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Sustainability roundtable

MODERATOR

Jerry Gandhi, Director, CAP Services
Jerry is an independent pensions professional with extensive experience as a pensions manager. He is also a professional independent trustee. Jerry has worked within small and large pension operations covering projects, hands-on management and delivering to both trustees and company. He is a leader in the field of trustee governance and operational excellence for both DB and DC schemes. He fully appreciates, and has extensive experience in, managing the conflicts between company/commercial economic impact versus trustees' member/fiduciary responsibilities.

PANEL

Mark Hill, ESG, Climate & Sustainability Strategy, Policy and Analysis, The Pensions Regulator (TPR)
Mark is the climate and sustainability lead within TPR, responsible for developing the regulatory response to climate change and sustainability disclosure requirements, and delivering TPR's climate change strategy. He brings 30 years of experience working predominantly in the public sector. Mark is involved in work across government and the sector, from the Climate Financial Risk Forum to the Transition Plan Taskforce, in support of sustainable finance and better outcomes for savers.

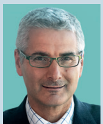
Martyn James, Director of Investment, now:pensions
Martyn is the director of investment for now:pensions, the UK master trust provider. He is responsible for leading the investment strategy for the business, with a focus on improving returns and retirement outcomes for its members, and enhancing the sustainability characteristics of the portfolio. Martyn joined now:pensions in 2024. Prior to this, he spent 22 years at Mercer, most recently as partner within its UK DC business, also with a two and a half year secondment leading Mercer's Wealth (pensions and investments) business in Latin America.

Lauren Juliff, Climate and Sustainability Product Lead, Head of UK Institutional, Storebrand Asset Management
Lauren is a climate change specialist and a product specialist on the Storebrand Plus fund range. She is responsible for working with clients on their sustainability goals, specifically helping develop and deliver tools to assist clients meet and demonstrate progress on their goals. Lauren joined Storebrand as part of the SKAGEN merger in 2018. She joined SKAGEN in 2013 as head of UK institutional and has over 20 years' experience working with UK institutional investors.

Ben O'Donnell, Chief Investment Officer, Climate Asset Management
Ben has more than 20 years' experience in fund management and investment banking, and across a range of natural capital industries. As CIO, he oversees deployment of more than $1 billion into a developed market real asset fund and two emerging market carbon strategies. Climate Asset Management's funds are Article 9 aligned, applying an impact framework to guide investments towards improved environmental and climate outcomes in addition to attractive financial returns.

Anne Sander, Client Director, Zedra Governance
Anne holds numerous professional trustee appointments and is chair of several contract based pension governance committees. She is currently head of Zedra's governance advisory arrangement and leads the ESG forum. Prior to becoming a professional trustee, Anne worked in consulting, insurance and asset management businesses as a qualified actuary, assisting corporate and trustee clients, advising on investment strategy, governance, risks and controls and working in project management roles.

Jane Wadia, Head of Sustainability, Core Products & Clients, AXA IM Core
Jane's responsibilities include engaging with clients on sustainability topics and working with teams across AXA IM to ensure that the firm's investment capabilities reflect the needs of its clients with regards to responsible investing (RI). She is responsible for defining and developing the RI product and client vision, and is a key stakeholder in shaping the overall RI priorities for the AXA IM Core business. Jane is also a member of AXA IM's strategic sustainability committee and the AXA IM Core RI steering committee.



Justin Wray, Head of DB, LGPS and Investment, Pensions and Lifetime Savings Association (PLSA)
Justin leads the PLSA's team covering DB, LGPS and investment issues. He was previously head of the policy department at the EU's insurance and occupational pensions regulator, EIOPA, where he led its work on regulatory policy, including reviews of the IORP II directive for pensions and the Solvency II directive for insurance. Before joining EIOPA, Justin worked at The Pensions Regulator; HM Treasury; and at the Department for International Development.

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Sustainability in the spotlight

Our panel of experts reflects on the evolution of sustainable investing in pensions today, the challenges facing trustees looking to meet their sustainability requirements, and the increasing focus on biodiversity

Chair: What does sustainability mean to pension trustees?

Ben O'Donnell: The mandate is to deliver risk-adjusted returns to underlying members, which is done in a way with responsible investment objectives and reporting regulations in mind. If you don't deliver on that, then sustainability beyond that doesn't carry a lot of weight.

So, from our perspective, you should incorporate sustainability into products that can deliver attractive risk-adjusted returns and portfolio benefits, but also assist trustees in reporting around climate, biodiversity and the overall impact initiatives that they would like to support – all the while, meeting the needs of their members.

