pi ESG CLUB CONFERENCE

SUSTAINABLE GROWTH FOR A NEW ERA

ESG Club Conference 2024

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Governments change, but the problems they face remain the same. That was certainty the case in July when Sir Keir Starmer walked into Number 10.
Towards the top of his in-tray was the energy transition, an aging population and growing lifestyle-related illnesses, such as diabetes. Private capital has been encouraged to pick up the tab but it cannot do it alone – the political will is needed to make change happen.
Yet this year the citizens of more than 50 countries vote for their next government and ESG issues could become battle grounds. The EU is an example of where the pro-ESG leadership took a hit, so it will be interesting to see what happens to the green agenda.
On the following pages you can read a review of the four panel sessions we hosted to help investors prepare their portfolios for what could be difficult times ahead.

ESG CLUB CONFERENCE:
PROTECTING THE ECOSYSTEM

This year's conference opened with a discussion on an issue that has stepped out of climate change's shadow to become a major theme in sustainable investing in its own right.

Natural capital is the subject of more and more discussions among institutional investors. The importance of a vibrant ecosystem of plants, animals, water, microbes and soils cannot be underestimated as they are the lifeblood that helps keep our planet habitable.

Unfortunately, construction, overfishing and pollution mean that the air is becoming poisonous in some places while there is less freshwater to go around. If investors want to build a sustainable future, they need to help repair hundreds of years of damage to our life support system.

It is unsurprising, therefore, that the topic of natural capital, or biodiversity, opened this year's ESG Club Conference.

Sitting on our panel was Doug Clark, head of investment research at Brightwell – the primary service provider to the BT Pension Scheme. Clark announced that natural capital is a risk that Brightwell considers when managing its portfolios.

For this it uses a framework, which is based around four pillars: portfolio construction, investment managers, stewardship and advocacy.

It then has a series of actions to manage each pillar. For example, portfolio construction involves scenario analysis and stress testing the portfolio against natural capital risks.

"Natural capital is still at an embryonic stage relative to climate change," Clark said, pointing to data as an area that needs improving. "There is a lot of work we can do in terms of stewardship to push for improvements in that area."

Brightwell takes biodiversity loss seriously and for good reason: without successfully tackling nature risk, no matter how big the effort, there can be no net zero as carbon and biodiversity are intrinsically linked.

Fellow panellist Alex Godfrey, investment director of Octopus Investments, said: "Just focusing on net zero and carbon often leads to you not considering the other side of the issue, which is the biodiversity crisis that is going on around us."

Indeed, around $44trn (£34trn) of capital, or half of the world's GDP, is at risk due to its dependence on nature, Godfrey said.

"If you are a portfolio manager or a pension fund and you are not factoring in climate, biodiversity and water, it is a systemic risk to your portfolio," he added.

Danager stocks

The natural world is not safe from any industry as they all negatively impact it to a certain degree, said ShareAction's Alexandra Pinzon, who went on to say that energy and materials, such as plastics, are among the worst culprits, as are food and beverages.

"The production of food puts huge pressure on land," she said. "Half of the habitable land that we have on this planet is devoted to agriculture."

For example, agriculture drives more than 90% of tropical deforestation and less trees means fewer carbon sinks to help clear the gas from our atmosphere.

Agriculture also depletes our water supply with 70% of the water that is safe to drink is used to grow crops. Then there are fertilisers and pesticides, which pollute our air, water and soil, while overfishing is another driver of biodiversity loss.

Pinzon then fired a warning to make sure investors are not missing some of the risks. "It is critical to look at the value chain as a whole, as opposed to focusing on the direct risks associated with a specific industry," she said.

For example, when you source raw materials as part of the manufacturing process, also consider the plastics or chemicals used by the customer when they receive the product. "If you just focus on the direct impacts, you may be neglecting a significant part of the risk for biodiversity as part of that value chain," Pinzon added.

Leave no one behind

Unfortunately, when fighting climate change there are consequences for society. This has led to strategies to produce a "just transition" to stop communities from being abandoned if, for example, a local mine closes and there are scores of job losses. Is the same happening in biodiversity strategies?

Brightwell has three core themes: climate change, natural capital and inequality, which considers the social aspects of ESG. "We don't view those three themes individually, but as overlapping themes," Clark said.

"The critical thing is balancing the issues," he added. "There are clear cut cases where there can be social benefits alongside natural capital and climate benefits, but there are often trade-offs."

For Clark, successfully considering the social aspects of a biodiversity investment involves consistent data to "ensure we are looking at all of the factors and issues".

How to invest

So how do you build a portfolio that protects against nature capital loss or to even restore it?

