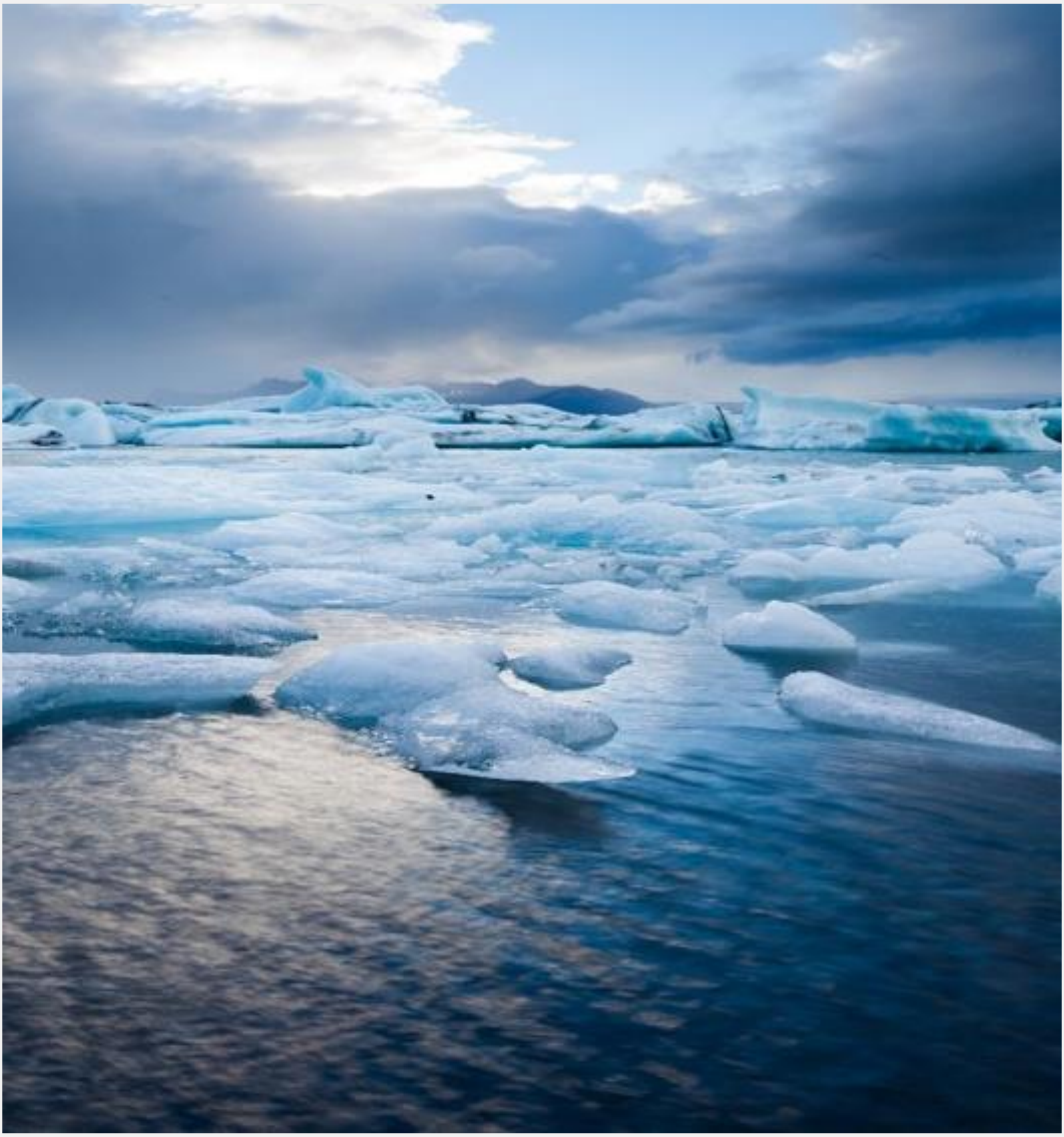
Thinking Ahead Institute

Threat and opportunity: where next for sustainable investment?