What we see in the pension market globally is that people have a desire to look at this space, but often the regulation is not supporting a proactive approach to that – people are looking to build their portfolios and in doing so identify products where sustainability can become part of the overall narrative that they receive.

So how do we get people to focus on delivering products that are fundamentally sustainable as well as delivering all those other portfolio benefits with an allocation to the sector? I think it's starting, but the dialogue and the learning still has a long way to go.

Anne Sander: To offer a trustee view, first, in terms of the regulation, there isn't anything stopping us investing in sustainable assets. What's stopping us is being able to show that these sustainable assets are going to deliver value to members. Climate risks/ESG risks and so on are often out in the future before they might materialise. So, being able to weigh that up against delivering for members today creates a challenge.

Then we're also thinking about reputation, and particularly our sponsors' reputation. If the sponsors support sustainability, it makes it easier and almost expected that we will follow.

One of our problems is that the regulations are driven by reporting, and we can tick the reporting box; but winning people over to understand what the long-term value is of investing this way is where we struggle.

Lauren Juliff: Earlier this year, the Financial Markets Law Committee (FMLC) published a report looking at what fiduciary duty means in the context of sustainable investing. That was helpful in terms of trying to modernise understandings of fiduciary duty, because we're going through a huge global, economy-wide transition, so we have to start thinking about things differently and talking about things differently.

Ultimately, the way that we see sustainability risk is financial risk. But the FMLC was helpful in that it said there were several contextual things we need to think about. One is that narrative is important on this because we don't have all the right data yet, so we won't necessarily assess value for money in the same way that we have before.

Another one is timeframe – if your timeframe as a pension scheme is long-term, then climate change is a risk, it's a financial risk, and that's what the FMLC has been clear about. So, we must also shift that focus on short-term timeframes to long-term thinking.

Martyn James: The trustees on our board do obviously want to deliver strong returns for members at the right risk, but they also want to make a real-world impact with their investments. The investment strategy therefore was changed at the start of the year to terminate third party manager appointments and manage the assets directly in-house, with the aim of investing responsibly and of stewarding those assets to target net zero by 2050.

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The trustees have obviously looked at their fiduciary duties too and, in their recent Task Force on Climate-Related Financial Disclosures (TCFD) report, they've undertaken scenario analysis and it's just confirmed their view that a three degree warming world or more is going to be catastrophic for global economies. It's going to impact investment portfolios poorly, and they feel it's their duty to invest in a way and steward the assets to not get to that point.

They benchmark listed global equities versus the MSCI All Country World Index (ACWI), but disinvest companies that do not have credible plans to transition to net zero by 2050. Otherwise, there is engagement with the company holdings to support the transition. So, they've managed to align the need for strong returns and the fiduciary duty there, but also are able to have a real-world impact so their members can retire into a better future.

Chair: Does that include private assets?

James: There are different parts of the portfolio. We are working on implementing a private markets portfolio in 2025, which will possibly have investment solutions related to climate change; but I was referring to the listed global equity portfolio. Our in-house fund manager assesses each company in the index – for example, if a company is a high emitter, does it have a credible transition plan? If so, we will invest, we will engage and we will vote in the right way. If there's no credible transition plan, we may disinvest from that company, which obviously then creates tracking error against the MSCI ACWI, but we then re-weight factor and sector exposures back to the index. So, it's a passive portfolio with enhanced ESG characteristics.

Passive investing

Chair: What are the panel's thoughts on passive investing in the sustainable arena?

Juliff: We've done a lot of research on the passive offerings in this space – on the Paris-aligned benchmarks (PABs), for example. Our conclusion is that none of them are passive. There can be substantial active risk depending on which one you choose, the tracking error between the different options is varied and large.

They can also have substantial tracking error from the parent benchmark, and it's not necessarily managed. It's also not necessarily aligned with climate. Our research shows that most of them have meaningful Magnificent Seven risk.

Also, we need to be flexible, we need to adapt and evolve with the transition, as there's new data, new policy and new science coming in all the time – this makes setting a 'passive' strategy around an index particularly difficult. The other issue with the PABs is that this seven per cent indiscriminate decarbonisation approach is not what Paris-aligned is in reality, but that's how it's being defined by those benchmarks. One of the key things with the Paris Agreement is about equity for emerging markets. That isn't covered by that either. That 7 per cent is just applied across every region, company and sector which can lead to some unintended consequences in portfolio construction, like divesting emerging markets and solutions.