BlackRock's Christopher Kaminker warns that it could pay to understand that some business models assume that natural resources, such as water, will be infinitely abundant and free. "That isn't going to be the case on a forward-looking basis," he said. "Historically that may been the case, but now they face depletion, policy change – bans on this, prices on that, subsidies for this, taxes on that – and technology change," he added, warning that some of these risks may not be priced into corporate valuations.

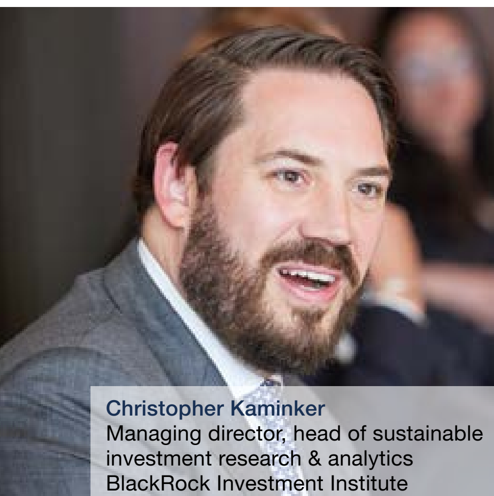
Kaminker looks for the business models that could benefit from technology and policy changing the input costs of, and the availability of, natural capital.

There is, for example, a net-nature restoration law in Europe that targets 20% of land being restored by 2030. "There are companies that are going to win those contracts, and they are impactful, important companies, but most of that is government expenditure, which doesn't have a rate of return on it.

Investors can gain exposure to companies and projects that are working to restore or protect the natural world through the green bond market. BlackRock has identified $330bn (£255bn) worth of such debt.

It has also identified well over 1,000 companies that have activities that protect nature, restore nature or take the pressure off nature. These mainly have business models that are circular, such as those making the water system more efficient or agriculture more precise. "It is about all repair, reuse, recycle and

Alexandra Pinzon
Head of biodiversity
ShareAction



Christopher Kaminker
Managing director, head of sustainable investment research & analytics
BlackRock Investment Institute

Douglas Clark
Head of investment research & solutions
Brightwell

Alex Godfrey
Investment director
Octopus Investments

reduce – all the Rs," he said. "These are valuable business models, and we are operating at scale in that space."
Finally, there is the bio-economy. BlackRock has identified hundreds of companies, mostly in private markets, that are making products from nature. "There is some amazing stuff here," Kaminker said.
One particular company BlackRock has invested in makes leather out of mushrooms. "Mycelium-based leather could be an exciting new biomaterial," he added.

Alternative products

Pinzon added that investors should not forget that stewardship and engagement are ways to improve the biodiversity performance of a portfolio.
"Companies are prioritising better agricultural practices, better water management and reducing pollution," she said.
"That is where I see the opportunity for stewardship as a tool to drive those investment opportunities within your portfolio. Start asking the companies in those key sectors to devote more of their capex to alternative products.
"So that is potentially sitting within your portfolio and you can combine it with options around new companies that are creating, for example, protein based on plants. That is a new market that is trying to find an upside," Pinzon said.

Tipping point

When questioned over how resilient Britain's pension schemes are against biodiversity risk, Godfrey's answer was bleak. "Not very well hedged at all," he warned.
"We are still trying to figure out how biodiversity, nature and climate are overlaid in our pension portfolios," Godfrey added.
"But it doesn't take much analysis to work out if half the world's GDP is directly linked to nature, and you are a pension fund listed across 85 of the world's companies, then you are probably going to be pretty exposed.
"Pension funds are inherently slow moving because they have such a big fiduciary responsibility. But we are on the tipping point, if not past it, where the cost of moving forward faster will be less than the cost of standing still."

Complex and limited

The issue of a lack of consistent data has been raised several times, which makes the task of managing biodiversity risk harder. So how are Brightwell managing the inconsistency?
"Be aware of the limitations of data," Clark said. "It is something that will improve over time."
He then reminded the audience about what happened with climate data, where "huge improvements" have been made over time, although he conceded that it is far from perfect and estimations are still being used in some areas.
"The issue with natural capital is that the data is even more complex," he added. "There is no single metric, like tons of CO_2.
"And water use is another issue. A gallon of water in the UK is different to a gallon of water in some emerging markets."
It is the same issue with deforestation. He cited the example of an acre of deforestation in the Amazon being different to an acre of deforestation in the UK in terms of the impact on biodiversity.
"Don't be too beholden to the data. It will improve, but it will be a journey," Clark said.

