Nordic climate change investment focus:

A LEADING LIGHT

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How are investors reacting to climate change in the Nordics?

In a *European Pensions* podcast, Natalie Tuck speaks to BNP Paribas Asset Management and AP7 on how investors are reacting to climate change in the Nordics

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PODCAST

How are investors reacting to climate change in the Nordics?

With land stretching up into the Arctic Circle, Nordic countries are already experiencing the worrying impacts of climate change in their own territories. What role can the investment community play in helping to combat the inevitable crushing humanitarian and economic consequences of climate change?

In this podcast, BNP Paribas Asset Management's Chief Sustainability Strategist, Mark Lewis**, and AP7's Head of ESG and Communications,** Johan Florén**, discuss with** *European Pensions'* **Editor,** Natalie Tuck**, how investors are reacting to climate change in the Nordics**

Johan, could you start by telling us how important climate change is to AP7 and the work the scheme has been doing to tackle climate change?

JF: We take a universal owner perspective on sustainability and in practise this means two things; one is a norms-based strategy that we apply to our whole portfolio, which covers the environment, human rights and labour rights etc. The other aspect is thematic work, where we prioritise the most important systemic challenges and look in depth at developing new methods and knowledge and engaging with specific companies.

At the top of our list of priorities is climate change. As an example, one thing that we have focused on for several years now is corporate climate lobbying, which is a global barrier for the Paris Agreement to materialise. This is something we have done with BNP Paribas Asset Management (BNPP AM) and the Church of England.

Mark, from the perspective of an asset manager, what do you think are the biggest challenges facing the industry and what action has BNPP AM taken to address these challenges?

ML: The challenges facing the investment industry are no different from those facing society and the world. The asset management industry ultimately is operating within the investible universe provided by economic, social and global conditions.

I think it is fair to say that we are living through an era of multiple crises. We clearly have a climate change crisis, the manifestation of that has been with us almost on a weekly basis throughout this year. We've seen wildfires, floods, hurricanes and this is increasingly impacting different parts of the world.

There is also an ecological crisis around the question of biodiversity and the loss of biodiversity. There is an economic crisis brought on by a public health crisis, in the form of the pandemic, and there is increasing concern, quite understandably, about gender and race inequalities.

We are living through an era of multiple crises and the asset management industry has to make responsible choices in the face of that. At BNPP AM, we put sustainability at the heart of our investment philosophy. We think that is the way a responsible asset manager should respond but it also makes economic, financial and business sense. It is no longer possible to ignore the impact of these crises on the financial performance of the companies and the asset classes.

Sustainability and responsible investing is an integral part within BNPP AM's portfolio construction; our asset managers are required to take a full account of environmental, social and governance (ESG) issues when building their portfolios. This is because their portfolios are being measured on financial performance and ESG performance. We think this will generate better long-term performance for our clients.

Johan, as a universal owner the bulk of your investments are in index strategies but you have also made dedicated 'green' investments both in the private and public markets. Can you explain what role these investments play as part of your overall investment portfolio and in your work against climate change?

JF: If you look at it conceptually, we blacklist the worst companies at one end of our portfolio and then at the other end we make thematic investments in companies that solve climate-related problems. These green investments are of course on the solutions side; we have problems globally and the companies here are part of the solution going forward. If you look at it financially, the green strategies are within a diversification part of our asset allocation, so it's a building block together with other things we do.

You also recently increased your allocation to BNP Paribas Asset Management partner Impax's green impact mandate, is this part of AP7's climate change strategy?

JF: Yes it is, and the mandate we have with Impax is an example of these solutions investments. In our view, companies create sustainability value for society and we want to help finance this. It also gives us a chance to develop methodologies and metrics to evaluate the impact of the investments together with one of the most advanced asset managers in this area. We have two separate goals; one of course is for financial returns and the other is to measure this value, as we want to see where we are making an impact.

