with the 6.3% achieved by the STOXX Europe 600.

In June last year, US financial services firm Morningstar analysed the performance of 4,900 funds over a decade to determine whether the sustainable ones among them could beat their standard equivalents in the long term. It discovered that most sustainable funds outperformed their traditional counterparts.

Over the decade, the average annual return for a sustainable fund invested in large global companies has been 6.9%, while a traditionally invested fund has made 6.3% a year. In the 10 years to 2019, 58.8% of surviving sustainable funds across seven categories were considered by Morningstar to have beaten their average surviving traditional peer.

Vikram Raju, MD and partner responsible for emerging markets and climate impact investing at Morgan Stanley Alternative Investment Partners, believes that non-sustainable investments have become the riskier proposition.

He explains: "No serious investor can afford to ignore the impact of climate risk on input prices, insurance premia and supply chain resilience. Lost shipments owing to extreme weather events equal lost sales, for instance. On the other side of the coin, there's also the high growth and premium pricing associated with sustainable brands in every segment, from food to textiles."

In February, research published by the Morgan Stanley Institute for Sustainable Investing found that sustainable investment funds had outperformed their traditional peers and reduced investment risk throughout 2020, weathering the volatility of the first year of the Covid crisis better than their counterparts. According to its *Sustainable Reality* report, "sustainable funds' strong risk and return performance during an exceptionally turbulent year further erodes the persistent misconception that sustainable investing requires a performance sacrifice."

> **Investing in companies that rate highly on environmental, social and governance factors can provide another opportunity to reach your financial goals while aligning with your values**

For many investors, the lower volatility and steadier performance of sustainable investments is the attraction. So why do some investors still think sustainability must be traded for performance? In part, the devil is in the detail. What does sustainable mean, after all? How green is a company that produces legs for both oil rigs and wind turbines? Which measures of sustainability are critical: would you prioritise water or biodiversity? Is it enough to do no harm or should firms be actively seeking change?

There's a raft of areas to consider, says Christensen. For example, last year Allianz "came out of coal. We don't want long-term exposure to coal; we don't think it's going to be a winner. Yet we don't have that view on oil, where we are looking at how we can work with energy producers in a more regulated environment."

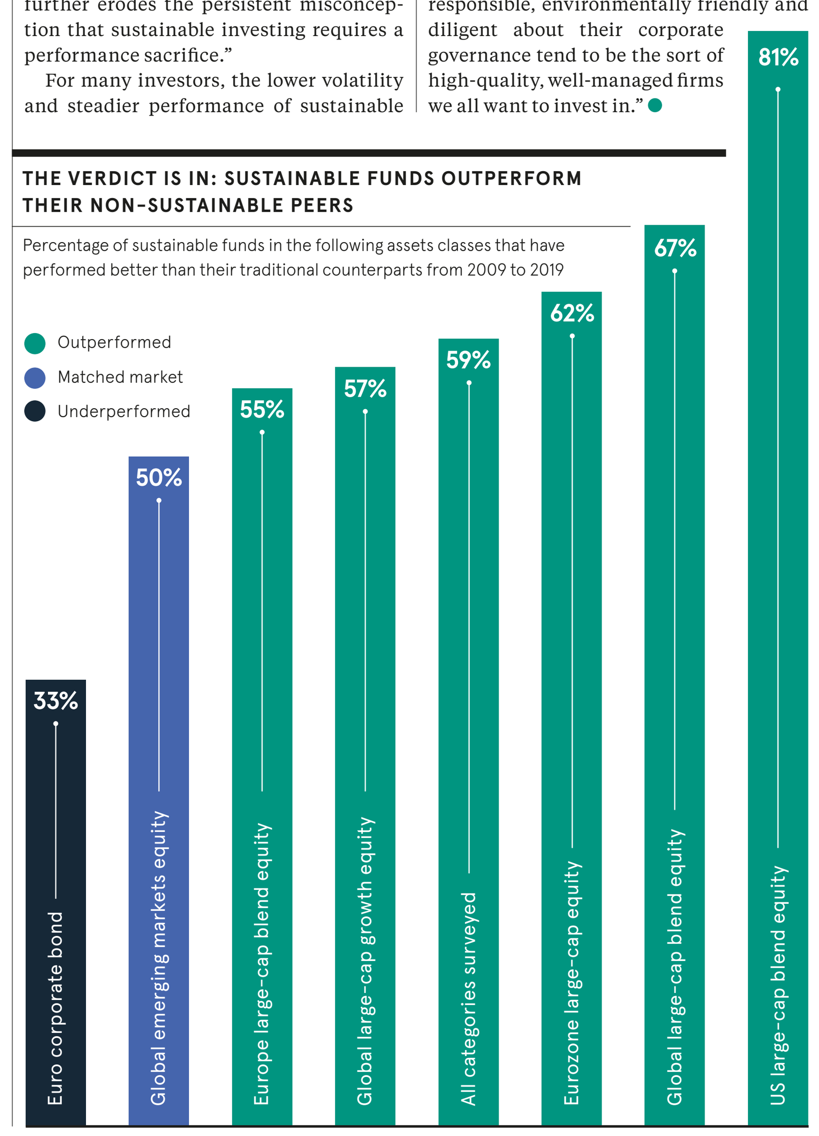
Transition and stewardship are important parts of the sustainability debate, according to Alexander. "This is not a divestment agenda," he says. "We aren't going to change the world by selling all the 'bad' companies to people who care less than we do. This is about using our voice to push management to make changes."