A whole new framework

Most frameworks that investors use in this space are principles-based or disclosure-based. BlackRock, however, has developed its own framework which is designed to search for alpha signals.
"It is true that the data space is incredibly challenged, but we found three alpha signals in the space," Kaminker said. "They have to do with water and waste."
Companies that are better at handling water stress are more efficient companies and outperform during times of water stress. "So we lean into those companies on behalf of clients," he added.
It was a similar story with waste. "Companies that are more efficient at closing the loop on waste, creating value from waste are better companies and have higher return on assets."

Leading the way

If there were any regulators in the room, Alexandra Pinzon had a message for them. Governments around the world are spending $1.7trn (£1.3trn) a year on subsiding nature-negative activities, she said.
Pinzon then asked for those funds to be re-directed toward nature-positive practices instead.
Godfrey agreed. "That is a massive swing that needs to happen," he said, before adding that the UK is quite forward thinking in this area.
"The UK government has done an amazing job of trying to push these nature markets," he added, speaking before the election. "We have removed subsidies from nature-negative farming, and the replacement is only for nature-positive food production in the UK. That shift is starting to happen, and that is why the UK is an interesting example of what happens when the government starts to slide their policies and subsidies towards nature and climate positive actions."
Natural capital is a complex but important issue. It is clear that we cannot build a sustainable world without a vibrant ecosystem of animals, plants, water and microbes. It is good to hear that investors are considering and taking action on the issue instead of focusing on climate change.

ESG CLUB CONFERENCE:
EXPLORING SUSTAINABLE ASSET-BACKED FINANCE

It costs trillions of dollars each year to achieve net zero, so the financial services industry has to be innovative in filling the huge funding gap. Is asset-backed finance the answer? If so, what do investors need to know?

The sustainable asset-backed finance session proved to be highly informative. When the audience was asked at the beginning of the session how familiar they were with sustainable asset-backed finance only a few hands went up. Asked the same question at the end, just over half the room gave a positive response.

Therefore, one can conclude that the speakers did an excellent job in breaking down the topic.

The place to begin with was defining what sustainable asset-backed finance is. Anand Rajagopal was given that task. "I have seen the market evolve over decades," he said. "Asset-backed finance, as the name suggests, is backed by assets. And they can be a variety of asset types.

"At the core of it, asset-backed finance is a way to boost corporate balance sheets and financial assets like inventory, as banks retreat from the market," Rajagopal said.

In addition, he added: "Hard assets increasingly have a role to play, from infrastructure to transportation to potentially aircrafts and others.

"And last but not least, auto-loans, consumer loans and student loans. That is asset-backed finance in the broadest sense."

It is important to add, Rajagopal said, that the market has historically performed much better compared to the corporate bond market. A good reason for any investor to get involved. "The reason for that is you have diversified assets [in asset-backed finance] that are standing behind these transactions. So there is no single point of failure."

On the sustainability element, Rajagopal, added: "Sustainable asset-backed finance are transactions that could be public or private, but aim to achieve certain sustainability objectives. These can be environmental, social or broader sustainability led."

Being left out

Taking this on, Malea Figgins said that it was important to note that securitisation as an asset class has been left out of the conversation on sustainability and decarbonisation.

"What this creates is a massive opportunity for sustainable securitised that the market is missing," she said. "We at TCW want to make sustainability and securitisation real as an investment opportunity. And there are ways to do that. Securitisation can offer diversification for a fixed income portfolio and do it in a sustainable way, without sacrificing credit quality, returns or liquidity," she said.

In addition, Figgins said securitisation naturally lends itself to sustainability because it is backed by physical assets. "We can look through the underlying collateral and look for the green, social and sustainable attributes within the securitisation," she said.

This, Figgins argued, is much more tangible than an unsecured green bond where the use of proceeds are going to general corporate purposes, and there is no follow up, or on-going engagement, on how those proceeds are being allocated.

"In securitised we get the data. That is important to note, as it can be used to build the sustainable argument and sustainable portfolio," she said.

Con Keating
Head of research
Brighton Rock Group

Anand Rajagopal
Shareholder assets and private markets sustainability lead
Phoenix Group

The growth argument

Con Keating explored the role of defined benefit (DB) schemes and where they sit within such investments. “DB schemes and pension funds generally in this country are being encouraged to invest in growth assets. This is government policy. The thing to understand about growth assets is you cannot have sustainability without growth. If there is no growth, then very little is sustainable,” he said.

So what assets should pension schemes be looking at? “The first thing to understand is that asset-backed finance, whether or not the loans, the transactions you are entering, serve their purpose,” Keating said. “In other words, a loan to a company, if that company is using it to invest, to increase their productivity is perfectly sustainable and consistent with a growth strategy.”

