Nordic investment focus:

BRIDGING THE GAP

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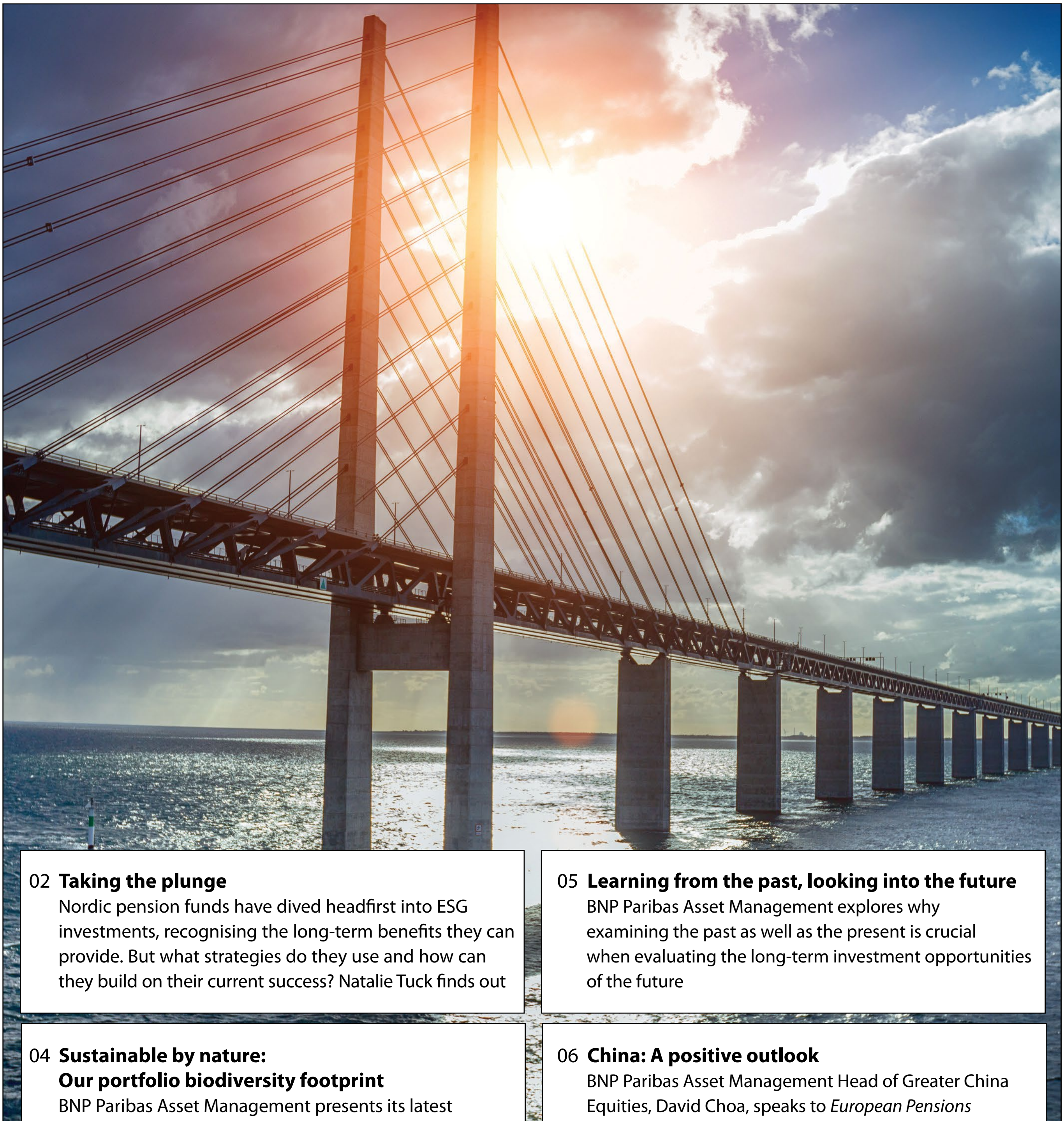


ESG IN THE NORDICS

Taking the plunge

Nordic pension funds have dived headfirst into ESG investments, recognising the long-term benefits they can provide. But what strategies do they use and how can they build on their current success?

WRITTEN BY NATALIE TUCK

A popular winter activity in Nordic countries is that of ice bathing; the act of plunging oneself into ice-cold water. At first thought it might not seem appealing, but the long-term benefits are plentiful, such as boosting one's immune system, lowering blood pressure and acting as a natural pain relief.