Unfortunately for those who prefer their investments to be clear cut, sustainability cannot be divided neatly into 'good' and 'bad'. There is certainly demand for sustainable investing; UKSIF members report a massive increase in the number of people who want to manage their investments sustainably, even if few of us can define what we mean by it. But the financial services industry still has a job to ease the cognitive dissonance that surrounds sustainable investment.

"Being a good ESG company is a kind of proxy for just being a good company," Currie says. "Businesses that are socially responsible, environmentally friendly and diligent about their corporate governance tend to be the sort of high-quality, well-managed firms we all want to invest in."

THE VERDICT IS IN: SUSTAINABLE FUNDS OUTPERFORM THEIR NON-SUSTAINABLE PEERS

Percentage of sustainable funds in the following assets classes that have performed better than their traditional counterparts from 2009 to 2019



Morningstar, 2020

EDUCATION

Asset class: inside a course for ESG investors

The CFA Institute's certificate in ESG investing has sparked great interest this year. What can students expect to gain from the qualification?

Simon Brooke

Image Source RF/Cadalpe via Getty Images

As global ESG asset values surge, investors need the most up-to-date knowledge available to make the best possible allocation choices. The CFA Institute's certificate in ESG investing aims to satisfy this need.

Bloomberg estimates that global ESG assets are on track to hit \$53tn (£39tn) by 2025, accounting for well over a third of the \$140.5tn in total assets under management. Against that backdrop, it's more important than ever that asset managers and other investment professionals have the right information at their fingertips.

For example, how can those investing these vast sums, be they institutions or retail investors, know that they aren't falling for greenwashing? Assessing and verifying the sustainable element of stocks and investments is hard, not least because regulations and the basis of calculations are constantly evolving. According to research published in July by financial consultancy Duff & Phelps, 45% of valuation experts believe a lack of a standardised and recognised measurement system is the biggest threat to effective ESG disclosures for businesses. The new course aims to address this issue.

The certificate was first offered in 2019 by the CFA Society of the UK, part of the global CFA Institute. But the course is now being marketed in financial hubs around the world, aiming to equip investors to integrate material ESG factors into their analysis. According to the CFA Institute, the course is also suitable for anyone looking to improve their understanding of ESG issues in functions such as sales and distribution, wealth management, product development, financial advice, consultancy and risk management.

Seven months after the certificate's worldwide launch by the CFA Institute, about 11,500 candidates have registered, coming mainly from the UK, followed by the US, Switzerland, France, Hong Kong and Singapore.

THE ESG EXAM AT A GLANCE

100
The number of questions, all of which are in multiple-choice format

130 hours
The total time that students are advised to spend on preparing for the exam

CFA Institute, 2021

The self-study qualification looks at the history of ESG and puts it into context before exploring the concept's three main aspects in depth. It then focuses on how to analyse and evaluate data, integrating these factors into the investment process. The awarding body recommends that candidates put in a total of 130 hours of study.

