INVESTMENT

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

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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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