Much the same, when it comes to environmental, social and governance (ESG) investing, Nordic countries have long recognised the benefits of taking such factors into consideration. While many other countries debated for several years the impact of ESG investing on investment returns, the Nordics have been fully immersed with the concept of ESG for some time. Even now, as other countries play catch up, the Nordics are lengths ahead, particularly when it comes to climate.

Climate conscious

Cerulli research analyst, Ross Langbridge, notes: "Climate is one of the most important investment themes in the Nordics." Indeed, last year's COP 26 climate conference saw Nordic pension funds from across the region, along with their UK counterparts, commit to investing USD 130 billion in clean energy and climate investments by 2030.

The move demonstrated pension funds' awareness of the role they can play in the green transition. In Denmark, Insurance and Pension Denmark (I&P Denmark) deputy director, Tom Vile Jensen, says the pensions industry plays an important role in facilitating a sustainable transition, which is driven in part by consumer demand.

"Through its investments the Danish insurance and pension industry can assist the global effort to reach the UN Sustainable Develop Goals, as well as the Paris Agreement on climate action. Public interest in sustainability has increased considerably in recent years.

"Danes have to a great extent adopted the sustainability agenda and do increasingly demand products that are produced in a sustainable manner. Consequently, demand for pension funds to invest in e.g. renewable energy instead of fossil fuels is also on the rise."

Sweden's AP7 also has a mission to create good returns for its savers, with its sustainability work dependent on the Paris Agreement's implementation.

"One of the most pressing sustainability issues of our time is climate transition," AP7 communications strategist, Mikael Lindh Hök, notes. "Consequently, we pay special attention to the overarching objective to reduce global emissions. It lies in our interest that a change occurs in the real economy and not just in our equity portfolio since it is difficult to avoid transition risks if the global economy is put under pressure by physical risks and climate change."

A survey by Cerulli found that 50 per cent of Nordic asset owners target clean technology and renewable energy when allocating capital to responsible investments. "That being said, biodiversity is gaining traction in the Nordics too... In the same survey, nearly half (47 per cent) of investors said that they focus on biodiversity risks when seeking responsible investment opportunities," Langbridge explains.

Nordic institutional investors

also have a propensity for impact investing; more than half (53 per cent) of those surveyed by Cerulli already invest in impact strategies, the highest proportion in Europe.

ESG strategy

In terms of strategy, Nordic pension funds tend to focus on ESG integration, Langbridge says, which is often used alongside an active ownership approach.

"What sets Nordic institutional investors apart from their European peers is their extensive due diligence. Nordic investors, in common with their French counterparts, not only assess the process asset managers follow when integrating ESG consideration into investments, but also place importance on asset managers' participation in industry organisations involved in sustainability issues," he says.

Another debate that centres around ESG investing is whether pension funds should just divest from companies that do not fit their expectations, or whether it is best to open a dialogue with those companies and work with them to change.

Vile Jensen says: "Danish pension funds have different strategies when it comes to dialogue vs. divestment. Most Danish pension funds are actively engaged in the opportunity to influence companies through dialogues and perceives divestment as a last, but important, tool."

Activity in this area is ramping up; Denmark's Danica Pension significantly increased its active ownership in 2021 and was in dialogue with almost 60 per cent more companies than in 2020. Publishing a report on active ownership, the pension provider also revealed that the proportion of dialogues with companies on climate and environmental issues increased by almost 50 per cent.

Lindh Hök, too, says that it is in AP7's interest that the companies it invests in have longer perspectives on efficiency and revenues, for example, strong human capital and solid sustainable operations.

"We are certain that it is also in the interest of companies. Our most important contribution to achieving that, is to be active owners together with other investors, and engage with companies on the entire market and encourage them to adapt their operations," he says.

of reporting data would mean data can be compared easily and time taken to create client reports would be cut significantly. It would also go a long way to cutting green washing."

Perhaps unsurprisingly Nordic pension funds are already working hard in this area. Danish pension funds Industriens Pension and PenSam have joined fellow provider ATP's initiative on better improving sustainability data. The initiative from ATP aims to provide better data and more knowledge about the work

"COLLABORATION AND COORDINATION ARE KEY TO ACHIEVING GREATER IMPACT"

Collaboration

In order to build on their ESG success, Nordics pension funds, as exampled by their propensity for investor action groups, believe that collaboration is key. For AP7 this is a priority and Lindh Hök notes that "with most large pension companies and asset owners having well diversified portfolios, collaboration and coordination are key to achieving greater impact".