The course culminates in a supervised 140-minute computer-based exam that can be taken at a centre or online. This presents 100 multiple-choice questions. Some of these are fairly straightforward, such as: "Which of these least reflects how qualitative ESG data is used in company analysis?" Others are more nuanced, such as: "Which of the following statements is generally accepted as not true for companies that score well on ESG metrics relative to companies scoring less well?"

> **There are two main target areas: people who are actually involved in integrating ESG considerations into the investment process and those who need to understand it**

The pass rate so far has been between 70% and 80%.

The certificate's development has been led by practitioners, reports Nick Bartlett, head of practice analysis at the CFA Institute. "We rely on our ESG panel members for their insights, because this is a fast-moving sector."

The qualification is focused on foundational competence, he adds. "There are two main target areas: people who are actually involved in integrating ESG considerations into the investment process and those who need to understand it."

Other courses in ESG investment are available from universities and the Principles for Responsible Investment Academy. But hasn't this official, industry-led qualification been relatively slow to launch?

"We've been developing ESG resources and courses for quite a long time now," Bartlett says. "It's just that we're really seeing the interest in this market now."

Businesses can benefit greatly when their staff gain the certificate, according to Tim Garza, director of insurance strategy and solutions at Duco, a provider of financial data services. "ESG isn't a simple concept for insurers, as the ways in which companies manage their policies and practices in this sector are constantly evolving," he says. "The CFA Institute's exam will help insurance professionals to get themselves up to speed with these issues and prepare them to adapt to the fast-moving world of ESG investing."

Jonathan Wood is the founder and CEO of C2 Cyber, which helps clients to gauge the ESG maturity of unlisted companies. He believes that the qualification suffers from its relative lack of focus on matters of corporate governance.

"This reflects a tendency for sustainability to be seen as synonymous with environmentalism. If the past couple of years have taught us anything, it is that governance shouldn't be overlooked," Wood argues, pointing to the Boohoo scandal.

When it was reported last year that workers at some factories in Boohoo's supply chain were being paid as little as £3.50 an hour, fund managers and retail investors sold their shares to distance themselves from a firm that had demonstrated a worrying lack of governance.

"The certificate in ESG investing should recognise the critical role that governance plays," he stresses.

The qualification may now be recognised globally but ESG reporting standards still aren't, notes Dr Zhenyi Huang, research fellow at the Bayes Business School in London. "There is significant variability in legislation and data inconsistency across jurisdictions," she says. "Given that many of the ESG metrics are highly associated with local regulations and national cultures, it would require much individual judgement when applying the knowledge to a specific market context."

Bartlett stresses that the syllabus of the CFA Institute qualification is under constant review, while a group of practitioners in senior roles – heading ESG teams and working as investment analysts and portfolio managers – meets annually. "They will be reviewing the outputs we get from our practice analysis and research. They'll make determinations as to how the syllabus should evolve," he adds.

The course's uptake is being driven by increased demand as more fund managers seek training. But there is also a supply-side element, with more ESG information becoming available, driven to some extent by tech such as artificial intelligence. As a result, this fast-developing qualification looks set to become a must-have for successful investment professionals.

OPINION

The mark of true leadership: the UK's intelligent but demanding financial services rule-making

The UK is seeking to extend its global leadership in green finance by way of intelligent but demanding financial services rule-making – a topic at the forefront of the COP26 talks, chaired by the UK.

This is a praiseworthy ambition that partly reflects global demand from investors for products that better take account of environmental, social and governance (ESG) risks and opportunities. But, for the UK to get it right, it will be vital to craft rules in a way that reflects the diversity and global profile of the nation's investment management sector and its investor base.

This challenge is evident in recent proposals from the Financial Conduct Authority (FCA), the City's regulatory watchdog, to oblige investment managers to report publicly on how they quantify and manage climate risks. The rules will be finalised by the end of 2021 and should go live in January 2022 for firms with the largest investment portfolios.

The focus on climate risks is sound. Investment managers recognise the enormous societal challenges posed by climate change and have invested significant resources in recent years to assess risks that were historically considered 'non-financial' but are now increasingly seen as material to firms' bottom lines. Some companies have hired ESG specialists and many now purchase data to track the performance of their investments from a sustainability perspective. This trend is likely to continue as the analytical tools continue improving.

