Asset owner conversations

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Topic: Rightsizing investment ambition

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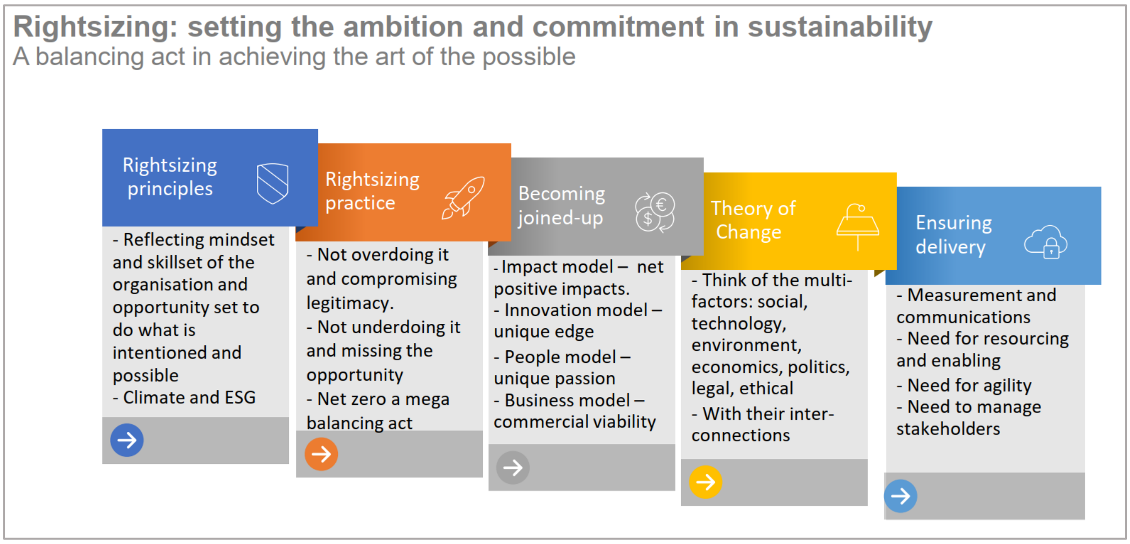
Rightsizing: setting the ambition and commitment in sustainability
By Roger Urwin, co-founder of TAI



- The rise of sustainable investing has four big themes: climate, politicisation, systemic risk and complexity
- Climate has become a big piece in the risk, return and real-world impact puzzle
- Systemic risk needs to be thought about more deeply and integrated into portfolios
- Complexity of all these issues together is becoming too difficult to deal with and requires a strategy
- The concept of rightsizing means trying to set ambition and commitment correctly sized and shaped for the unique circumstance of every fund and to make these unique circumstances count with respect to the mindset, mission, skill set, competitive edge and opportunity

- Often organisations are over enthusiastic with respect to sustainability, but are not exploiting the opportunity enough. Positioning yourself somewhere in the middle is extremely important.
- This is a difficult area to be joined up on – the number of dimensions and challenges makes it hard to have a coherent proposition running through the theme, especially for asset owners
- Having a *theory of change* is necessary for allowing certain interventions to take place, depending on circumstances and making sure that we consider all these multiple factors which would increase interconnectedness
- As with any change, vision process and a coalition of leaders are required to ensure the delivery of change. It is also a lot about improvement of measurement. In addition to the quantitative metrics, new measures have to be introduced such as a RAG analysis. This introduces a degree of subjectivity, but it matters, because it is descriptive of qualitative things that are really important alongside the ultimate outcome. So multiple goals and a combination of quantitative and qualitative data probably requires a balanced scorecard type of model of measurement
- Larger asset owners have significant internal resources, but they still have a massive external reliance on asset managers. Asset manager IP is underutilised in the current structure. Instead of asset managers being very product based and benchmark sensitive, they could do more of other things, be more engaged and be part of a bigger relationship. This direction would lead you to fewer, but deeper relationships and more rewarding overall.
- Politicisation is becoming significant. It has a local and a global geopolitical element to it. The investment industry has been a taker on politics, but it can be a maker as well. We could influence through public policy engagement, industry engagement, as well as individual issuer engagement. This requires development of a stronger stewardship discipline.