"Initiatives such as Climate Action 100+, Institutional Investors Group on Climate Change (IIGCC) and Taskforce in Nature-related Financial Disclosures (TNFD) is thereby crucial when investors need to coordinate their ownership dialogue, place consistent requirements, and work from common scenarios where they conduct dialogue with the companies and vote at general meetings," he says.

Another area where more collaboration, and standardisation, is needed is that of ESG data. Langbridge says: "From conversations with asset managers this is definitely an area that needs to be improved on. Standardisation

on sustainability of unlisted companies in the portfolio.

Furthermore, Vile Jensen highlights how I&P Denmark is part of two initiatives which help to create transparency and clarity on climate footprints and lead to action that can help cut emissions.

One of those initiatives was the creation of 13 Climate Partnerships in 2019 by the Danish government, aimed at producing specific recommendations on how the Danish business community can contribute to the ambitious target of reducing Denmark's greenhouse gas emissions by 70 per cent in 2030.

"The financial sector's Climate Partnership is led PensionDanmark CEO, Torben Möger Pedersen. The recommendations were directed at the government as well as the industry itself. In this context the entire insurance and pension industry has adopted a set of common climate reporting rules for the sector – I&P Denmark's recommendation for climate reporting – as part of the ongoing work to meet the national 2030 emissions reduction goal," Vile Jensen concludes. ■

INVESTMENT

Sustainable by nature:
Our portfolio biodiversity footprint

Research has found that on a number of levels, nature is unravelling. This poses an existential threat to societies and economies – and by extension asset owners and investors. As an asset manager, we have a responsibility to understand how our investments impact nature and how nature loss may translate into financial risks.

Such an understanding involves carrying out regular research. Just over a year ago, we presented our biodiversity roadmap. We assessed our dependencies and impacts on nature – in particular, our exposure to water and deforestation risks.

In our latest research paper, we present findings on how to determine a biodiversity footprint. This complements work on our water and deforestation footprints with data to arrive at a more complete picture of our exposure to, and impact on, global biodiversity loss.

Our goal is to integrate this data into our sustainability-based approach to investment decisions. In this paper, we are testing biodiversity footprinting on selected holdings in our global portfolios so that we can understand what it looks like, what it can be used for, and to identify improvements.

Biodiversity footprinting is a tool that helps combine the modelled and reported data of companies we have invested in – and their supply chains – to quantify their potential biodiversity impact. It does not measure how dependent they are on nature, nor does it quantify the risks that arise from biodiversity loss.

It should be stressed that the goal at this point is to have an indication of potential damage to enable us to visualise total potential impact and compare one company to another.

It must also be understood that while all biodiversity is local, a variety of global events – in particular, greenhouse gas (GHG) emissions – are having a significant impact on local ecosystems. Such events occur independent of business activity, but still affect biodiversity.

Furthermore, corporate transparency on nature loss is poor – we often do not have the full data on how specific operations affect a particular piece of land. This forces us to work with averages.

Our research focused on two asset classes – equities and fixed-income [1] securities in publicly-traded companies.

Our 'financed absolute biodiversity footprint' shows that for each EUR 1 million invested in our funds six fully degraded hectares are potentially maintained each year. Our analysis also found that we are relatively less invested in issuers with a higher biodiversity impact.

The research highlighted one of the main biodiversity challenges for investors: Impacts are predominantly situated within value chains, but issuers typically do not provide the information and traceability required for investors to properly assess these impacts.

Based on our analysis, we note some key takeaways:

- More than 65% of the selected assets are invested in sectors with a low biodiversity intensity. This is mostly due to our high exposure to financials.
- Consumer staples has the highest intensety– mostly due to land use change. It represents over 5% of the assets.
- We find that in most sectors, our average biodiversity intensity is lower than the sector average, particularly the consumer discretionary sector. It is higher than the sector average for energy, industrials and utilities.

This first assessment complements our sector and issuer analysis and helps us identify targets for engagement by our stewardship team and portfolio managers. We continue to encourage our most biodiversity-impactful investees to disclose useable data such as tonnes of GHGs emitted or hectares of land converted.

We encourage data providers to pay particular attention to, for example, a company's mitigation efforts and develop methodologies for measuring positive impact.

We plan to investigate the links between issuer-level biodiversity footprints and the other indicators we use to steer investments such as our environmental, social and governance (ESG) scores. We believe our proprietary ESG scoring framework is instrumental to generating long-term sustainable returns for clients, while having a positive impact on the environment, the economy and society.