The FCA plans to base its rules on the guidelines of the international Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) – a well-regarded framework that marries narrative reporting on companies' approaches to climate risk with quantified reporting on key climate-related metrics.

The FCA's suggestion of orienting its approach to the TCFD is a good call, particularly given the global nature of the industry. Moreover, allowing firms to combine metrics with an explanation of their approach is important to give investors a complete picture of how their investment managers are looking after their money.

But we at the Alternative Investment Management Association (AIMA) believe that a prerequisite for the effective implementation of this framework is the availability of better data from corporate issuers, for both shares and bonds. Without meaningful, comparable data on their underlying investments, investment managers will be unable to give investors a true account of their risk exposures. We're pleased to see that the FCA is taking steps to tackle shortcomings in corporate data, but it must also allow time for improvements in corporate reporting to become fully embedded before turning its attention to reporting by investment managers.

Another challenge is how to ensure that the rules are workable for the wide set of firms to which they will soon apply under the UK's regime. Keep in mind that these enterprises differ widely in scale, global footprint, resource base and investment philosophy. For example, the rules will need to address investments outside the corporate sector, such as government debt, currencies, interest rates and other instruments. It's worth mentioning that the EU's own reporting rules for investment managers don't fully address these difficult issues, leaving asset managers and investors scratching their heads.

Another key element is the treatment of short selling. The AIMA and Principles for Responsible Investment have both provided guidance on how to embed short selling in a sustainable investment framework, but we await a response from the regulators.

If the UK wants to live up to its ambitions to become an ESG leader, it must stand ready to tackle some of the thorny questions about how to apply its standards to the widest range of real-world investments. This will be the mark of true leadership.

Jack Inglis
CEO, Alternative Investment Management Association

Commercial feature

Net zero: don't over-pledge

The corporate scramble to publish carbon reduction targets is papering over a worrying lack of action plans, warns ISS ESG Climate Solutions' Viola Lutz

As the climate crisis continues to intensify and the focus on reducing carbon emissions to net zero by 2050 ramps up, companies have been eager to shout about their carbon reduction pledges. Few, however, have been quite as forthcoming about how they plan to achieve that.

"The net-zero movement and all the pledges around that is very much a positive development, but once you have a commitment in place, that's just the starting point. One can observe that there is a large number of commitment statements and nowhere near the same level of action plans and transition plans to go along with that," says Viola Lutz, head of ISS ESG Climate Solutions, the responsible investment arm of Institutional Shareholder Services.

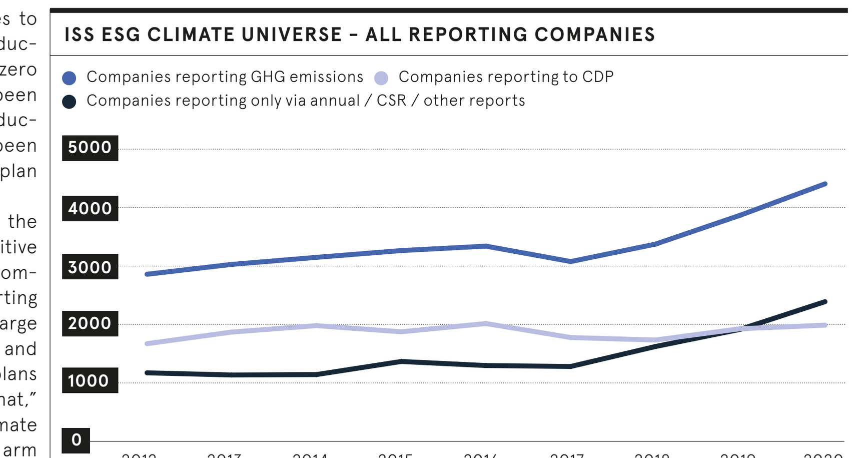
One of the main challenges is that there is not yet an established net-zero roadmap for businesses to follow—in part because achieving net zero by 2050 will require yet unproven carbon removal technology to work—which means companies need to be realistic and transparent about how they intend to meet their targets.