In addition, leasing, Keating said, is short term, but is attractive to closed pension funds. These though can be depreciating assets. But this can offer benefits. “The attraction to me is as a depreciation asset, as a way of income, to earn the depreciation and the rate of interest applicable for the maturity involved,” Keating said. In times of liquidity crunches these are the last assets you should consider selling, he added.

Big opportunities

Expanding on this a little more, Malea Figgins looked at the sustainable asset-backed finance market, and the opportunities within it. She started by citing that the securitised market is worth $13trn (£10trn), the second largest and most liquid market, just behind US treasuries. “Within that only about $300bn (£231bn) is labeled green, social or sustainable,” she said.

What this generates is an opportunity for the securitised market to be creative, Figgins said. “In the asset-backed security market we have the solar market, which has dominated more in the US. There have been whispers about Europe getting its first asset-backed security [solar] deal, which is encouraging,” she said.

Figgins then added other areas of opportunity. “We are also seeing energy efficient data centres with the first in the UK this year. In residential mortgage-backed securities we get affordability, data and social housing,” she said. “Commercial mortgage-backed securities are also a good example, which falls outside the labelled-bond market. Our commercial real estate properties come with a green building certification – which are 25% more energy efficient and with stronger credit fundamentals.”

Adding further, Rajagopal offered insight into the types of innovations we are seeing. “What is striking for me in the past two decades is how things have changed materially. It is a very different game that is played today,” he said.

In the beginning, it was typically public-backed asset securitisations, he said. “Since then, we have seen banks retreat from the space and in a post-global financial crisis environment leverage has come down, so private asset-backed finance is now $5trn to $10trn (£3.5trn-£7trn) of the around $20trn (£14trn) overall asset-backed finance market.”

Looking at the public and private sides, they have changed quite materially, with a focus on the latter, Rajagopal said. “Private opportunities are those that are negotiated on a bilateral basis. It is typically asset managers that are specialised. Some of the things mentioned like green buildings, are promising sustainable assets for the market.”

Effective risk and return

Importantly, Rajagopal explained that the structure of the deals, and the collateral cover, can be done in such a way as to suit certain risk-return outcomes and provide certainty of execution as well.

“Not all borrowers have access to public markets in the same way,” he added. “That is where private asset-backed finance has gone to a different level.”

Keating then pondered assets in this area that investors should

David Favier
Senior portfolio manager and analyst – structured finance
BNP Paribas Asset Management

Malea Figgins
Vice president, fixed income
TCW

be looking at to secure their investments. "It does depend on the type of investor you are talking about," he said. "I would make one important distinction: do I, or do I not, own it."

If investors do not, it can get "extremely messy" Keating added, when you have large pools being aggregated together. "I would personally advocate asset-backed finance as being assets which I own, and invest in," he said. "Assets which I can source the production, and the sustainability of that production. Then assets being used by others that I consider to be sustainable."

Bigger market

David Favier then questioned whether investors can play an important role in increasing the market's volume? "Simply, yes," he said. "We at BNP Paribas are engaging with co-ordinators to push them to be able to issue securitisation with more green assets."

He pointed to the public securitisation market in Europe, specifically looking at the numbers on the green bond side there is $400bn (£308bn) of assets that have been issued, $200bn (£154bn) in green loans, but in public European securitisation there is just a few.

"It is not enough. The main topic for every discussion is ESG and the size of asset they can issue," Favier said. "Things are changing. Securitisation is now embedded in the green bond framework, which is a good thing. But we need more. Some barriers do not help. We have to ask the regulators to ease the regulatory costs."

On the issue of regulation, Rajagopal looked at the issue of transparency. "This is where public versus private starts. Traditionally you have had high capital charges and there has almost been this cliff edge capital charge effect. More clarity is needed, and the reform process should get us there."

But he added: "The real test is how you monitor the [sustainable] investments over time. You need annual critical surveillance, accompanied by sustainable and ESG-linked surveillance. To grow the market further, more transparency can only help."

Employing engagement

Moving to an important issue in this regard, Figgins said: "Engagement is how we bring all this to life. It is how we make it real. We get access to better data."

She then added: "And for us, that means engaging across the entire ecosystem. That is public issuers, private issuers, regulatory bodies, data providers and trade associations."

Favier added that when it comes to the reporting of underlying assets, such as carbon footprints, more transparency is needed. "Reporting is my middle name," he joked. "We are in a world of reporting. On securitisation we have higher standards of reporting" he said.

"I say that because if you look at the broader markets you don't have this bunch of data if you are investing in carbon bonds," he said. That said, he added: "In Europe, we do have a step forward to take with more transparency."

