Sustainability Guide 2020:

Investing in a brighter future

Featuring:

- The help at hand to guide trustees with sustainability investing
- Global environmental opportunities
- ESG and emerging market debt
- Investing today to build a better tomorrow
- Whether 'sustainable' and 'investment' go together
- Focusing on the 'social'

Summary
• Sustainability has been a hot topic in recent years, but industry feedback suggests too much discussion could be overwhelming trustees.
• Regulation is also growing in relation to sustainability, particularly around climate change, meaning trustees may be feeling the pressure.
• Help is at hand from industry bodies and the wider market to assist schemes in knowing what they need to do right now.

Tuning out the background noise

Francesca Fabrizi asks whether trustees are feeling overwhelmed with all the noise around the topic of sustainability and asks what help is at hand to guide them in the right direction

The topic of sustainability has been climbing up the trustee agenda for several years now and the recent pandemic has further highlighted the need for trustees to take any potential future risks to their pension portfolios very seriously.

Additionally, increasing regulation has been put in place to help ensure trustees don't ignore their duties in relation to environmental, social and governance (ESG) issues while, in the background, providers have come to the market with an influx of products, services and funds to help meet pension schemes' sustainability needs.

But while trustees do need to take the issue of sustainability seriously, is there a danger that we are overwhelming trustees with all this noise around the topic?

Absolutely yes, says PTL managing director, Richard Butcher. "Trustees are absolutely feeling overwhelmed by the amount of noise there is around sustainability.

"Over the course of this year, I've met directly with 60 of the biggest funds and indirectly with hundreds of others. They want to invest in a sustainable way but are struggling to keep up with the plethora of different initiatives and requirements.

"I'm hoping this will all settle down in due course, relieving trustees of the 'compliance' burden and allowing them time to think strategically about how best to invest sustainably."

Butcher is not alone in his thinking. BESTrustees trustee executive, Rachel Brougham, agrees that it can all feel a bit too much for trustees, particularly in relation to the amount of regulatory updates that are hitting their inboxes: "It feels like new regulations are coming at us thick and fast. Given the climate emergency, this isn't unexpected perhaps. However, what might be overwhelming trustees is wondering what it all means for them."

Many trustees, she continues, consider that their job is to maximise returns for the benefit of members with little regard for anything else and, in any event, many are invested in pooled index funds, so what's to be done about it?

It is important, however, for trustees to move away from this mindset, she stresses: "Maximising returns for the benefit of members is, of course, a great aim, but trustees don't do this without regard for the risk that they are running in their investment strategy. What is helpful is to understand that sustainability presents a series of risks and opportunities like any others that will impact on investee companies financially.

"When trustees understand this, they can see that the assessment of risk and opportunity due to ESG considerations is another element in the overall assessment of the quality of a company that an investment manager carries out," she says.

That said, even when trustees do understand why this all matters, getting the right information can be challenging, argues Butcher.

"There is no common language, objective or metrics. As a consequence, consultants and managers are being pulled in several directions simultaneously meaning they either can't or can't quickly provide everything trustees need," he explains.

And, says Brougham, as there is no universally accepted means of measuring/scoring ESG factors, this can mean one fund manager's ESG score for, say, M&S might be very different to another's depending on which factors are being prioritised and what data they are each using.

Finally, while investment advisers are best placed to help trustees through the regulatory requirements, trustees need to accept that this is not solely a box-ticking exercise, says Brougham.

"The regulations are pointing towards taking more positive action, particularly around climate change," she says.

Climate change

As Brougham highlights, much of the recent regulation in relation to sustainability has been around the topic of climate change, in recognition of the fact that "climate change has the potential to have a big effect on scheme investments and sponsor covenants", says The Pensions Regulator (TPR) executive director of regulatory policy, analysis and advice, David Fairs.

In a recent blog, entitled *A changing climate for pension trustees,* Fairs warns that, if trustees don't consider climate change risks and opportunities or exercise effective stewardship, investment performance may suffer. "This could mean savers missing out on better outcomes," he says.

Fairs goes on to look at how the Pension Schemes Bill will enable regulations to be made requiring trustees to consider, in-depth, how climate change will affect their pension scheme and its investments and to publish information relating to the effects of climate change on the scheme.

"The bill is making its way through parliament. But trustees need to act now so they're prepared for it coming into law. Already trustees must produce a statement of investment principles (SIP) setting out their policies on financially material ESG considerations (including climate change) and their policies on stewardship – including when and how they plan to engage with investment issuers or managers on matters including risks and social and environmental impact."

From this year, he adds, trustees will have to make further changes which include publishing an implementation statement describing whether certain policies in the scheme's SIP have been followed, and the trustees' voting behaviour.

To sum up, Fairs' advice to trustees is to "build capacity" in this area if they haven't already. "You'll be better placed to understand what climate-related issues mean for your scheme – and better able to make decisions that contribute towards good savers outcomes," he concludes.

Building capacity

In response to Fairs' advice of 'building capacity', what can trustees do in the here and now to ensure they are doing enough around sustainability overall?