"Realistic means laying out measures you can apply now to address your emissions and that most likely means improving efficiency in your operations, sources of your power supply and implementation of technologies that are already viable," says Lutz. "Too often, companies don't even disclose their emissions (see chart)".

The need for more transparency also means being realistic about the extent to which companies are relying on future tech as part of their carbon reduction pledges.

"Too many actors are putting a plaster of carbon removal on top of their decarbonisation strategy and assuming that magically in 2040 we will see breakthroughs in carbon technologies that allow dramatic reductions in line with the net-zero pledge," says Lutz. "The challenge is these technologies don't really exist, so there might be a certain level of wishful thinking, where 'business as usual' is still an option if we have access to certain technologies. That most likely will not be the case. There needs to be more transparency around this issue, including short and medium-term operational action plans and technology roadmaps."

ISS ESG CLIMATE UNIVERSE - ALL REPORTING COMPANIES



ISS ESG
All publicly listed companies globally that report greenhouse gas (GHG) emissions for the reporting years 2012-2020
(*2020 extrapolation based on research trend)

Investors also need to be wary of over-reliance on strategies which can create the short-term appearance of doing better with their emissions reduction targets than they actually are. Take short selling securities, for instance. Some fund managers might run a shorting strategy where they say the carbon emissions of the companies they hold long positions in are netted out by the emissions from their short positions.

"From a perspective of managing emissions risk in your portfolio that might make sense but from an impact perspective it's really not helpful," says Lutz. "You might go short on Volkswagen but Volkswagen isn't selling any fewer cars or Tata Steel isn't reducing the emissions intensity of a tonne of steel produced, so that's very key to be mindful of."

Another corporate strategy to be aware of is the role of carbon offsetting. Companies can buy a certificate for a tonne of carbon that has been reduced by someone else and then claim they have reduced overall emissions.

"That's problematic because if we want to reach net zero we can't shift the reduction of emissions from one actor to another as all actors ultimately need to reach net zero," says Lutz.

For that to happen, companies need to avoid over-promising on their carbon-reduction goals.

"The danger is that things look better than they actually are and overall, climate targets will be missed massively," says Lutz. "When you look at the reduction pathways of a number of companies, what you tend to see is that until 2030 the curve is flatter, then it becomes steeper after 2030 and again after 2040, but this is exactly the opposite to what the emission reduction pathways should be in a net-zero scenario—that is you have to reduce a lot right now and then in 2040 the curve can become flatter, so this is a systemic mismatch that we might be running into."

For more information please visit issgovernance.com/esg/climate-solutions/net-zero-solutions

ISS ESG

Roni Rekomaa/Bloomberg via Getty Images

Kaisa Hietala, partner at Gaia Consulting, won her boardroom seat at ExxonMobil as the result of a campaign by activist fund Engine No 1, with support from key investors including BlackRock and Vanguard Group

ACTIVE OWNERSHIP

How investors can make an ESG impact

From shareholder activism to active ownership, impact investors are showing that financial returns are compatible with ESG awareness

Sam Haddad

In May, a newly formed impact investment group called Engine No 1 persuaded ExxonMobil shareholders to vote three of its candidates on to the energy giant's board, sending shockwaves through big oil and corporate boardrooms around the world.

To achieve this feat, the renegade fund – which defines its mission as creating "long-term value by harnessing the power of capitalism" – emphasised the existential risks of the climate crisis to shareholders, including large asset managers such as BlackRock and Vanguard. Engine No 1 convinced them that ExxonMobil had not been doing enough to secure its own financial future in a post-carbon world.

This remains one of the most striking cases of shareholder activism. How exactly Engine No 1 will use its equity to steer ExxonMobil towards the desired energy transition remains to be seen, but the move provides a radical reminder of the internal influence that money can buy at a company – and how ethically inclined investors can make an impact through ownership.

Impact investing describes investments that are measured according to the positive environmental and social impacts they deliver, as well as their financial returns. The practice is growing at a staggering rate as ESG thinking moves away from vague notions of ethical investment and into targeted funding with measurable impacts

"We have seen the impact investment market grow exponentially over the past five years," reports Joe Dharampal-Hornby, public affairs manager at the not-for-profit Impact Investing Institute. He adds that it is now worth more than $2tn, with potential to expand to more than 10 times this level in less than a decade.