In addition, Favier looked at the challenges of securitisation and the energy transition. "We have to look to the US as an example. When you look at the digital transition, the energy transition in Europe and the UK, we have seen data centres publicly financed. But when you look at the money in the coming years to reduce carbon emissions by 2050, it will be a tremendous amount of cash." So the market, by implication, has a key role to play.

Technology, like in many markets, has a part to play in this specific market. "I do think artificial intelligence (AI) can have an impact on the green energy transition because all of us on the stage have at some point talked about data," Figgins said. "And that is where AI comes in to play because we are talking about massive datasets [within asset-backed finance].

"So this is an area that AI can come in and be a real solution."

ESG CLUB CONFERENCE:
IT’S GOOD TO TALK

Stewardship is one of the biggest issues in ESG-led investing, but how are companies approaching such strategies to improve outcomes?

There is little point investing in a company with a perfect ESG profile. You are not changing the world. You are not reducing the level of carbon in the skies above our heads, improving access to fresh drinking water or reducing waste.

Only through investing in companies with poor environmental or social practices can you help the economy achieve some of the many global sustainable targets. And that is where stewardship and engagement come in. One of the most important aspects of an ESG-led strategy.

For this panel, Best Trustee’s president Alan Pickering kindly agreed to sit into the question master’s chair, for which we at *portfolio institutional* are grateful.

No silver bullet

A subject of much debate across the responsible investment industry is, what does good stewardship look like?

“There is no silver bullet to good stewardship,” said Vaishnavi Ravishankar at Brunel Pension Partnership.

However, there are some critical factors that she believes the industry needs to consider. First, there needs to be a clear change objective. “The purpose is not information gathering but to have a clear end goal,” Ravishankar said.

That goal needs to be consistent and long term as it takes time to build the relationships that ultimately lead to change. Finally, clear milestones need to track progress.

Ravishankar then reminded the audience that it is important to acknowledge that progress isn’t always linear and so investors may have to use the different levers available to them in different circumstances. She gave an example of how Brunel successfully encouraged a company to appoint a woman to its board despite previous attempts having ended without success.

“We voted against the chair of the nomination committee at Charter Communications for two years due to diversity concerns. But it didn’t result in movement within the company.

“Then we decided to up the ante by co-filing a shareholder resolution with a small group of investors, and that brought the company to the table.

“During the course of the engagement, the company decided to appoint a female director to the board, as well as committed to incorporate diversity within the succession planning.

“That is an example of a successful engagement where we have used different escalation mechanisms to drive change.”

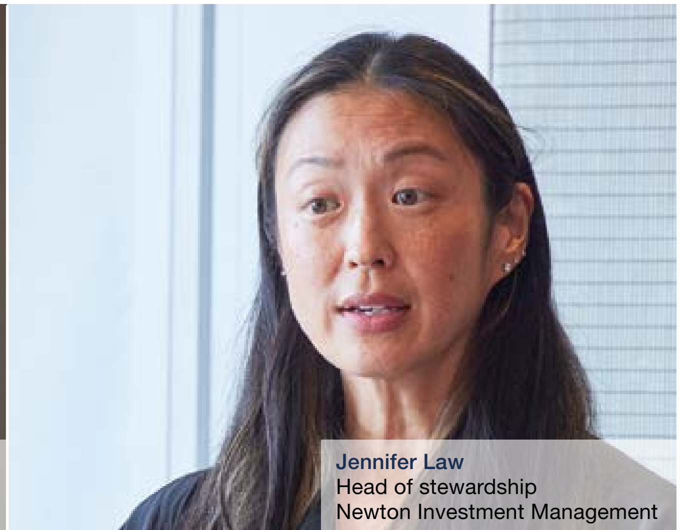
For Ravishankar, it is important to understand that success is not always guaranteed when it comes to stewardship.

“For any investor that has engaged with a technology company around tax transparency, you will know that you hit the wall pretty quickly when it comes to engagement progress,” she added. “So it is important to assess what are the other tools that you might want to think about – public policy, engagement or collaborative initiatives.”

Focused on outcomes

What stewardship means to Newton Investment Management is not a question that head of stewardship Jennifer Law is often asked. That could point to an assumption that all parties have the same objective and definition of such strategies.

Julia French
Responsible investment team manager
Local Pensions Partnership Investments


Jennifer Law
Head of stewardship
Newton Investment Management

Vaishnavi Ravishankar
Head of stewardship
Brunel Pension Partnership

Leanne Clements
Head of responsible investment
People's Partnership

"Stewardship is often presented as the way that we will precipitate change," Law said. "But then that comes to the question of what is stewardship for Newton? What is it that we are trying to achieve?