First of all, says Brougham, trustees should engage with their investment advisers. "Trustees should be helped to understand the financial risks posed by ESG factors, including climate change. These risks and opportunities extend beyond equity portfolios. With the help of their advisers they should establish their own beliefs around ESG and how proactive they wish to be in addressing the issues and satisfying the regulations."

Even when using pooled index funds, Brougham stresses, trustees should begin to understand the approaches taken by their fund managers to ESG factors and hold them to account. "In particular, what is their voting and engagement policy, and more importantly, what is their voting and engagement record and outcome. Some index managers are far better at this than others. Trustees can consider whether their manager is doing enough; ultimately, they could move their business elsewhere."

The importance of understanding what your fund manager is doing in this area cannot be emphasised enough, argues Law Debenture trustee director, Natalie Winterfrost: "Grill your fund manager. Really understand what they are doing or say they are doing, and ask if they can evidence that, because there is a substantive data requirement that is going to be needed going forward to evidence what you are doing in this area, and if you are delegating that, you need to make sure that your fund manager is set up to report everything you will need to know in the timeframe that you will need it."

If an investment manager's policy is aspirational, trustees are going to struggle to get the information out of them when it comes to showing how they have implemented those policies, she adds.

Ongoing monitoring of a manager's activity (regardless of whether market cap index funds, ESG tilted funds etc) will also be important going forward, Brougham concludes: "This isn't a one and done exercise – the universe of solutions keeps shifting, as does the availability of quality data on these factors. Trustees will need to keep their knowledge up-to-date and revisit their beliefs periodically."

Practical help is also available from the PLSA, which has worked hard to assist trustees in this area in recognition of the fact that help is needed not just in relation to existing but ongoing consultation and upcoming regulations.

PLSA head of DB, LGPS and standards, Joe Dabrowski, comments: "There are a number of existing, recently introduced and in-coming duties that trustees need to fulfil", he explains, the most immediate of which are the changes proposed in the Pensions Schemes Bill, the open consultation on TCFD reporting and last year's extensions to the Occupational Pension Schemes (Investment) Regulations 2005.

"There is quite a lot to understand", acknowledges Dabrowski, "but the PLSA has produced detailed guidance and templates for scheme trustees, available on the PLSA website".

In addition to the guidance from TPR and PLSA, help is out there from a plethora of other associations, providers, law firms and of course advisers. Winterfrost concludes: "The PLSA has put out very useful guidance and there is a lot of other guidance out there and, of course, trustees always have their advisors to help them understand their obligations and how they should apply their policies. So, if they look in the right places, trustees should have the support they need."

Written by Francesca Fabrizi

Global environmental opportunities: Transforming sustainable investment

Thanks to the emergence of a thriving environmental products industry, investing to safeguard the planet no longer means sacrificing returns

Danica May Camacho was born on 30 October 2011, to the sort of fanfare rarely seen in Manila's crowded public hospitals. That's because she represented a global milestone – her birth brought the world's population to seven billion. It was at once a joyful occasion and a reminder of the challenges posed by ever more people competing for finite resources.

In less than 30 years' time, the planet will be home to nine billion human beings, a larger proportion of which are likely to be part of the urban middle class. This is certain to put even more pressure on the environment, testing it to breaking point. Investors are increasingly alert to these challenges. Many now recognise that, as stewards of capital, they have a crucial role to play in placing the economy on a more sustainable footing. But for them to become part of the solution, investors need to resolve a paradox. How can they become responsible guardians of the environment and simultaneously secure an attractive return on their investments?

We believe the solution to that conundrum has already begun to take shape. With governments and businesses responding to growing public pressure to reverse ecological degradation, a distinct and attractive group of environmental equity investments has emerged.

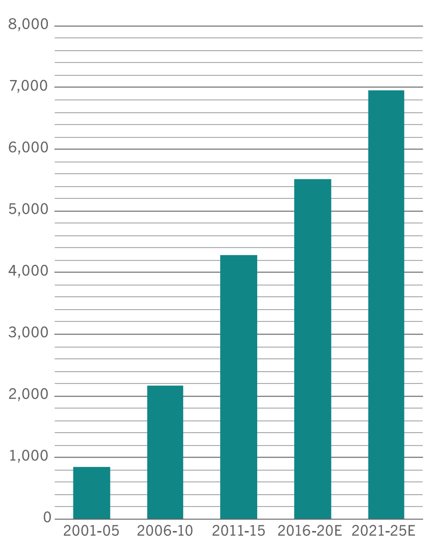
These are companies that combine strong environmental credentials with innovative products and services designed to safeguard the world's natural resources. Such firms form the core of our Global Environmental Opportunities (GEO) portfolio.

Public shaping the agenda

Once a niche activity, environmental investing is now moving firmly into the mainstream. There are several reasons for that. To begin with, society's attitudes towards protecting the planet have changed considerably in recent years. That's partly because a growing proportion of the population has personal experience of the damage ecological degradation can cause. In 2015, pollution killed nine million people – three times more than AIDS, tuberculosis and malaria combined.[1] Floods and droughts have brought untold misery to millions more.