As a large pension scheme and asset manager you not only manage clients´ money, but you can also have a wider influence on the asset management industry, clients and the wider society. What specifically do AP7 and BNP Paribas Asset Management do to exert that influence?

ML: On issues we are concerned by we look to engage, both in terms of our bilateral engagements with companies we invest in and with companies that we're not currently invested in that we perhaps would if there weren't certain barriers. We have also instituted several policies that signal our concern and commitment in areas of importance. On climate change, for example, we have introduced a very strict coal exclusion policy, which affects our ability to invest in coal mining companies and power generation companies that are particularly reliant on coal.

There is also the element of working with other like-minded asset managers and owner institutions to deliver broader change. As Johan mentioned earlier, we have worked very fruitfully with AP7 and other asset managers and owners. One example is our work within investor network initiatives, such as the Climate Action 100+ initiative. As part of this we are taking the lead on engaging with seven of the world's largest emitting companies to put pressure on them to align their business models with the Paris Agreement.

JF: From our perspective, we have stated that the final goal for our work is to create a real world impact, so we want to have an effect on and make a difference on the real economy. To do this as a pension scheme, one key success factor is collaboration. We are trying to make our companies develop and change their behaviour towards a more sustainable direction.

To be able to succeed in this, I would say that collaboration is the number one factor; nobody is strong on their own but together we are quite a force. We actively look for like-minded peers with similar philosophies. Then we work with them to agree on good principles that we think are healthy. As part of our active ownership, we then encourage companies to change.

Mark, as a final point, looking more broadly at Nordic investors, what trends, in general, do you see with those investors in terms of climate change?

ML: The thing that has always impressed me about the Nordic region is that it has always been one step ahead of the rest of the world on climate change. I think its governments and society, more generally, really understood the seriousness of this issue much earlier than other regions in the world. Even within Europe, the Nordic region stands out as a beacon of action and commitment on this topic.

For example, electric vehicles are a very hot topic as people see electrification as a very essential way of decarbonising transport. However, on my last trip to Scandinavia I had a lot of questions on the end of the battery life cycle, the pollution impact of batteries, whether they can be recycled and issues relating to child labour with regard to the cobalt mining. This is what I have found, that in the Nordics they have always been leading this debate on climate change, setting clear targets and leading shareholder initiatives on many topics. ■

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INVESTMENT

Getting the green light on green investment

The lessons the world is learning from the Covid-19 pandemic are as multi-faceted as they are wide-ranging. We have learned that new ways of working are possible and that our habits are surprisingly easily changed. We have also learned that from great challenge often comes great opportunity, which should stand us in good stead for the future

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While the world has been distracted by the current pandemic, even greater threats have continued to build. Global warming, climate change and other environmental issues remain ruthlessly pressing. The global population is still on course to reach nine billion by 2035, increasing demand for energy, food and water by 35-50%. Without immediate intervention, our current practices to meet these needs involve huge and irreversible environmental impact.

Unlike the coronavirus, these issues are not localised, nor can they be solved by short-term, isolated measures. Instead, they require coordinated, focused efforts or risk failing at the first attempt. The good news is that the reaction to the pandemic – or rather to its catastrophic economic impact – has seen governments and a range of other stakeholders keen to take a fresh approach to rebuilding.

Support for a green rebuild

We can see a consensus emerging for the money earmarked to address the economic fallout to align with and even support measures to tackle climate change, along with other challenges such as pollution, water shortages, flooding and electrification. Encouragingly, the support for this approach to 'build back better' can be seen around the world. Although not yet universal, there is already considerable backing – and this is the largest and most important investment theme I have come across in my career.