Learn more about the *Sustainable by Nature: Biodiversity Footprint* and *Sustainable By Nature: Our Biodiversity Roadmap* of BNPP AM's investments. ■

[1] *Including asset-backed securities*

INVESTMENT

Learning from the past, looking into the future

At BNP Paribas Asset Management, our Environmental Strategies Group believes it is vital to consider the past as well as the present when evaluating the long-term investment opportunities of the future. They believe, examining the interconnections between the drivers of previous industrial revolutions, can help us assess the role and value of those of today.

The world is on the cusp of a new industrial revolution that promises a greener future through a revitalised biosphere. As with previous industrial revolutions, it will emerge on the back of an infrastructure platform. In this case, technological advances in areas such as artificial intelligence (AI), 3D printing and the gathering of big data will fuse with cheap energy supplied by renewable power.

This new industrial revolution promises to deliver abundant cheap and green energy and generate an abundance of employment opportunities. Combined with the fusion of new technologies, this will drive significant advances in productivity – the key driver of economic growth and living standards. The process will also involve the decarbonisation of the economy, bringing hope that the challenge of climate change can be addressed, abetted by a new focus on the replenishment of our biosphere. The interconnected nature of these developments, driven by the Internet of Things, will usher in a sharing economy, bringing society closer together.

But to really see how our lives could be revolutionised over the next few decades, we should look back to previous revolutions. The original industrial revolution in England, between 1760 and 1860, was driven by technological progress, education, and an increasing capital stock. The second industrial revolution, which began in the US in the 1850s and was driven by factors such as electrification, crude oil, the rapid spread of the telephone and assembly-line manufacturing of the automobile, ignited the country's ascent to global superpower status.

Economist and author Jeremy Rifkin argues that the new revolution could be equally transformative, not just for economies but for the environment and the way societies are organised too. While many people are aware of the potential impact of new technologies such as AI and 3D printing, Rifkin is one of the few who have thought and written intensively about how all these technological changes will combine. He believes the cost of producing and delivering an increasing array of goods and services will dwindle to near zero. Rifkin points out that technological advances have already taken the marginal cost of producing goods and services in certain areas to near zero, including in publishing and the media. So, how did this come about, and what does it mean?

Rifkin argues that each industrial revolution created a new architecture that drove the overwhelming majority of productivity gains. By the early 2000s, the productivity potential of the infrastructure upon which the second industrial revolution was built was exhausted. However, a new technological infrastructure is emerging, driven by digitalisation. This is enabling the creation of a digital power grid, stretching across continents, which allows millions to produce their own wind and solar electricity and send excess power back into the system.

Over the next decade, this infrastructure will expand to include autonomous electric and fuel-cell vehicles operated by near-zero marginal-cost renewable energy on smart road, rail, water, and air 'internets'. This new infrastructure will allow people to share communication, energy and mobility, partially in the capitalist market and in the emerging sharing economy.

But, identifying themes alone does not guarantee returns for investors. It is extremely difficult to identify those companies that will be able to survive and prosper for the next 10 to 20 years. But at BNPP AM, we are confident that using an expert and holistic historical lens, as well as detailed fundamental projections in the context of thematic trend analysis, helps us to target those businesses that could prove to be the long-term winners.

Finding winners takes research, an open mind, and the ability to examine challenges and opportunities from multiple perspectives, as well as having the conviction to invest purely with an unconstrained approach that targets positive environmental outcomes. ■

INTERVIEW

China: A positive outlook

BNP Paribas Asset Management Head of Greater China Equities, David Choa**, speaks to European Pensions Editor,** Natalie Tuck**, about the opportunities available in China and ESG developments in the country**

To begin with, what opportunities are available and how attractive is China for institutional investors?

I think China is very interesting because everyone knows about the downsides and the risks concerning China but there are several positives coming down the track.

Regarding earnings revisions, we have already seen three quarters of earnings downgrade revisions. After August, there will have been four consecutive quarters of downgraded earnings revisions, meaning expectations are much lower now.

If we look at the cycle of the market, this time last year we were entering into a period of high-base comparison, and China was still recovering from the effects of Covid-19. At that time recovery was moderate but now it's exactly the opposite. Expectations are very low, meaning that from the second half of 2022 to the first half of 2023, there will be a period of low-base comparison.