Social media has also helped shape world opinion. Thanks to platforms such as Twitter and Facebook, people can now voice and share their concerns about pollution and sustainability in a way they couldn't before. People power has, in turn, brought about a change in government priorities. China is a striking example of this trend.

Growth in China's environmental spending (in RMB bln)



Source: National Bureau of Statistics of China, Pictet Asset Management

In the run-up to the 2008 Olympics, the US embassy in Beijing started tweeting hourly air quality data from its roof-top monitor. This was the first time the public had access to live data on airborne particles known as PM2.5, which kill more than 4 million people worldwide a year.

As a result, local residents began voicing their concerns about air quality, eventually taking to the streets to stage large public demonstrations.[2] In response to growing social discontent, China's leadership unveiled a ground-breaking action plan in 2013 to tackle 'Airpocalypse' with investments worth hundreds of billions of dollars and a slew of regulations. China's Premier Xi Jinping has named environmental degradation as one of the three main battles the country has to fight along with political and financial risks and poverty alleviation, adding that: "We will never again seek economic growth at the cost of the environment."

But this is unlikely to be the end of its spending boom. Beijing has promised to invest even more heavily in advanced environmental science and technology.

Also giving sustainable investing a shot in the arm is a sharp drop in the cost of technologies such as renewable energy, water recycling and agri-tech.

Stars aligned for environmental industry

The combination of people power, government policies and economics has given rise to a thriving – and eminently investable – industry for environmental products and services.

Critical mass

Environmental industry in numbers

The size of the environmental industry today

USD 2.5 TRILLION

Expected annual growth

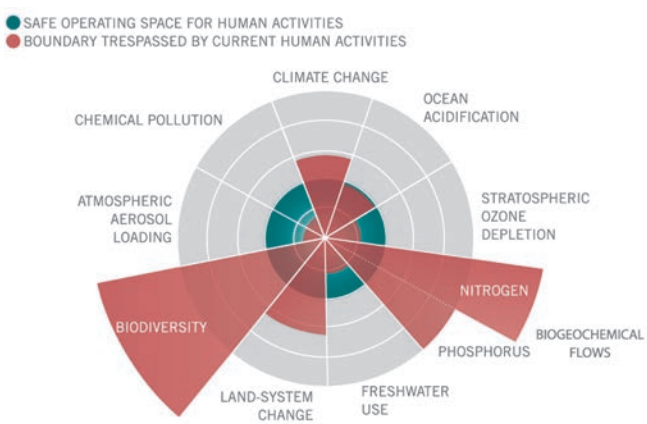
6-7%

Source: Pictet Asset Management

China's generously-funded anti-pollution drive, for example, is likely to boost the prospects of firms that develop environmental technologies such as filters for engines and industrial applications for pollution control.

More broadly, as corporations worldwide embrace sustainable business practices, publicly-listed firms specialising in the development of a broad range of environmental technologies have mushroomed.

Overall, we estimate that the environmental products industry is already worth some $2.5 trillion, and can grow by about 6-7 per cent per year.



Source: "The trajectory of the Anthropocene; the great acceleration". Steffan et al. Stockholm Resilience Centre, September 2009

That should matter to investors: sales growth of companies operating in this sector should outpace that of firms in the MSCI All-Country World equity index.

A process to unlock the potential of environmental investments

When it comes to investing in rapidly-evolving industries such as environmental technology, identifying the most promising opportunities isn't straightforward.

That is why investment managers of our Global Environmental Opportunities strategy have developed a process that deploys both a scientific, rule-based framework and traditional company-by-company research to build their portfolio. Central to the investment process is a ground-breaking scientific model called Planetary Boundaries (PB).

This is a model developed in 2009 by a team of leading scientists at the Stockholm Resilience Centre (SRC) and other leading environmental organisations.

The PB framework identifies the nine most critical environmental dimensions – including carbon emissions (climate change), fresh water, land use and biodiversity – that are essential to maintaining a stable biosphere. What makes it particularly useful for investors is that it quantifies the safe operating space within which human activities should take place.

The model states, for example, that for global water use to remain at sustainable levels, humans must not draw on more than six million cubic metres a year. Breach that, or any of the other eight thresholds, the model says, and the risk of triggering abrupt or irreversible damage to the Earth's biophysical systems increases significantly.

As the figure below shows, several of the nine boundaries have been transgressed.

Making a demonstrable impact

The Global Environmental Opportunities portfolio achieves a significantly more positive environmental impact than that of a typical global equity strategy across all nine dimensions, particularly in climate change.

Investors can make many positive impacts with this strategy to protect the planet. As stewards of global capital, investors matter. And in two ways. On one hand, investors can provide vital funding to the companies developing products and services that can reverse ecological damage. On the other, they alone have the power to withhold or withdraw capital from businesses that fail to take their environmental responsibilities seriously.