US presidential candidate, Joe Biden, has embraced the 'Green New Deal' and, if successful in taking over the White House, is looking to turn the world's largest economy into a global clean energy superpower. Already, the Democrats' long-term stimulus plan includes replacing more than 200,000 polluting and unreliable US Postal Service trucks with electric vehicles. Similarly, the European Commission has put forward a detailed roadmap aiming for net zero greenhouse gas emissions by 2050 – just one of the aims within the trading bloc's overall plan. Elsewhere, Indian Prime Minister, Narendra Modi, unveiled a substantial Green Plan in July, with China pledging in September to be entirely carbon neutral by 2060.

So far, governments and other interested parties have offered high subsidies and low interest rates to companies developing new, future-focused strategies. But, as we enter the economic post-Covid recovery, it is the creation and capturing of opportunities that is going to be the catalyst for this green rebuild to really take off.

Designing a financial, fiscal and monetary system with environmental issues at its heart will not come cheaply -- but nor will it be a zero-sum game. Showing how we can turn climate and environmental challenges into investment opportunities is the carrot needed to drive more capital to fund the huge change we need. Long-term plans need long-term solutions funded by long-term capital, but it will only come if there is a demonstrable benefit to this reallocation.

Broaden your horizons

We need this broad governmental

support to become a green light for investors to begin to explore the huge range of opportunities on offer. From energy, materials, agriculture and industrials, there are companies providing solutions to decarbonise and futureproof these sectors of all shapes and sizes. The investment universe ranges from solar and wind energy to batteries, electrification, green buildings, biofuels, and pollution control and testing. There are also noteworthy opportunities in cleaner shipping and ocean freight.

These forward-looking investment ideas are fundamentally tied to a clear growth opportunity, which will increase and solidify in line with the escalating global policy response. For example, the EU has set hydrogen – a source of clean energy – as a key instrument for its 2050 Green Deal objectives. This signals that there is likely to be a huge jump in the investments in renewable hydrogen – estimates put the cumulative figure in Europe to reach between €180-470 billion by 2050[1]. The turnover in the hydrogen economy is also predicted to jump from the current €2bn to €140 billion by 2030[2].

The global offshore wind market is also set to expand significantly in short order. The International Energy Agency is forecasting 13% growth per year and a 15-fold increase in capacity by 2040. This is expected to become a $1 trillion industry over the next two decades[3].

This is just the tip of the renewable energy iceberg. Distribution of this power is as important as its creation and requires similar, if not greater, levels of innovation and capital. Existing grid networks need updating, with storage another key piece of the puzzle that requires immediate and rapid attention. All these new technologies align with one theme: creating a world that not only prevents further deterioration of the planet but helps create resilience to deal with what is yet to come.

Sustainability and sustainable returns

For investors, this should chime with the responsibility of not just targeting sustainability for its own sake, but also expecting sustainable returns. We can and should not just commit blindly to ideas that promise a greener future – rigorous investment processes are now more important than ever.

Importantly, we have witnessed an encouraging mindset shift over the last decade. After years of research, there is now substantial evidence showing that companies with strong environmental scores outperform those that are less committed over time. This research also confirms that companies acknowledging and working to resolve environmental challenges will outperform those that do not. We can already see stranded assets and outdated technologies causing significant issues for companies in all sectors.

Companies that appreciate how embracing the future can add value are already pulling ahead in investment portfolio performance, while also reducing overall risk. Their performance is also more stable than their peers, as they suffer less in downturns and are less susceptible to swings in market trends. Of course, it is possible to short the companies that may be set to lose out in the long term – we are, after all, investors seeking returns.

Future first

At BNP Paribas Asset Management, we are already exploring the investment opportunities arising from this once-in-a-generation chance to shape a better future – all while targeting attractive returns and managing myriad risks. While all our strategies integrate environmental, social and governance considerations, we offer thematic and impact funds that cover a wide range of future-focused ideas. We are pleased to see investors aligning with our view that opportunities lie ahead, with new assets flowing into sustainability themed investments, even amid the coronavirus outbreak.