Discussion

Engagement

- Sustainability challenges emphasise the importance of investment management, which boils down to capital allocation and ownership decisions. The investment industry has increased its resourcing for stewardship, which has always been a tiny proportion of the overall resource, but is it enough and are we deploying that talent in the best way and shape?
- There are a couple interplays in the process of internalising the responsible investment process within organisation's broader investment management function and overall ambition. Firstly, it's about joining the two together and making those discussions with companies not just about responsible investment, but part of investment more broadly – getting a range of insights from these companies and trying to add value to them and their processes. And secondly, it is bringing in the broader organisation and our executive teams into those discussions as well. In terms of fitting responsible investment into the broad organisational context, it sits alongside our corporate responsibility and becomes part of advocacy on behalf of our members and the type of influence we want to have.
- It is too risky for investors to be passive in these highly uncertain times, our role in relation to the government and regulators is important and there are certain elements we could lead the way on and help shape what happens in the future.
- Governments are setting these ambitious carbon targets, but then stepping back, so it feels too uncertain. There needs to be more of a partnership between governments and asset owners to allow us to do some things that will help us to meet these targets through giving us enough air cover. Pension funds should probably be more active in the public policy advocacy in the future.
- Stewardship in the unlisted company space has evolved over time, but some effort and right shaping around solving collective action problems across asset owners might be useful in the unlisted space - in private and infrastructure equity for example. There are some spots of efficiency in driving change at portfolio company level, but its uneven across the industry. There is a big opportunity with the unlisted sector where stewardship and ownership are big parts of the business model.

Impact

- Some of the language in the sustainability area can be dividing - impact investing and real-world impact have two different meanings – so it is necessary to have some precision with respect to exactly how that impact works and what it means. Also, it is part of the existing political challenge and can constrain investment process
- Investment excellence with impact can essentially mean bringing to life an organisation's vision to invest in and for our members and wanting to have a positive influence and drive positive outcomes for the environment and society. Also, thinking about capital allocation and active ownership with the view to drive positive outcomes aligned to SDGs.
- When looking at impact, three important points to consider are:
    - Intent - where there are measurable positive benefits to society and the environment
    - Required financial return
    - It must be incorporated in the organisations' purpose statement for it to be embraced and have a meaning internally.
- Redefining of the objectives is deep work and takes up a lot of energy. The operational part of the process requires cultural shift withing organisation and close communication with colleagues and it is not easy for anybody. Impact generating needs to be additional, happening because of our actions.

Strategic partnerships

- The industry hasn't done the best job of becoming joined up across the full investment spectrum. Asset owners need investment managers and their IP to solve some of these sustainability and climate problems. We need a more finessed evolution of the strategic partnerships concept where it is strategic sharing of the organisational context and the problems that we're trying to solve within a total portfolio context.

Sustainability commitments

- It would be concerning if 3D investing was a distraction from generating best possible pension outcomes for members. Members might be more interested in the size of their pot, than our impact on the world. There is a worry that particularly in Europe and the UK investment community is captivated by sustainability so much, that it becomes the priority over and above generating good pension outcomes. However, social licence to operate is a very important and legitimate principle. Sustainability is part of it, so it does mean you have to pay attention to it. Getting the balance right is important.
- There is a lot of uncertainty around climate pathways with many assumptions. Interaction between climate, financial and economic variables is very uncertain. It is necessary to spend time to try to understand the range of possible scenarios and outcomes.
- Net-zero commitments might have been too ambitious to a degree, but it has stimulated certain actions and thinking in the industry, which is all useful. Some of the assets that are the most essential for our way of living are the most difficult to decarbonize quickly, so we need to accept that net zero might be too hard to achieve and move forward. Some level of repositioning is already happening as we move into figuring out transition plans. This feels more rational, is in the realm of right sizing and probably the best approach to solving the conundrum.

About the Thinking Ahead Institute
The Thinking Ahead Institute is a global research and innovation network of the world's major investment organisations and aims to mobilise capital for a more sustainable future. As an outgrowth of WTW's Thinking Ahead Group, it was established in January 2015 as a global not-for-profit group comprising asset owners and asset managers. Currently it has 50 members with combined responsibility for over US$16 trillion.