For investors, the opportunity to bring about change has never been greater. Many investors have long appreciated the need to protect the planet. But they have not always been convinced sustainable investment was financially viable. Thanks to the emergence of thriving environmental products industry, the calculus is now changing. Investing to safeguard the natural world does not mean sacrificing returns. It can enhance them.

Written by Luciano Diana, senior investment manager, Pictet-Global Environmental Opportunities strategy

In association with

[1] The Lancet Commission on pollution and health, 19.10.2017

[2] According to the Chinese Academy of Social Sciences/South China Morning Post, as many as half of public protests in China involving at least 10,000 participants in 2000-2013 stemmed from concerns about pollution

ESG and EMD: Doing the right thing

Carl Shepherd and Trevor Holder highlight the importance of integrating environmental, social and governance analysis when selecting emerging-market government bonds

Summary
• In our view, emerging-market governments that are engaging, transparent, and trying to do the 'right thing', are more likely to be treated favourably if they do require assistance from multilateral lenders.
• This hypothesis has proved to be valid, and through our own research we have been able to find a link between sovereign governance scores and credit spreads.
• Those countries that are trying to do the 'right thing' are also being afforded greater flexibility as they seek emergency funding in response to the pandemic.

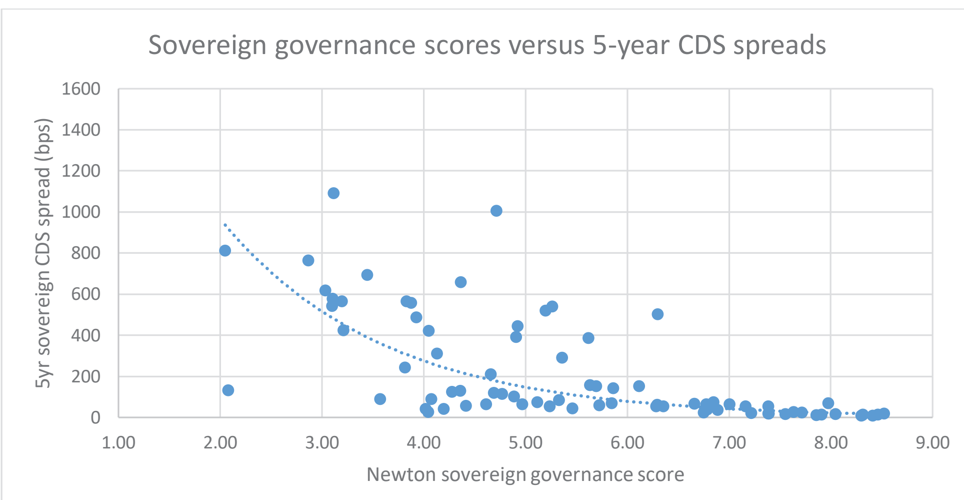
As bond investors at Newton, we have been integrating environmental, social and governance (ESG) analysis alongside conventional financial considerations when selecting fixed-income investments since 2010, across all areas of the credit markets in which we invest. In this capacity, we have long held the view that ESG considerations are crucial to the selection of bonds across all areas of the fixed-income universe, but nowhere is it more important than when used to help select emerging-market government bonds.

Our premise begins with the view that improvements in the governance or 'G' component of the ESG triumvirate will have a knock-on effect, first bringing social benefits and, ultimately, environmental improvements too. We base this view on our strongly held belief that improved governance strengthens the social contract between a government and its citizens, thus helping to reduce policy volatility, while environmental prospects should also be enhanced as initiatives such as sanitation and energy efficiency improve over time. In short, we believe that improvements beget further improvements and thus, a virtuous circle is created.

Emerging markets for a reason
We believe it makes sense to begin with the premise that emerging markets are emerging markets for a reason, in that they face a number of challenges over and above those faced by more established nations, as they seek to develop their economies. For this reason, we place our ESG expectations for emerging-market sovereign bonds firmly in the 'reform' and 'ability to move forward' categories when making investment decisions, rather than simply excluding those with current poor ESG standards.

As emerging-market governments seek to develop, grow and broaden their economies over time, multilateral assistance can often offer a crucial backstop for them in that process. It is often the case that many nations (and in particular the lower-credit-rated emerging markets) possess inadequate resources or financial-market depth to manage economic, social or geopolitical shocks to the system – especially if they are dependent on a narrow tax base for the bulk of their revenue.

Doing the 'right thing'
In our view, governments that are engaging, transparent, and trying to do the 'right thing', are more likely to



Source: Newton, July 2020

be treated favourably if and when they do require assistance from multilateral lenders such as the International Monetary Fund (IMF) or the World Bank.

This hypothesis has proved to be valid, and through our own research we have been able to find a link between the quality of sovereign governance scores and their respective credit spreads, as illustrated in the chart on page 64 using five-year credit default swap (CDS) spreads. The higher the governance score, the narrower the spread tends to be, although correlations will change depending on the point reached in the economic cycle.