Summary of sustainability summit held on 5 November 2019



There are a number of big sustainability issues facing society – climate change, water scarcity, inequality to name a few. The investment industry currently manages around $100 trillion of capital, carrying a massive burden for the wealth and well-being of billions of people. But can the industry contribute positively to big societal issues without compromising on their financial responsibilities? In short, can they 'do good while also doing well'? The Thinking Ahead Institute's sustainability summit brought leading academics and asset owners and asset managers together to ignite fresh thinking and action in the face of an increasingly worrying body of scientific evidence.

While the sustainable investment train, for a long time very slow-moving, has been gathering pace in recent years, it has arguably reached a set of points. Down one track are by-stander approaches that report on their portfolios relative to certain sustainability criteria. By largely positioning investors as observers of global and environmental trends they effectively support a continuation of business-as-usual. Down the other track are approaches where asset owners and asset managers are more active participants in shaping the societal issues through providing various funding solutions, particularly with respect to the low carbon transition.

A challenge for the industry, and individual players within it, is to determine where on that spectrum they and their end investors want to be in the longer term, and what actions that positioning requires. And, even more importantly, what's needed to support those actions.

You save more water by not eating 450g of beef than not showering for 60 days

Tapping in to the mood

Tim Hodgson, Head of the Thinking Ahead Group at Willis Towers Watson, kicked off the summit by asking delegates what they individually consider the most important thing to happen right now in respect of sustainability. Delegates responded with impressive creativity and versatility in their ideas.

Mindset	Getting woke / awareness
Mindset	Counter social media influence
Mindset	Education
Mindset	Younger and more diverse voices in the conversation
Mindset	Financial services people get woke to their role
Mindset	Joined-up thinking by asset owners
Mindset	Re-wire brains
Mindset	Climate and inequality and biodiversity to be considered together
Mindset	Collaboration

Values and ethics	Collective responsibility in industry for all
Values and ethics	Activation of compassion and interdependence
Values and ethics	Individuals understand and responsible for actions
Values and ethics	Global empathy
Values and ethics	Reduce selfishness
Values and ethics	Reduce pointless stuff (consumption)
Timing	Seize the moment
Timing	Do something tomorrow as result of today
Timing	Agree actions today for TAI / members

Measurement	Measurement of impact
	More transparency
	Find signals in noise
	Improved ESG data / analytics
Investment	Increased investment in tech
	Responsible use of capital
	Better responsible investment
	Sustainability on every agenda, always
	Focus on solutions
	Lower cost of capital for those properly pricing climate
	Alignment of interests
Force	Stronger leadership and bold decisions
	More radical; and back solution providers

Stewardship	Better stewardship
	AO's and AM's unite to engage companies
	Decisive collective engagement
	Guidance to board, chairs and nominated committees to question – better people on boards
Politics	Fix fiduciary duty
	$100/ton carbon price
	Green new deal
	De-carbonise energy
	Focus on worst country carbon emitters
	Better political leadership
	Get USA to commit to Paris
	Fight populism
	Secure the right USA election result
	Brexit behind us
	Catalonia independence

Where are we with sustainability beliefs?

What do these responses tell us? Well, they are indicative of the beliefs and value systems of the individual delegates. And as Roger Urwin, Global Head of Investment Content at Willis Towers Watson, noted in his talk, it is values and beliefs systems that drive investment preferences, including those related to sustainability. While sustainability issues challenge traditional investment beliefs and practices in a number of ways, he said, the single shift for the industry to make is to see success not in maximising risk-adjusted financial return terms but as a balance of financial and extra-financial outcomes in which effective governance, culture and stewardship are amplified.

To that end, his experience is that rewiring values and investment objectives along these lines provokes diverse reactions among asset owner boards. That's partly because the phase of critical thinking about sustainability beliefs and of enacting them is largely unexplored and a potential competitive opportunity. He suggested that at present boards beliefs about climate change are more emotional ('this can't be happening') than dispassionate ('the scientific evidence suggests this is happening').

As an indicator of where investors' heads are at with sustainability issues, Roger summarised the research that the Thinking Ahead Institute has been conducting to assess the consistency of concepts used in defining sustainability beliefs and to benchmark these. To date, this has registered 550 responses from 45 organisations.

This has found, for example, that the most commonly agreed statement among a roster of 36 questions – by 86% of respondents – is: "sustainability in investing is broader than considering ESG factors, and includes sustainability of the economic and financial system." This is a statement that the TAI team think is completely true.