"Stewardship for us is the responsible allocation, management and oversight of our clients' capital," she added. "For us, it is outcomes focused and we use it to seek to reduce risk or potentially add value to an investment."

A typical approach is when they believe a risk or opportunity is material, Newton may suggest improvements to a company which could lead to better outcomes that can help the firm meet our clients' investment objectives.

Newton approaches these through three stewardship tools: engagement with issuers, voting at shareholder meetings and advocacy in the wider marketplace.

"Engagement for us is the most central. It is where we can have the most influence," Law said.

"We define engagement as being focused on outcomes. It is the purposeful dialog that we have with issuers to constructively challenge the management and the board on financially material risks."

Big issues

Heading the list of themes and priorities of LPPI Investments' engagement strategies is climate change. "That has been a theme running through our engagements for a long time, but it has a lot more traction, a lot more structure, a lot more focus on objectives from our net-zero targets," said Julia French, responsible investment manager at LPP Investments.

The target for the pool is to pursue greater in-depth awareness, management and reporting on climate change and set targets. "We want to see that within our listed equities, fixed income, real estate, infrastructure, and next year from private equity."

Diversity is another engagement target. The pool wants the companies in its portfolios to have greater female representation in the boardroom. And its efforts appear to be working.

"We have seen that gradually tick up across our entire portfolio," French said. "We had about 28% female representation on boards as an average, and that has moved over to 32%. So as a globally diversified portfolio, that is quite an improvement."

Being honest

ESG is more than just protecting the environment. There are

also social factors to consider. So if a stewardship strategy repurposes a company away from coal, for example, which leads to the closure of a mine. Is repurposing those who worked in the mine part of the engagement discussions?

When it comes to addressing community impacts, we are talking about trade-offs. "And we, as an industry, are not in a more honest place about the fact that there are trade-offs," said Leanne Clements, People's Partnership's head of responsible investment.

"I could have done a PhD analysis on the trade-offs of the energy transition and nature-positive economy.

"It is deeply complicated, and we have just started to understand what these mean and what guardrails we want to establish around that.

"This is all very nascent. So we need to just be honest that they exist in the first instance," she added.

Then to make an accurate assessment of the trade-offs, asset owners need to look at these risks as interconnected, not in silos, such as nature-related trade-offs, climate related trade-offs, etc. "If we don't have products and services that reflect the interconnectivity of these things and how they amplify each other that is going to reduce the accuracy on the trade-off piece which is important that we address that."

A unified voice

"Just like any other resource constrained asset owner, we need to be highly selective and targeted in our approach to stewardship," said Brunel's Ravishankar. "We have more than 3,000 companies in our listed portfolio, so it is not always possible to meaningfully engage with all of these companies."

The pool relies on its asset managers in the first instance to help here but collaboration is one way to optimally use its resources to drive the change.

As an example, Ravishankar discussed Brunel partnering with ShareAction and 19 other investors in co-filing a shareholder resolution at Barclays to get them to re-think their financing of oil and gas infrastructure. "Because of successful dialogs that followed, we were able to then withdraw the resolution.

"The company published an updated energy policy that addressed direct financing of new oil and gas infrastructure, which was a positive outcome," she said.

When investors come together to form a coalition, they are sharing not only votes at AGMs, but also research, knowledge and relationships with the target company.

The 'D' question

A lack of data is a common theme no matter what ESG topic you are discussing. So, is it a hinderance to effective stewardship and engagement? Or, as Alan Pickering put the question: is it an excuse for doing nothing?

Clements quickly dashed any thoughts that a lack of data should be seen as an excuse. "In fact, it should amplify your stewardship resource to try and address it at an industry level," she said.

For example, People's Partnership has an ESG maturity map within the priorities section of its responsible investment policy. "The more nascent an ESG issue is, the more stewardship resources we will allocate towards an industry and collaborative engagement. Human rights would be an excellent example of this," she said.

Clements added that the Department for Work and Pensions (DWP) has also recognised in their social taskforce that data is an issue, but that is not an excuse to do nothing. "As a result of that we are involved in an investor coalition to drive better industry standards around human rights data," she added.

This includes liaising with ratings and analytics agencies.

"We have a responsibility to conduct industry and collaborative engagement around these issues," Clements said. "We are not passive actors here. It is the same with policy engagement. We need to be actively contributing to that debate. Same goes for data quality and robustness issues."

Stewardship is not limited to the in-house stewardship and engagement team. An asset owner employs external experts to help achieve its investment aims, so how do, for example, asset managers interact with the stewardship team.