Over the years, we have observed one anomaly which has bucked this trend. During periods of relative economic calm, we have seen on several occasions a tendency to factor in geopolitical sensitivity issues ahead of the normal modus operandi of the IMF and other lenders, which is to make lending decisions based on sustainability criteria alone. This seems like a sensible approach to us, as lenders need to ensure that they avoid throwing good money after bad.

Bespoke solution

As fixed-income investors, we have always had numerous sources of data at our disposal. Much of this derives from our own industry and responsible investment analysts who assess corporate governance and sustainability, but there is no standard way of extending this to apply to government bonds. We believe that global and emerging-market government bonds, which often play a key role in flexible or unconstrained bond funds, require a bespoke solution.

To this end, we believe it makes sense to align ESG analysis of governments alongside an environmental attribution, screening and scoring process. We have been doing this since 2010, and we feel that it provides us with a great starting point for discussions over bond selection, as well as acting as an effective screening process for our government-bond picks.

Emergency funding

At the time of writing, 102 governments across the globe have applied for emergency IMF funding in response to the global pandemic. Some of the poorer nations are rightly only required to meet much looser criteria to qualify for emergency funding, as without such aid being granted, there are likely to be some major humanitarian crises.

However, among the governments which are issuers of emerging-market bonds, we are now finding that our belief that good governance brings rewards to sovereign issuers and investors is holding true, in that those countries which are trying to do the 'right thing' are being afforded greater flexibility. We have already seen a handful of governments that we downgraded during our regular government ESG screening process, and others where we had expressed concerns, currently facing greater delays with their own emergency funding application processes (South Africa, Zambia and Belarus, for example). Moreover, approval of more substantial IMF medium-term lending programmes will entail greater conditionality (and a full debt-sustainability assessment) before further funding is granted, highlighting once again the enduring importance of open and transparent political governance.

Written by Carl Shepherd and Trevor Holder, portfolio managers, fixed income, Newton Investment Management

In association with NEWTON Investment Management

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ESG: Investing today to build a better tomorrow

Gareth Trainor explains Standard Life's current approach to responsible investing and ESG, and how they plan to future-proof this to meet growing customer demands

The importance of responsible investing and environmental, social and governance (ESG) keeps growing. Gareth Trainor, head of unit-linked investment solutions at Standard Life Assurance Limited (Standard Life), tells *Pensions Age* that it's all about what customers expect from their pension provider.

Seventy-four per cent of our customers expect us to consider how responsible all their investments are, not just those labelled responsible or ESG

Almost three-quarters of people responding to a Standard Life survey[1] believe we should be thinking about responsible investing factors when we choose investments on our customers' behalf. However, many are unsure if their investments have an ESG approach.

At Standard Life, we listen to our customers. And we aim to help them meet their expectations about investing responsibly in their pension plan.

We've tested our customers' understanding of the overarching term 'responsible investing'. We've also engaged with them to find out what ESG issues matter to them. The top three cited as most important, from many options, were climate change, human rights and recycling.

Clearly, there are a lot of themes under the responsible investing or ESG banner so we're helping our customers understand what we're already doing and how we're doing it. We're taking action now to deliver significant change over time so we continue to resonate with most of our customers' expectations. Of course, we're making sure we still meet our customers' other investment needs and goals as well.

Improving outcomes and delivering value for our customers

Standard Life Assurance Limited is part of the Phoenix Group, which aims to help people save for a stable and sustainable future. This purpose is supported by our four group sustainability commitments:

- Deliver for our customers
- Foster responsible investment
- Reduce our environmental impact
- Be a good corporate citizen

To make this happen, Standard Life has a comprehensive policy setting out how we incorporate ESG-related risks and opportunities into our investment processes. This includes how we engage with our investment providers in our stewardship role; that's how we keep an eye on their ESG investment approach on behalf of our customers.

Plus we benefit from our strategic partnership with Standard Life Aberdeen and their investment manager, Aberdeen Standard Investments (ASI). Across their actively managed funds, ASI aims to invest considering ESG risks and issues as well as practicing high stewardship standards in their investment process.

Anyone investing in a Standard Life fund actively managed by ASI has benefitted from having the key financial risks associated with ESG taken into account for many years. ASI have a long and distinguished history of investing responsibly. Plus, they have an extensive stewardship capability, encouraging the companies they invest in to improve their practices right across the ESG landscape.

The examples in the table on the next page give an indication of the actions taken on behalf of Standard Life customers, day-in, day-out, across our funds managed by ASI.

While many of our customers have actively managed solutions with ESG risks taken into account, and extensive stewardship applied on their behalf, many customers invest passively. It's challenging to effectively consider ESG risks and principles in low-cost passive solutions, which typically track the broad market. This needs to be a key focus for the industry in driving positive change.

That's why we're working with our investment partners, using our collective capabilities, to provide appropriate solutions for Standard Life's advisers, trustees and customers. For example, we'll be launching a passive ESG solution later in the year to provide a credible low-cost passive option. In addition, we'll introduce more sustainable and thematic options through the rest of this year, which will provide a broader range for customers who wish to invest in this manner.