The statement with the least support – from just 9% of respondents – is phrased in the negative: "asset owners should steer clear of non-financial considerations on the basis that financial factors should represent the only consideration”. Implying strong support for wider than finance-only considerations. Here the TAI team is completely agreeing with this too.

And specifically on climate change, 69% of respondents have said that the market doesn’t accurately price ESG externalities, while 77% have agreed that companies can gain significant competitive advantage through their strategic response to climate change and resource scarcity/degradation. These are convictions that the TAI team again believes to be true.

The overall responses in the survey have been framed using six vectors to gauge conviction, motivation and coherence (see figure below). The main conclusion is that fundamental beliefs about the value, both financial and societal, of investor mobilisation in addressing sustainability matters are reasonably strong (but not unanimous). The matter requiring some critical thinking is what to do about this level of conviction.

Conviction	▪Belief in **materiality** of sustainability factors in investment outcomes ▪Belief in market **mispricing** of sustainability factors
Motivation	▪Belief in a **financial motive** for integrating sustainability into investing ▪Belief in **extra-financial motive** (eg investing for a better future) for sustainable investing
Coherence	▪The degree to which an individual’s responses are internally **consistent** ▪The extent to which there is **uniformity** among the beliefs of individuals in the group

While a strong set of collectively held investment beliefs are indeed a foundation for a sustainable approach, they are not the sole consideration, noted Urwin. Fundamentally asset owners have to work from their values into a practicable mission. Then a benchmarking and a sustainability framework that outlines policies and an investment roadmap are all essential elements in translating beliefs in to mandates and practices.

The combination of elements means that most asset owners and asset managers are in a middle ground between a mission that is solely focused on financial goals and one that explicitly includes non-financial considerations. Barriers to overcome to progress towards the latter will include governance and data availability, but most of all in his opinion, there is rethinking fiduciary duty.

Urwin observed that asset owners and asset managers operate in a narrower field of accepted practice in their fiduciary standards than corporations. Asset owners are emphatically biased in favour of financial outcomes and shorter-term factors.

The case for a new fiduciary standard for asset owners is that:

- Funds are operating in very cautious finance-first terms in current fiduciary duty and wider stakeholder interests like the state of the climate are not appropriately safeguarded
- Funds could commit much more investments aligned to the low carbon energy transition if they were offered some 'safe harbour' protections that allowed dual objectives (financial and extra-financial) which would result in funds doing more for societal well-being
- A 'sweet spot' from strategies that produce financial outcomes giving up some near-term return but delivering better long-term returns is much more likely to come from a safe harbour configuration.

Climate change – tipping points are lurking

From the sustainability beliefs with which investors are grappling, the summit moved to the underlying problems that more sustainable investment approaches and thinking might need to help address.

Professor Tim Lenton, Director of the Global Systems Institute and Chair in Climate Change and Earth System Science at the University of Exeter, outlined the scale of the climate emergency by firstly presenting projections of carbon dioxide and temperature rise and, arising from those, evidence of vulnerability to a number of potential relatively near-term climate tipping points, where a small change beyond a certain point could irreparably destabilise systems and economies.

Among these are the instability of the West Antarctic Ice Sheet, which studies show is retreating at a particularly alarming rate, the dieback of the Amazon, and the melt of the Greenland Ice Sheet which, in turn, affects circulation in the north Atlantic. Moreover, several of the identified tipping points are potentially coupled. Successive Intergovernmental Panel on Climate Change (IPCC) reports between 2001 and 2019 have shown an increasing likelihood of one or more climate tipping points occurring at lower levels of global temperature rise. The significance of this is that the global target of stabilising temperature at 1.5ºC to 2ºC above pre-industrial levels looks wildly optimistic (it currently stands at around +1.1ºC).