Impact investing is not merely about having noble intentions, according to Shami Nissan, head of responsible investment at Actis, an investment fund specialising in emerging markets. Long-term investors have a financial responsibility to consider the environmental and social implications of their investments, she stresses.

"These are matters of global urgency that affect everything. Investors with long-term investment horizons, such as public pension plans and sovereign wealth funds, wouldn't be fulfilling their fiduciary responsibilities if they weren't thinking about the risks of climate change, for example."

The expectations of asset owners and beneficiaries have also evolved to prioritise environmental and social impacts, Nissan notes. "We've seen a real sea change in what clients want their money to achieve. They want returns, of course, but they want impacts alongside them."

Environmental initiatives, especially net zero, often get top billing when it comes to impact investing. But Dharampal-Hornby says it's also important to consider social sustainability, recognising that E, S and G at an organisation are interlinked.

He adds: "If we're going to move to a low-carbon economy and for it to be stable, we need to have that investment in education to deal with potential unemployment and the economic fall-out."

The Impact Investing Institute has partnered with the Green Finance Institute and the London School of Economics to propose a sovereign bond called Green+Gilt, which ties in environmental and social benefits.

"It would be the first of its kind in the world," says Dharampal-Hornby. He has high hopes for its success – the first UK green bond, issued in September, was oversubscribed by a factor of 10.

Nissan believes that the pandemic has "helped to put the S of ESG on the table, but there is still work to be done". She is part of the G7 Impact Taskforce, established to encourage cooperation on impact investing among the world's richest nations.

> Shareholder activists aren't just concerned citizens; they are concerned company owners. That legitimacy is recognised by companies themselves

"We talk a lot about enabling a 'just transition'. This isn't simply about carbon and sending trillions into renewables; this is about ensuring that investment and infrastructure are inclusive and equitable," she explains. "There has to be value to communities at a grass-roots level, not just to the investor who takes the returns and then gives them back to their base in New York or London. You can choose to be an active owner and to extract impacts every year that you're there as an owner."

Nissan cites Atlas, a renewable-energy firm that Actis works with in Latin America, as an exemplar. Even during the pandemic, the company has trained 800 women to install solar panels. "It shows what is the art of the possible," she says.

The companies that Actis works with are mandated to have an ESG sub-committee that reports to the board and a head of sustainability. Actis also encourages firms in its network to collaborate so that they can learn from each other.

$12.5m

The amount that Engine No 1 spent on winning three seats on the ExxonMobil board in May 2021

Thomson Reuters, 2021

Shareholder activism along the lines of the Engine No 1 model is another effective impact investing tool. Catherine Howarth, CEO of charity ShareAction, observes that shareholders control a set of tools to push firms to become more sustainable.

"These range from holding discreet private meetings with managers and board members through to more forceful methods such as filing shareholder resolutions to change corporate policy or voting against directors where progress on ESG issues is altogether unsatisfactory," she says.

Being a shareholder is a huge advantage when exerting influence, Howarth adds. "Shareholder activists aren't just concerned citizens; they are concerned company owners. That legitimacy is recognised by companies themselves, which are usually far more willing to listen to shareholders, especially large ones, than they might be to other types of activists."

Some forms of activism even have the power to change the articles of association and force companies to change tack, she says. "For example, in the UK, a shareholder resolution that receives 75% backing from the shareholder base becomes legally binding on the company."

Howarth points to ShareAction's resolutions at HSBC and Tesco, where it convinced some of the world's largest investors to back shareholder activism.

"We were able to secure a commitment from the bank to phase out its financing of the coal sector and from the supermarket to set itself stretching new five-year targets to sell more healthy food," she says.

In neither case did these shareholder resolutions actually come down to a vote. "Well before their annual general meetings, the boards of these FTSE-100 giants had decided that they would accede to our demands," says Howarth, who adds that it's now vital to watch carefully and ensure that they keep their promises.

Is there a risk that shareholder activism could be harnessed for negative outcomes? Dharampal-Hornby isn't too concerned.

"Global regulation is moving in one direction. The public's mood is moving in one direction," he says. "Whether companies are being forced by shareholder meetings or just reading the room, we see them moving in that direction too."