ESG needs further education, for our industry and our customers

Beyond what we're doing, there's still much more to be done within our industry. Different companies use different terminology, which may leave customers confused. Our research showed customers' levels of understanding were typically low, with many not realising the crucial differences between some of the language used across the industry.

That's why Standard Life has aligned its language and terminology to the UN-supported Principles of Responsible Investment and the UK Stewardship Code. And we keep an eye on initiatives to standardise and simplify this language.

ESG integration is applied in all of our actively managed options managed by ASI. Our passively managed options don't integrate ESG considerations to the same extent as they tend to track a market index; however, it's an area in which we're developing. Our passive investment managers also perform stewardship activities to try and improve practices within the firms they invest in.

ESG incorporation combines three broad approaches to include ESG into the overarching investment process and fund design. ESG integration helps spot opportunities and manage risks and can be applied across all funds. Screening removes 'bad' or seeks 'good' investments and includes ethical funds. Thematic aims to address specific ESG issues and includes impact funds.

While our customers' views and our own principles are important, we also provide solutions under the oversight and/or direction of our Independent Governance Committee and Master Trust Board. Both have clear and distinct responsibilities when it comes to ESG and investing responsibly. We're continuing to work closely with both these and our wider stakeholders to make sure we achieve our shared goals.

One small step, one giant ESG leap

At Standard Life, we have significant ambition across our sustainability agenda. We have a position of strength to build from and are excited to launch further capabilities later in 2020. We believe that what some see now as forward-thinking will one day be the norm. However, there's a real risk that our industry doesn't use this moment of opportunity to drive real sustainable change.

At the heart of our activity is our corporate purpose, our group sustainability function and the sustainability ambassadors embedded across every function in the wider Phoenix Group. Plus there's a growing number of passionate employees, trustees and customers who are all determined to make a difference to the world that we live in and to help build a better tomorrow.

Written by Gareth Trainor, head of unit-linked investment solutions, Standard Life Assurance Limited

In association with

Here are just a few of the examples of how ASI's research and actions could add value for Standard Life customers:

E.On SE: an international and privately owned energy supplier.

ASI is the lead investor with E.On as part of Climate Action 100+, a collaborative initiative to engage the highest greenhouse gas emitters globally.

Following a request from ASI, E.On set a net-zero target and they've committed to publishing a "task force on climate-related financial disclosures" report in 2020.

ASI continues to engage and encourage progress with the company.

Boohoo: an online fashion retailer.

ASI was originally encouraged by Boohoo's aspirations to be a leader in sustainability. In particular, the companies discussed the transparency of Boohoo's end-to-end supply chain.

However, in July this year, ASI removed Boohoo from all funds following allegations of modern slavery within their supply chain. Boohoo hadn't adequately met ASI standards as responsible stewards of their clients' (including Standard Life customers') capital.

Royal Dutch Shell (Shell): a multi-national oil and gas company.

ASI has been working with Shell over a number of years to help manage its low-carbon energy transition strategy and to achieve the ambitions of the 2015 Paris Agreement with the United Nations (UN).

ASI and Shell's relationship shows how constructive engagement can lead to much stronger carbon-emission-reduction commitments.

Companies have been selected for illustrative purposes only to demonstrate the investment management style described. This is not an investment recommendation or indication of future performance.

[1]Source: Standard Life, based on 3,924 responses, 2019

Do 'sustainable' and 'investment' go together?

Finding ways to be part of the solution

Interest in sustainability and environmental, social and governance (ESG) has grown strongly in recent years and the Covid-19 pandemic has thrust the topic into the limelight. Global capitalism, however, is often seen as directly opposed to sustainability: can investors really find solutions that marry the two goals?

Climate change has become a megatrend

We have reached an inflection point. Society wants better environmental policies, consumers demand more sustainable products, and investors seek investments that will make a difference.

Companies that offer solutions to climate and environmental challenges are seeing – and will continue to see – strong growth in demand. Nordea's Global Climate and Environment Strategy is at the forefront of thematic investment solutions, investing in exactly such businesses. Thomas Sørensen and Henning Padberg, managers of the strategy for over 12 years, have built a deep understanding of this area. "We see climate and environment as a sustainable megatrend," Sørensen says, "and there are many opportunities to capitalise on this."

Resource efficiency can make economic sense

New legislation and customer demand are big drivers of change, but pure economics may be the biggest motivator for a business to become more climate friendly. If a manufacturer can improve its energy usage, it saves money while also reducing emissions. An example held by Nordea's strategy is Rational, a German manufacturer of appliances for large and industrial kitchens. Rational Combi Ovens can reduce by 70 per cent the energy commercial canteens and restaurants consume when preparing food and offer a very short pay-back period.

The majority of the strategy's assets are allocated to companies like this, which offer products and services that improve the user's resource efficiency. This wide-ranging theme covers areas as diverse as smart farming, intelligent construction, eco-mobility and advanced materials.