In terms of the biggest hurdles there are two; one is property, the second is China's zero-Covid strategy. On the property side, I think there is still a big overhang. The government is being much timelier and more reactive, but we think it's still not enough. On the issue of China's zero-Covid policy, I think there's scope for the government to ease the policy after the party congress.

Furthermore, innovation in technology is a positive. Not necessarily just online companies that people are familiar with, but beyond that, there are lot of interesting Chinese technology companies. They used to be on the lower value part of the value chain, but now they're slowly catching up with their Western peers. The products are better, and they are cheaper.

Another key area is consumption; consumption upgrade is not only about Chinese people buying more physical goods from Western big brands. Beyond physical goods, Chinese consumers are looking for more experience-based consumption such as entertainment, food and beverages, for example, and travel.

Last but not the least is consolidation. Yes, China has been slowing in terms of growth, but beneath the surface of a slowing environment, there are a lot of companies in China that are very progressive. They look beyond the low hanging fruit of top line growth. They look at the other side of the equation like brand equity, productivities and research and development. These are the companies that can still grow at a relatively high pace and consolidate the market.

Can you talk about regulatory pressure in China and the implications of that?

Last year was really a shock to the market, to investors. This year, I think the score is quite clear, the peak of the regulation is over. The government's agenda of lowering the gap between the rich and the poor, fighting an ageing society and protecting national security is here to stay. However, that doesn't mean that we will see more regulation. Last year was about the change of the curve of regime. This year is more about the implementation.

On the property side, we are seeing the same approach with the government unleashing all kinds of easing measures on both the supply and the demand side of the market. A lot of cities have relaxed the rules on mortgage requirements, making it easier for people to buy houses, and easier for people to buy their second home. On the supply side, the government is making sure projects have enough financing.

You mentioned Covid-19 – what is the ongoing Covid risk in China and the implications of that on the economy?

That is one of the biggest hurdles for the Chinese economy. The strict Covid policy really changed the expectations of businesses and consumers. For businesses, uncertainty meant that they did not want to make big investment choices. For consumers, it dampened the sentiment and lowered income expectations, therefore reducing the sentiment to consume things. However, things appear to be easing slightly; for example, the number of days in quarantine from international travel has reduced by about half, and we are seeing more government officials travelling around the country again, and meeting without masks.

I think the government sees the damage the policy did to the economy in Q2, and it cannot have another quarter like that. When the market sees there's a light and roadmap getting out of it, then sentiment will change, and I think we are already beginning to see this.

Another big global issue is high inflation. Is China seeing inflationary pressure?

China is unique because while the rest of the world is facing high inflationary pressure, China is not currently seeing that kind of pressure due to several reasons. On the energy side, China is more dependent on coal, which is cheaper, and there's abundant resources. In terms of food security, China is self-sufficient in most areas.

Then, unlike the rest of the world, if you think about the Covid situation, China was the first to get it, then the first to get out. Now, the recovery phase of China from Covid is over. The country is in a slowing down phase due to several reasons – property, the zero-Covid policy and geopolitical tension. The US and Europe are now experiencing what China experienced last year, which is a strong recovery from Covid, when demand was exceptionally strong. When China is ready to end its zero-Covid policy, demand may start to pick up. I think at that stage, China would be ready to stomach higher inflation than normal because growth would be more important.

"COMPANIES WANT TO BE BETTER, BUT THEY MAY NOT HAVE THE RESOURCES OR SOMEONE TO GUIDE THEM"

Moving on to environmental, social and governance (ESG) factors in China, what are the opportunities in China for ESG investing, and what are the challenges?

ESG in China is very interesting because the perception is that China is lacking in this area. However, China is increasingly looking at ESG factors. It has become increasingly important not only in local regulation, but also from a company point of view as well.

As well as being pushed down from the government, it is also being pushed from the bottom up, as companies are becoming more aware of it and are devoting increasing resources.