> The disappearance of the West Antarctic ice sheet would add three to four metres to global sea levels; the losses of the Wilkes Basin in East Antarctica and the Greenland ice sheet a further 10 to 11 metres

Looking beyond pure global system effects, one of Tim's particular areas of interest is the impact of climate change on societies. In some research with co-authors that has not yet been published they have identified a climate and precipitation niche in which the majority of people live, and have lived for thousands of years, and where economic activity is concentrated. Climate change will push an increasing number of people out of that niche as average temperatures rise. In the case of a 3ºC global temperature rise (equivalent to 6ºC to 7ºC on land, because land heats up quicker than water), around three billion people would face intolerable living conditions. In other words, we are facing large scale social disruption, particularly in migration, and, presumably, economic disruption.

When it comes to assessing measures to mitigate the effects of climate change, Tim noted that traditional economic cost/benefit analyses aren't helpful. For example, some cost/benefit analysis has claimed that effective mitigation could take place at around 3ºC of warming, while the scientific evidence points to serious planetary consequences at that level. Adding a tipping point module to the standard economic model suggests we should be willing to pay much more now to avoid the risk of tipping the climate. We should be much more risk averse as a precautionary principle to these uncertainties recognising that most scientific projections have so far been unduly optimistic.

Tim noted that his views and scientific beliefs on climate change may be shared by the vast majority of scientists, they were not shared by most people or even most politicians. He saw this as an inherent challenge to addressing climate change as a problem. He suggested more should be done to understand why people are so reluctant to apply rational thinking to this area. It would need a behaviourally-informed approach to counter-balance these factors.

He noted the importance of game theory considerations where too many important participants in the system are minded to apply a strategy that relies on others. This is expressed often as 'how can we do anything meaningful when China is not playing its part'. Clearly this thinking is counter-productive, and we need to find better political constructs to do better.

But to finish on a positive note, he said that it would only take a fraction of the $100 trillion in investors' hands, suitably applied to what he frames as more than a climate emergency and more like an existential crisis, to make a real difference to the tipping points we're facing.

There is no Planet B

Climate change is also a focus of Mike Berners-Lee's much acclaimed latest book, *There is no Planet B: A Handbook for the Make or Break Years*. But it is not the only one. Mike, who is a professor at Lancaster University and has founded a consultancy to help organisations visualise a more sustainable future, covered topics ranging from population, food and energy to antibiotics, travel and the world of work.

He places his ideas and the need for action in the context that we are now living in the Anthropocene era. What that means in layman terms is that the balance of power on Earth has shifted. Until relatively recently, he said, the restorative powers of the planet were sufficient to rebound from what humans threw at it. We would have had to do something pretty stupid, like start a nuclear war, to destroy it. Now, we don't have to do anything stupid to destroy it. We can just carry on as we are, running economies, investing, generating and using energy and allocating resources in the same way (and as result 'smashing' the place up). Or we can come up with some alternative policies and practices that are Anthropocene-fit.

His view is optimistic, in that the solutions are technically possible, but that we have to approach the problem differently, and quickly. Essentially, he said, that's because the sum total of everything we've done so far to address global sustainability challenges is precisely nil. We continue to release greenhouse gases into the atmosphere at an increasing rate. Given our knowledge of climate change our rate of emissions should have levelled out and then started to fall by now.

> An area 228 miles square, or 0.1% of the world's land mass, covered in solar panels would be sufficient to generate all the world's current energy requirements

He urged delegates to contemplate three values that, in his estimation, we can't live without in the Anthropocene era:

- All people are of equal inherent value
- Show respect for the world in all its forms (human, animal or mineral)
- Respect truth, for its own sake.

He demonstrated how to incorporate those values in solving the technical challenges. This includes the premise that not all growth is bad, but that it will need to have a different flavour. For example, GDP can conceivably still go up while carbon dioxide emissions go down, even if he thinks more rounded economic metrics are preferable to GDP as a success measure. Also, he noted, sustainability involves growth aspirations in other areas, such as biodiversity and empathy. Furthermore, the idea that "we're all in one boat now", he believes, needs to be reflected in politics, approaches to addressing inequality, and in companies pursuing purpose rather than focusing solely on profit.

But when it's all so global and systemic, he acknowledged that it inevitably raises the question of what can individuals and individual organisations do? Aside from adapting values and thinking skills to the realities of the Anthropocene, he advocates a number of key principles, including: imagining a better world on the basis that there's an opportunity for a higher quality of life, not worse; acting as behaviour roles models; working out areas of influence; and getting forceful.