Growing environmental protection

Another major theme Sørensen and Padberg focus on is environmental protection. This includes businesses involved in waste management, environmental services, sustainable forestry and clean air and water, but also covers the extensive green consumer movement. Here we find companies such as the Norwegian company Tomra, the global leader in reverse vending machines for recycling of plastic bottles.

Alternative energy is still growing

The final area the team invests in is the perhaps more predictable alternative energy sector. This category includes both renewable power and energy storage solutions. The strategy's holding Vestas is the world leader in design, manufacture, installation and maintenance of wind turbines. These turbines generate 25-50x more energy than they will use during their lifecycle.

Picking stocks at the forefront of the sustainable revolution

The global equity market offers plenty of opportunities for a well-differentiated solution-led investment approach. The Global Climate and Environment Strategy picks stocks from an opportunity set of more than 1250 investable stocks with a combined market cap of over €6 trillion. This universe has a bias towards growth-oriented mid and large-cap companies and is therefore able to offer diversification benefits against a wider global equity investment universe. From this, the managers build a portfolio of 40-60 high-conviction stocks.

Invest in sustainability

The Nordea Global Climate and Environment Strategy has invested in innovators delivering new solutions to climate change for more than 12 years. This strategy is a key example of sustainable investment at its best, allowing its investors to benefit from the climate megatrend while at the same time being part of the solution.

Written by Thomas Sørensen and Henning Padberg, portfolio manager of Nordea's Global Climate and Environment Strategy

Focusing on the 'social'

Guillaume Mascotto explores the elevation of the social dimension of ESG

It is clear Covid-19 has altered global economies, but it has also affected investment theory. Investors assume what is good for the long-term viability of our economic system and society will also lead to positive investment outcomes. It's no longer about what makes a good stock, but what makes a good company. The virus's escalation to a global pandemic has hastened the shift in mindset toward sustainable investing. While public health is a key ESG issue, the effects of Covid-19 are being felt in areas beyond individuals' health and well-being. We believe investors will increasingly focus on the social (or 'S') pillar of ESG in the aftermath of the global pandemic. Investors will also measure the impact of an effective and transparent diversity, equity and inclusion (DE&I) strategy, business ethics and strong corporate governance on company performance.

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The 'S' pillar will gain traction

While social issues have always been central to ESG analysis, especially for exposed sectors such as health care, technology and consumer, one of the pandemic's tangible consequences is the elevation of the social dimension of ESG.

For ESG analysts to consider public health negative externalities idiosyncratic, they would need to determine if the issue is triggered by misconduct or failure of companies' process quality or asset integrity (ie, 'ESG fundamentals'). In the case of Covid-19, available evidence does not establish a link between the cause of the pandemic and companies' ESG risk management practices (as was the case in 2008).

However, the pandemic's societal reverberations are having an impact on these ESG fundamentals, especially under the social pillar. Institutional investors are likely to increase focus on companies' emergency response mechanisms (eg, telecommuting and distributed management) and employee benefits (eg, paid sick leave and telemedicine) as a gauge of long-term competitiveness (human capital) and operational integrity (business continuity). While companies could adapt to the 'working from home' era, they will also likely face heightened data privacy and security risk.

Pre-pandemic, these factors were difficult to quantify. Investors now understand they can have material implications for the companies they invest in and therefore need to be quantified and accounted for. Subsequently, and considering the growing issue of 'green washing', the post-Covid-19 investment space is likely to result in increased investor ESG due diligence. Investors will likely ask for verifiable evidence that ESG considerations, including those flowing from Covid-19, are formally integrated into a manager's investment process and for support of such claims by stock selection, reporting and portfolio construction.

DE&I and the effect on the bottom Line

From an investment perspective, research increasingly shows the financial benefits to companies that emphasise DE&I in their organisational and business strategies. For example, the Pipeline's *Women Count 2020* report found FTSE 350 companies with executive committees comprised of at least 33 per cent women had a net profit margin over 10 times greater than companies with no women on their committees.

Investors place growing importance on this topic and are the main drivers of momentum in the ESG space. DE&I is also playing a larger role in manager selection as asset owners and large investment consultants include more questions and criteria during the due diligence process. A survey by the CFA Institute found that 83 per cent of institutional investors value gender diversity specifically, with 55 per cent believing that it drives better performance in investment teams.

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Even so, governments are passing new regulations to establish quotas for female participation and revamping older regulations with stricter requirements. Examples include Germany, France and California (the first and only US legislation).

We believe companies lacking transparency in this area or trailing their peers' DE&I efforts may see negative impacts to their long-term competitiveness, brand reputation or financial condition.