Covid-19 has shown us that we cannot control the future, but that we need to prepare to face it. As investors, we have the opportunity to help the world be as well-positioned as possible – and ensure our portfolios are prepared, too. ■

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[1] Source: https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1257
[2] Source: https://www.pv-magazine.com/2020/06/19/leaked-eu-hydrogen-strategy-eyes-e140-billion-turnover-by-2030/
[3] Source: https://www.iea.org/reports/offshore-wind-outlook-2019

INVESTMENT

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Room at the top

While some Nordic pension funds are already leaders in their field when it comes to ESG investing, more can still be done, discovers Francesca Fabrizi

WRITTEN BY FRANCESCA FABRIZI

Nordic pension funds are undeniably some of the most sophisticated in Europe and, most significantly, recognise the significance of environmental, social and governance (ESG) issues much earlier than their European counterparts.

While in some countries, pension fund investors are only now recognising that ESG considerations are not just about doing something positive for future generations, but about mitigating real risks to pension fund assets, in the Nordic space this has been at the core of some pension funds' thinking for many years – in particular, in relation to the potential impact of climate change on their portfolios.

BNP Paribas Asset Management co-head of environmental strategies group, Ulrik Fugmann, comments: "The Scandinavian investor base is very much at the forefront of the integration and thoughtfulness of ESG. Whilst a lot of climate-related investments have been in the infrastructure space, there is a broader awareness of opportunities in the public markets through environmentally themed portfolios."

One only needs to look at the news headlines daily to see evidence of such commitment. In recent weeks alone, several Nordic names were confirmed to be among an international group of 30 institutional investors delivering on a commitment to transition their investment portfolios to net-zero greenhouse gas (GHG) emissions by 2050; while a number of Nordic pension asset owners were included in the Principles for Responsible Investment (PRI) leaders' group for 2020, which showcases signatories that demonstrate a 'breadth of responsible investment excellence'.

"Nordic pension funds are clearly at the forefront in the field of sustainable finance," agrees PensionsEurope secretary general, Matti Leppälä, "and have taken ambitious decisions to support the pathway towards a carbon neutral economy. All over Europe, the interest among pension funds in generating a positive, measurable social and environmental impact, alongside a financial return has been steadily growing over the past few years. The Nordic pensions market reflects this reality, as pension funds have continued increasing their investments in green and social bonds, dedicating a greater share of their portfolio to impact investing," he says.

On a country level, examples are plentiful. The Swedish Pensions Agency recently announced it had invested SEK 1 billion in the government's new green bond, which launched on 1 September. Sweden's AP1 also announced the adoption of a new fossil-free approach to emerging market equity and global high-yield exposures.

Meanwhile, in Denmark, the pensions industry has, in collaboration with government, announced plans to invest more than €46 billion in green transition towards 2030, to include investments in energy infrastructure and other green activities such as green stocks, green bonds and investments in energy efficient construction. Leppälä comments: "The Nordic pension industry has often played pioneering role in the adoption of new green initiatives. For example, PFA and Danica Pension have recently launched their respective green pensions, for which the underlying investments have clear sustainability objectives and will contribute to the green transition."

Danish labour-market pension fund Sampension has also reached a milestone of DKK 1 billion invested within green bonds.

ESG responsibilities have also been one of the key focus points within the Icelandic pension market in recent years, EFIA and LSBI pension fund managing director, Snaedis Ogn Flosadottir, confirms. "Every pension fund in Iceland has put forward a responsible investment policy, which defines the board's objectives, focus points, methods and metrics. Keep in mind that every pension fund is different so the implementation of the policy, follow-up and decision-making does not have be analogous. But I believe they are, as a whole, keeping pace with their responsibilities and impressive work has been done in recent years."

In recent weeks, Icelandic pension funds have also, alongside Prime Minister Katrín Jakobsdóttir and the wider Icelandic financial market, signed a Declaration of Intent to use funds to maintain sustainable development both on a national and international scale.