"We definitely consider our asset managers to be our first line of defense when it comes to stewardship," Ravishankar said. "They select our stocks, so we rely on them to manage all portfolio-related risks, including ESG.

"That means we expect them to have the data, the analytics, to support a rigorous ESG analysis, but also demonstrate alignment with, say, our climate framework."

Brunel tries to work with its asset managers in the "spirit of partnership, but that is not to say we don't challenge our managers". Ravishankar points to a project last year looking at asset owner/asset manager alignment expectations. "Following the proxy season, it became quite clear that there were gaps in terms of asset owner expectations of climate stewardship and how it was happening in practice."

A misalignment between asset owner and asset manager is an experience shared by Clements. "Realistically, it is possible that you may not get perfect alignment," she said. "So what do you do with that? You identify how big that gap is and how much you are willing to live with it over an extended timeframe.

"If you find that you can live with it, then you move forward. If you feel it you cannot live with it, and you have reached an impasse, then you have various escalation strategies at your disposal," she added. "You can either reduce the assets with the manager, you can look to an overlay to mitigate against it, or you can fire the manager."

ESG CLUB CONFERENCE: HEALTHY ECONOMICS

The final discussion of this year's conference looked at the importance of innovation in healthcare and where it is most needed.

There is more to improving people's health and their quality of life than producing a little bottle of pills. And the panel we put in front of the audience reflected that.

Investment experts in drug development, societal impact and real estate took the stage to explain why innovation is needed in healthcare and how private capital can drive it.

"We have come a long way with health innovations in terms of making an impact on society, but we need more," said Flora Liu, a portfolio manager for Pictet Asset Management's health and biotech strategies.

From the accidental discovery of penicillin to the global concerted effort of Covid vaccines, the world has come a long way in terms of decreasing the prevalence of infectious diseases. "But chronic diseases are unfortunately on the rise," she added.

Today, seven out of 10 deaths globally are caused by chronic diseases like heart disease, diabetes or obesity. And then there is cancer, a condition in need of treatments that don't kill healthy cells. "We need more innovation in these areas," Liu said.

But as science has largely reduced the rates of infectious diseases, another condition has ascended from the resulting aging populations. Liu points to there being 55 million suffers of Alzheimer's and that there are no therapies addressing the condition. Donanemab has been approved in the US, but "it doesn't slow the progression of the disease enough".

"We need more innovations from biotech or pharma companies in this area before [the number of] Alzheimer's patients more than doubles by 2050," she said.

But this is not just about discovering a cure. "More innovation is needed at preventing the disease," she said. "That means better diagnostics and better screenings are urgently needed. With technologies such as liquid biopsies we are already on the right track to achieve that."

And it appears that interest from the stewards of private capital already exists.

Mark Hall is senior programme manager specialising in place-based impact investing at the Impact Investing Institute, an organisation working to connect private capital to specific challenges, one of which is creating positive health outcomes.

He told the audience that he is seeing more private equity and venture capital interest in areas such as healthcare technology. North Edge Capital is an example of such a firm in that it backs, for example, AI-driven diagnostics.

Hall is seeing a range of innovative investment models, such as social impact bonds, impact funds and blended finance, that are making health more accessible to institutional investors who have not always been able to generate commercial returns from the industry.

Another area of healthcare that could be fertile ground for institutional investors is real estate. Hall said that care homes and supported living are attracting good inflation-linked returns while delivering positive outcomes.

Michael Toft knows all about healthcare real estate. He heads up Octopus Investments' strategy that invests in elderly care and specialist residential facilities in the UK, boasting around 700,000 beds in its portfolio.

Octopus uses institutional capital to address the supply-demand imbalance for higher-quality care homes. This can be blamed on competition for the limited land available and planning delays in the face of an aging population, Alzheimer's and bed blocking in the NHS.

Toft said that "the stark fact is" 70% of care homes in the UK are over 20 years old while 40% are over 30 years old. "So the physical quality of the real estate is restricting the provision of care.

"We are trying to introduce private capital into the sector to develop new care homes that are fit for the future and have the right foundations for the operators to provide that care.

"So institutional capital is an exciting point that we can provide a strong risk-adjusted return while solving one of society's biggest challenges," Toft said.

Flora Liu
Client portfolio manager
Pictet Asset Management

Mark Hall
Senior programme manager, place-based impact investing
Impact Investing Institute

Hidden risks

Completing our panel was Scott Anderson, an investment manager at the Environment Agency Pension Fund. The big question was, when investing in healthcare does Anderson and his team have to consider the environmental impacts of the sector, given who the scheme is sponsored by.