He also raised the need for critical thinking that is fit for the Anthopecene-era. He highlighted in particular big picture understanding, global empathy, self-reflection and joined-up thinking (also referred to as T-shaped thinking incorporating deeper narrow-system knowledge with ability to connect dots in the wider system).

Like Roger Urwin, a key area where he believes the investment industry can make a difference is to change the way fiduciary duty is interpreted; change needs to take place to shift the balance to care about more than financial factors alone in his view.

Other measures he believes will have an effect include making investment as transparent as supply chains and better quantification of non-financial targets to help redefine value creation boundaries. But perhaps most of all, there has to be recognition and buy-in to the simple truth that investment will involve a trade-off between better sustainability and financial returns.

'How do we get going?', he asked. His answer: do the small stuff to remind ourselves we really care about the big stuff. The scale of the challenge may feel impossible, but small changes bring us closer to a positive tipping point.

The implications for portfolio management

That clarion call brought discussion back to the whole point of the summit – greater clarity about the investment industry's responsibility for, and role in, promoting sustainability.

An initial panel discussion, explored how the topics covered during the day could, or should, be addressed in portfolio construction.

Selected issues probed by panel leader, Marisa Hall of the Thinking Ahead Institute, and a selection of paraphrased responses are summarised in the table below.

The panel participants were Catherine Flockhart (Baillie Gifford), Russell Picot (HSBC Pension Scheme) and Aled Smith (J.O. Hambro).

How organisations interpret fiduciary duty	We have a conservative industry that finds it easier to do less on sustainability than do more due to fiduciary constraints. However, ESG-factors are increasingly viewed as critical to the long-term health of investment portfolios.
Approaches to stewardship and governance	Active engagement with trustee boards helps us to determine the value proposition. Focus groups help us get a sense of what members think, but we are responsible for taking decisions in their best interest. We don't and won't invest by referendum! Investment is becoming an extraction industry with its focus on dividends. Delivering sustainable positive returns to investors goes hand-in-hand with long-term value creation. Transparency about what funds can and can't do to map investment strategy to SDGs can be a real differentiator. What's left for active investment industry after machines have taken over rules-based investing? It's transparency and trust; it's a rebirth of forward-looking equity research.
Potential progress towards agreement on ESG data and a common ESG framework	Don't think we're going to get to a common standard on non-financial metrics within 10 years. Needs a coordination function … we haven't got to that point yet. We're dealing with questions that can't be solved by the private sector alone. For example, the carbon price is an externality that's not included in the framework of metrics. We need to also lobby governments and influence public policy.
How accurately markets price long-term ESG risk	From 2014 the best ESG rated stocks have demonstrated better performance. There is something going on. When you get pricing uncertainty, you get volatility as occurred with the move of retail online – which was the big thing not so long ago. That's where we are with ESG, in the volatility phase.
General perception has been that investors leave their values at the door. Accurate? Fair?	Not sure that's the case. I think it's been demonstrated in returns that it's a good thing to bring values to the workplace. The values expected of workers in current best practice is to bring your values to work.

	We have talked a long time about our values, but right now it really is still a problem across the industry at senior level. Too many values are self-centred and not inclusive. People (pension funds, private investors) will see through more and more what's important and what isn't in an investment mission.
Barriers to action	Recent Climate Risk Foundation report sums them up well. But the single most important thing I think is needed is alignment of public policy with a 1.5ºC warming target. For some this is a 2ºC warming target. Eliminate consideration of 'alpha' – this is not a holistic target metric. Make every metric EPI (Environmental Performance Index)-related. We'll get the future we invest in, so we have to provide capital to the businesses that deliver real change. The regulatory and governance environment clearly matter so we have to make governance and fiduciary duty more consistent with the realities facing us in the Anthropocene era.

On current projections, China's investment in renewable energy (principally solar) will mean it makes economic sense to shut down active fossil fuel generation capacity by about 2030

An action blueprint

The overwhelming sense, corroborated by the panel discussion and general feedback coming from the summit, is that the attendees get it – if not the whole investment industry quite yet. They understand the planet has problems (a +4ºC economy when it needs a +1.5ºC one, and there is no Planet B), the role the investment industry can potentially play, the barriers to overcome, that the benefits of doing something can be both financial and non-financial, and that the time for meaningful action is now.