Finland boasts a number of

trailblazing pension funds in the areas of ESG; while Ilmarinen, the biggest of Finland's pension insurance companies, has defined a stricter target and will make the firm's €48 billion of investments carbon-neutral by the end of 2035.

In Norway, the sovereign wealth fund maintains a negative exclusion list that Norwegian pension funds generally adhere to, which sets a solid foundation; and the funds employ a simple "follow-the-leader approach", explains Mercer Norway's investment consultant, Maria Haugtomt, which ensures that all trustees are familiar with the importance of incorporating ESG on some level. "We're therefore ahead in terms of coverage, which provides a base for developing and broadening the pension funds' efforts," she explains.

Of course, ESG strategies vary across the countries, as Leppälä explains: "The Finns have been using a more best-in-class approach and less exclusions than many other Nordics; while Swedish pension insurers have sustainable investments at the heart of their actions", but on the whole, the dedication to ESG across the Nordic space is undeniable.

Room for more

But while the positive examples of ESG integration across the Nordic space may be plentiful and numerous ambitious targets are being set daily, the topic of sustainability is wide-reaching and complex and, in particular, a lot of work still needs to be done by investors in articulating what the objective and use case is for E, S and G. "In other words", says Fugmann, "is it being used as a tool for screening in – and out – companies or portfolios, or is ESG being used as a tool for managing non-financial risk in portfolio allocation?" ESG and sustainability themed investing are not the same thing, he argues: "One is a tool for assessing non-financial risk in portfolios and/or companies and the other a thematic approach to invest in companies driving sustainable solutions through their products, processes or services."

Haugtomt agrees with this sentiment. While some Norwegian pension funds have a sophisticated approach to ESG, the pension fund population can do more, she argues. "The negative exclusion practice has remained unchanged over the years, while a great deal has happened in the market," she argues. For example, knowledge and science regarding climate change and its impact on capital markets has evolved; data availability and quality has improved considerably; and the breadth of products available to climate cautious investors has widened. "It's time to look beyond exclusion and into practicing a proactive, transformational approach to ESG," she adds.

According to Haugtomt, this view is also being reflected in the opinion of Norwegian pension funds. "Understanding the effect of climate change in the portfolio as well as the portfolio's effect on climate change is certainly on many pension funds' agendas. The exclusion-focused market we are seeing today won't prevail much longer."

The pandemic

But before asking pension funds to devote more time and energy to ESG, one needs to consider the topic in the context of recent market events. One could argue that the pandemic of 2020 may have justifiably pushed ESG down Nordic pension funds' agendas. Haugtomt argues otherwise: "While the pandemic hasn't pushed a specific agenda, it has highlighted the importance of 'the unknowns' or systemic risks that affect the portfolio but that fall outside the traditional view of pension fund risks. It is probably more straightforward to envision now how a risk such as climate change can impact markets, which means it's a good time to start discussing it with trustees," she stresses.

Fugmann agrees that the pandemic has not and should not push issues such as climate change out of the spotlight: "I think market participants see the pandemic as a transitory, exogenous shock to the economy that we will eventually come past – maybe even stronger than before through business models adapting quickly. However, climate change is only becoming a bigger problem the longer we kick the can down the road and so is the commercial opportunity in addressing it. What this year showed us was empirical evidence from numerous studies that investing in companies with strong environmental credentials tend to outperform those with poorer ones," he says.

So, while the argument may be there for doing more, the question for Nordic pension funds is: where do they start? "In my opinion, it is about starting to form a set of principles for what the objective is for ESG integration as well as climate change," says Fugmann. "Once you know what you want to achieve – which is often not as easy as it sounds and can lead to conflicting outcomes – then you are halfway to a successful implementation."

Finally, he adds, common sense perspective always should prevail, whilst keeping your objective in mind; and embracing the fact that ESG is not a black and white exercise. "Nuances and potential compromises may be needed in achieving your ultimate objective," he concludes. ■

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