"We have a holistic approach to ESG," he said. "We need to tick off every box – the E, the S and the G – in terms of the investments we are making."

Just ticking the S box is not good enough. It is expected given the industry we are discussing, but healthcare's supply chain carries huge biodiversity risk, which can get hidden under its social benefits.

"It is true that when you look at the overall ESG score, [healthcare companies] come out with a nice positive net impact score," Anderson said. "It is healthcare at the end of the day, and you hope it would do that.

"But when you look at the underlying breakdown, the environmental piece of it can be negative," he added.

Anderson wants investment managers to be aware of healthcare's risks to nature, to monitor them and report on them. "It is often the case we don't get any data on that at all.

"So the engagement piece is important to drive that improvement there," he added. "And that is something we are doing. In terms of new manager selection, we are being much more upfront about that."

Close to home

Shifting back to more general matters, taking a place-based approach could be the answer to creating higher standards of overall health and wellbeing, Hall said.

The social determinants of health and life expectancy include education and where you live. "The built environment is important for that from a place-based lens."

Legal & General have teamed up with the Institute for Health Equity to develop a £3m grant fund to address those issues locally.

"But to scale that to address the level of the challenge of health inequality is going to need higher levels of institutional investment," Hall said, adding that this means urban regeneration that delivers green spaces, walkable routes, green transport and integrated health centres within communities.

Indeed, the Impact Investing Institute is working in partnership with Southampton City Council to bring asset managers, developers and community stakeholders together to develop a regeneration project for a small high street that responds to those challenges.

Informed, not driven

The Environment Agency Pension Scheme aims to invest in unmet medical needs and to improve the quality of, and access to, healthcare.

To prove that this is happening managers have to agree to provide impact data on the assets in the portfolio. The problem is that this has tended to focus on the breadth of impact, so the

Scott Anderson
Investment manager
Environment Agency Pension Fund

Michael Toft
Head of care homes
Octopus Investments

number of patients served. “It is a good metric because you can see that our investment has touched this many patients,” Anderson said.

“But our ambition is to get to the point where we can look at depth of impact – how have we benefited the patients.”

He conceded that getting hold of that data is not easy, although he is seeing some private market managers reporting on how, for example, a particular drug or technology has changed someone’s life.

“If you create an innovation that helps 100 neonatal patients enjoy a healthier life, that sounds a lot more impactful than making a new formulation of paracetamol that is given to 1,000 patients with a short-term mild headache.”

Artificial support

Artificial intelligence (AI) is having more and more influence over our daily lives, from organising our next holiday to deciding what marketing messages we see. So could these algorithms help improve the success of medical research? It appears that drug developers are using such tools, but, according to Liu, for healthcare as a whole, it is still in its nascency.

“I do believe that AI has huge potential to make a huge impact to healthcare systems.”

Indeed, it can take up to 15 years to get a drug to market and could cost a developer billions of dollars despite facing a success rate of less than 10%. For Liu, AI has the potential to screen and optmise compounds to speed up the development cycle and improve the success rate. It could also improve the outcome of clinical trials by more efficiently analysing patient data.

Another benefit of AI is that it can read images, which makes it ideal to help radiologists to improve the detection of cancer and other diseases through reading pixels on a screen.

“AI is in its nascency but has huge potential to make an impact,” Liu added.

“We are already seeing companies looking at it across of prevention, treatment and access.”

All in the mind

Since Covid, mental health has been allocated more of the news agenda, so it was not a surprise when the issue was raised during our discussion.

“The Covid pandemic highlighted the need for more investment in solutions to support mental health outcomes,” Hall said.

“There is a range of platform apps, in terms of private equity and debt investments, on the mental health side that can be scaled to increase the reach of mental health services.”

Hall then highlighted that mental health impact bonds are another place-based route to help fund reducing anxiety or depression in society.

Future fit

To close our discussion on healthcare, Liu tackled what the future of the industry could look like. She started by sharing what she called a “mini prediction” based on the trends Pictet’s managers are observing: therapeutics will be more precise, she announced, more personalised.

For example, there will be a better alternative to chemotherapy, which harms cells, whether they are healthy or bad.

She also predicted that technology would play a greater role in medical testing and procedures with robots carrying out surgery, which will be designed to be more minimally invasive.

There will also be a greater focus on prevention, and machine learning will be used in healthcare throughout the value chain.

“I am excited about what the future of healthcare might bring in terms of the potential to invest behind innovative health solutions that make a real difference to patients and societies as a whole.

“So I’m super excited and it deserves a good spot in every institutional investors’ portfolio,” she added.