Tim Hodgson's concluding session solicited ideas from attendees for tangible takeaways for further action by all, and for research and analysis by the Thinking Ahead Institute in conjunction with its members that will help crystallise wider views and policy.

	Action idea (closing session)	Individual	Organisation	Macro
Measurement	Integrated reporting	Lobby own organisation	Commit and act	Lobby / work with reporting bodies / regulators
	Transparency on supply chain carbon footprint			
	Agree better reporting – long termism			
	Agree better reporting – impact			
	Agree better reporting – how to standardise?			
	Disclose ºC rating of portfolio			
	New success measures (multi-stakeholders) for company management			
	Fix our own firms – carbon footprint			

	Action idea (closing session)	Individual	Organisation	Macro
Mindset	Cultivate "8 thinking skills"	Practice thinking skills; engage colleagues	Provide training	TAI actions
	Training (get colleagues up to speed with size / urgency of task)			
	TAI to influence consolidating pools			
	Open source research agenda			
	Keep / strengthen links with academics			
Values and ethics	Cultivate "3 values"	Practice values	Leadership to initiate changes	
	Increase diversity of hires			
	Be prepared to compromise			
	Transparency / trust / transition			
Stewardship	Fix our own firms – purpose	Lobby own organisation	Clarify purpose; measure culture; allocate greater resources to stewardship	TAI to lead on 'how to' guide
	Fix our own firms – culture			
	Vote against management			
	Change board members			
	Change remuneration committees			
	Join Climate Action 100+			
	"How to" guide to be a steward – with 'questions to ask' kit			
	Write to trustees of our own pension funds	✓	-	-
Investment	Invest in new technologies		Implement relevant actions	Meet with / lobby regulators and politicians
	Ways to encourage private investment			
	Mitigate transition risks – how?			
	Asset managers to price in $100/ton carbon			
	Change mandates – stewardship			
	Change mandates – 3-D world (risk, return, impact)			
	Change mandates – exclusions / CPI benchmark			
	How could we disintermediate our own industry?			
	What is the investment "reward card"?			
Politics	Fix fiduciary duty (gets a double weight)			Meet with / lobby regulators and politicians
	$100/ton carbon price			
	Other natural resources priced			
	Mitigate transition risks – how?			
Other	Bring more stakeholders into conversation			
	Don't duck individual responsibility to act			

Limitations of reliance

Limitations of reliance – Thinking Ahead Group 2.0

This document has been written by members of the Thinking Ahead Group 2.0. Their role is to identify and develop new investment thinking and opportunities not naturally covered under mainstream research. They seek to encourage new ways of seeing the investment environment in ways that add value to our clients.
The contents of individual documents are therefore more likely to be the opinions of the respective authors rather than representing the formal view of the firm.

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About the Thinking Ahead Institute

The Thinking Ahead Institute seeks collaboration and change in the investment industry for the benefit of savers. It was established in January 2015 by Tim Hodgson and Roger Urwin, who have dedicated large parts of their careers to advocating and implementing positive investment industry change. It is a global not-for-profit research and innovation group made up of engaged institutional asset owners, asset managers and service providers committed to changing and improving the investment industry. Currently it has over 40 members around the world and is an outgrowth of Willis Towers Watson Investments' Thinking Ahead Group, which was established in 2002.

The Institute aims to:

- Build on the value and power of thought leadership to create positive change in the investment industry
- Find and connect people from all corners of the investment world and harnesses their ideas
- Work to bring those ideas to life for the benefit of the end saver.

It does this by identifying tomorrow's problems and investment solutions through:

- A dynamic and collaborative research agenda that encourages strong member participation through dedicated working groups
- A global programme of events including seminars and key topic meetings, webinars and social events
- One-to-one meetings between Institute member organisations and senior representatives of the Thinking Ahead Group.

These solutions fall into three overlapping areas:

- Better investment strategies
- Better organisational effectiveness
- Enhanced societal legitimacy.

The Institute has a governance board comprising both Institute members and Thinking Ahead Group representatives. For all membership enquiries please contact:

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