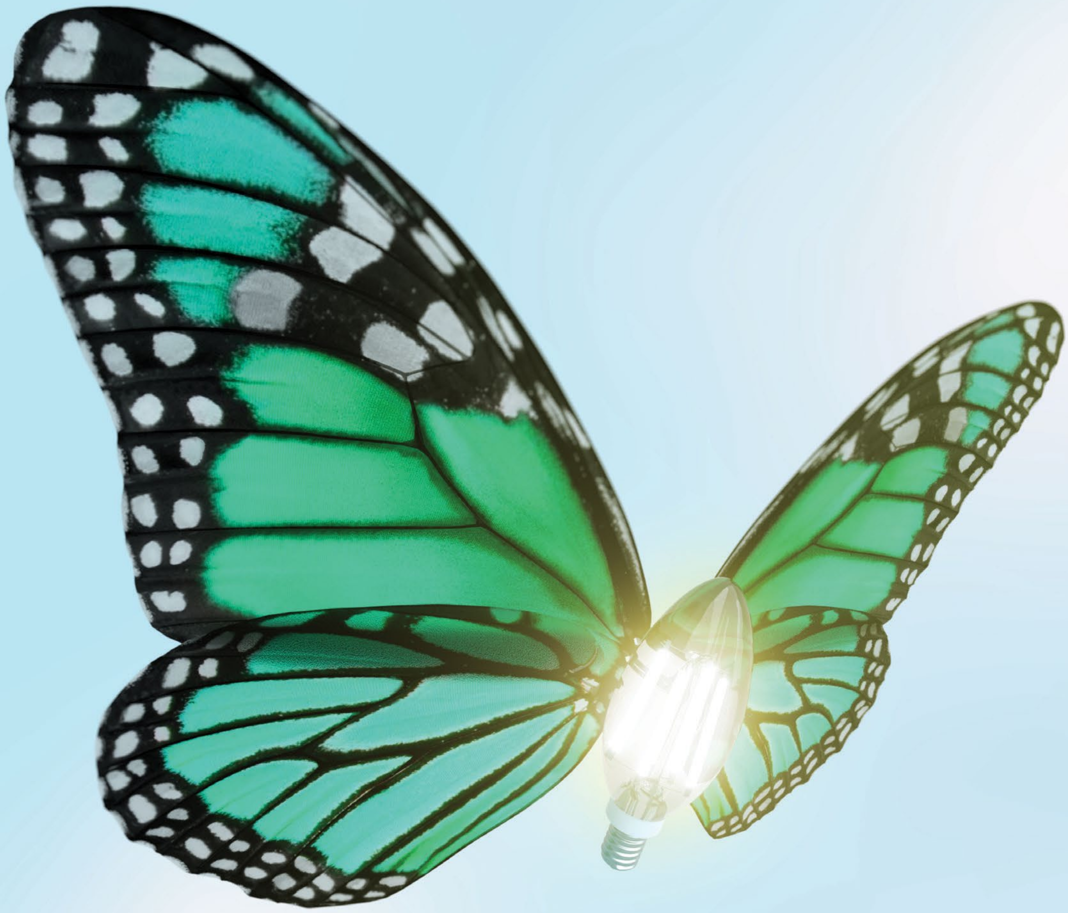
However, data collection is an issue, and for a lot of the international data sources, either because of a lack of language skills or the way they collect the data, they're missing some important data. Therefore, there is sometimes a discrepancy between the ESG score and what the actual situation is in China.

I also think more emphasis is being put on the environmental side of ESG, rather than other aspects. For some issues, such as biodiversity or female representation in top management, things that are not so important currently in China, BNPP AM is bringing those concepts to Chinese companies.

I think in today's world people focus on the numbers; the ESG score or ESG data. At BNPP AM we avoid just looking at the score of the company. Companies want to be better, but they may not have the resources or someone to guide them. For BNPP AM, it's important to identify companies that have good aspiration to adopt better ESG practice and help them achieve that, rather than just look at the number from a standalone basis.

I think that's the challenge when it comes to ESG in practice in China, because you cannot just rely on a third-party for the data. Secondly, it should not be run as a separate track, one as an investment track, another as an ESG track. These two have to be integrated in the investment process. That's the reason why at BNPP AM, we have an integrated holistic approach. ESG is embedded in every step of our process, from the pre-investing screening phases to the research phases, to the post-investment monitoring phases. For us, it's not only about putting a number or label on a company – it's about guiding a company to better practice so that we can make the world a better place for the future. That's the scope of it. ■

IN A CHANGING WORLD,
ENERGY TRANSITION IS MORE THAN JUST AN IDEA.



BNP PARIBAS ENERGY TRANSITION

At BNP Paribas Asset Management, because we focus on delivering long-term sustainable investment returns for our clients, we select companies that are dedicated to finding solutions that address climate change and contribute to the transition towards a low-carbon economy.

Discover how we drive sustainability for you
https://am.bnpparibas.com/sustainable-investor/en/

BNP PARIBAS
ASSET MANAGEMENT

The sustainable investor for a changing world