Governance as part of DE&I analysis

When evaluating companies for our portfolios, we use a proprietary framework to assess each company's risks related to environmental, social and governance (ESG) issues. Within this framework, we consider DE&I to be sector agnostic and include it under both the social and governance pillars of the ESG equation. We specifically look for strong evidence of DE&I as part of a company's human capital strategy. We believe DE&I to be a material factor for workforce acquisition, and by extension, long-term competitiveness. Gender diversity in the boardroom and in senior and middle management is another of the factors to consider when analysing a company's governance practices. We immediately flag companies with no women on their boards of directors. We also use the Hampton-Alexander Review's annual FTSE *Women Leaders* report to help evaluate corporate board membership. As part of our proxy voting guidelines, we also support resolutions pertaining to DE&I, including gender and racial pay gap and board parity.

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American Century Investments

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Written by American Century Investments vice president, head of ESG and investment stewardship, Guillaume Mascotto

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Company Profiles

Pictet Asset Management

Pictet Asset Management has been managing UK pension fund assets for over 25 years. We have had an office in London since 1980. This is an investment centre with nearly 300 employees, where we have an institutional team looking after our UK clients.

We are part of the Pictet Group, founded in Geneva in 1805. Our key investment capabilities include: Multi Asset, Emerging Markets Debt, Global Fixed Income including Absolute Return Fixed Income, Global Thematic Equities and Alternative Investments. We manage £169 billion in assets as at the end of June 2020.

Our approach to responsible investment

Responsibility goes hand-in-hand with a long-term, partnership approach. It means having a sense of responsibility and integrity not only towards the present generation but also to future generations – and to the real economy and the wider world. This is true sustainable thinking.

We are convinced that environmental, social and governance (ESG) considerations can help us make better long-term investment decisions for our clients.

We believe in responsible capitalism and take an enlarged view of the economy and its interactions with civil society and the natural environment.

We are committed to integrating material ESG criteria in our investment processes and ownership practices with a view to enhance returns and/or mitigate risks.

We embed ESG in our risk management and reporting tools in order to maintain high standards of transparency and accountability.

PICTET 1805 Asset Management

Newton Investment Management

Newton Investment Management is a London-based, global investment management firm, providing a focused range of investment strategies to public and private-sector DB and DC pension funds, corporations, charities and, via BNY Mellon, individuals. With £46.2 billion of assets under management (as at 30 June 2020), we run a broad range of equity, fixed-income and multi-asset strategies, and have particular expertise in absolute-return, income-focused, high-conviction and sustainable investing.

We use bottom-up security selection tied with a thematic framework to create and manage strategies that aim to help secure our clients' futures. Our global investment themes are vital to us in providing crucial perspectives on the investment landscape. They identify key long-term forces of structural change, such as changing demographics and a technological revolution, and give us a framework for research and debate.

Our investment managers are supported by career global research analysts who provide investment ideas based on bottom-up fundamental research. Our investment professionals work as part of a single investment team, which promotes perspective on the investment landscape, strong idea generation and the swift implementation of investment ideas.

In addition to financial measures, we evaluate factors such as environmental impacts, social standards, and the effectiveness of people in charge. We believe this 'purposeful ownership' approach allows us to better manage risk and make more informed investment decisions.

www.newtonim.com

NEWTON Investment Management

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We've been building our expertise, developing quality solutions and helping to shape the pensions industry since 1825.

Standard Life Assurance Limited is part of the Phoenix Group, the UK's largest long-term savings and retirement business. The Phoenix Group is passionate about helping people achieve a more secure and sustainable future.

Throughout the entire organisation, everything is anchored to four sustainability commitments:

· Deliver for our customers
· Foster responsible investment
· Reduce our environmental impact
· Be a good corporate citizen

People need more support than ever to make important financial decisions. So we're here to help them make better financial choices for their future. This is delivered in a way that works best for our clients and their employees.

We offer a range of high-quality products for workplace pensions, personal pensions, savings, investments and retirement. Our close relationship with Aberdeen Standard Investments allows us to offer world-class investment solutions.

We believe that experience matters. Our clients, and their employees, need us and together we'll succeed. When we work together, there's a lot to look forward to.

Standard Life
There's a lot to look forward to

Nordea Asset Management

Nordea Asset Management (NAM, AuM 223bn EUR*), is part of the Nordea Group, the largest financial services group in the Nordic region (AuM 311bn EUR*). NAM offers European and global investors' exposure to a broad set of investment funds. We serve a wide range of clients and distributors which include banks, asset managers, independent financial advisers and insurance companies.

Nordea Asset Management has a presence in Bonn, Brussels, Copenhagen, Frankfurt, Helsinki, Lisbon, London, Luxembourg, Madrid, Milan, New York, Oslo, Paris, Santiago de Chile, Singapore, Stockholm, Vienna and Zurich. Nordea's local presence goes hand in hand with the objective of being accessible and offering the best service to clients.

Nordea's success is based on a sustainable and unique multi-boutique approach that combines the expertise of specialised internal boutiques with exclusive external competences allowing us to deliver alpha in a stable way for the benefit of our clients. NAM solutions cover all asset classes from fixed income and equity to multi asset solutions, and manage local and European as well as US, global and emerging market products.

***Source: Nordea Investment Funds, S.A., 30.06.2020**

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Company Profiles

American Century Investments

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