Jane Wadia: We hear a lot about the Paris-aligned benchmarks, they're being used more and more, and there are pros and cons there. Where I would agree is that they can be useful from a measurement perspective, but if you're a mature pension scheme with a lot of fixed income managed in a buy-and-hold type approach, it's slightly hard to be necessarily churning the portfolio and meeting this seven per cent decarbonisation year-on-year (which looks very nice on a linear chart that we can put in front of clients, but real life doesn't quite work that way).

It also doesn't take into account the allocation to climate solution-type strategies as well, which are key in terms of decarbonising the economy.

So, they do need to be looked at with a lot of care and consideration and, like everything, it's about really understanding what you're putting into your portfolio. You can measure it against something, but ultimately the returns are coming from your actual portfolio and not the benchmark.

Chair: What is The Pensions Regulator (TPR) view here?

Mark Hill: As a regulator, we look at this through a sustainable finance lens. So, it's about downside risk management in terms of material financial risks – be they climate, be they nature, be they social factors – and then maximising the upside opportunities, such as new and emerging technologies and companies key to the transition to net zero, ultimately with a view to increasing portfolio and investment strategy resilience to the impacts.

It's not TPR's role to say what trustees should invest in, that is their decision, but we have been raising awareness through various means such as articles, blogs, speaking events and roundtables. We have also launched a landing page on our website with links to internal and external resources that is accessible to trustees.

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We appreciate it is a big challenge for trustees to get up to speed from a governance and reporting perspective and work out what is material for their scheme. It's one thing to get your head around climate, but now people are talking about nature and social factors, which brings in another set of data requirements, another level of understanding.

For TPR it's about trying to support trustees, it's about getting the guidance out there, updating the Trustee Toolkit so ESG is woven all the way through the core modules, taking part in discussions like these to get a good feel for where trustees are, finding out what are the barriers, what are the enablers and what we, as a regulator, can do to help.

Thinking about disclosures, I believe it's fair to say, looking at our reviews of TCFD reports and talking to trustees, the first two years of climate-related disclosure reporting successfully placed the issue of climate change on the agenda. It's got it on the radar for trustees and steps have been taken to understand and manage the risks and opportunities. The danger now that the reporting is established is that it becomes viewed by schemes as a compliance exercise and not a tool to help drive continuous improvements in governance and risk and opportunity management.

So, I'm looking forward to the Department for Work and Pensions (DWP) undertaking its review of TCFD and taking the opportunity to look at what could be done to avoid this, such as changes to the frequency of reporting. With the government's manifesto commitment to roll out Paris-aligned transition plans there is an opportunity to make disclosure reporting more forward looking and more decision-useful. As a regulator, we are cognisant of the reporting burden – you've got Statements of Investment Principles, Implementation Statements, TCFD and the voluntary UK Stewardship Code, not to mention reporting obligations in other jurisdictions. Add to this the requirements and guidance set out by the Taskforce on Nature-related Financial Disclosures (TNFD), the Taskforce on Social Factors and Transition Plan Taskforce and that's quite a bit for trustees and schemes to consider and manage.

Chair: What's the Pensions and Lifetime Savings Association (PLSA) view here?

Justin Wray: When I joined the PLSA, I was surprised at how supportive of, and how much it was pushing, sustainable finance and ESG – the association is certainly a supporter of the importance of climate and other sustainability risks.

Like TPR, we offer trustee guidance, how-to guides and so on, and we are very aware of how the pensions world is so diverse – large schemes will have their own resources, and they can hire consultants but, as you go down the scale, having an organisation like ours that can provide schemes with material, even on things like ESG terminology, is useful.

It's interesting to see also that more things are coming into the sphere of sustainable investing – nature and biodiversity, for example. You can see that TNFD, if it follows the same kind of sequencing as TCFD, is going to be compulsory. So, part of what we want to do is prepare PLSA members for that.

Likewise, in relation to transition plans, as has been mentioned, it was in the Labour Party's manifesto so, again, we know it's coming but, as a term, that can cover a huge range of outcomes. One of the things we're doing there is talking to DWP and others asking what exactly they mean by this.

The role of the consultants

Chair: How do asset managers face the challenge of persuading the consultants that your product is the right one?

O'Donnell: The consultants want to see demand from the underlying members before they rate a product so, while we've got to have dialogue and education with the consultants, we've also got to engage the underlying trustees to generate some demand, so that the consultants can see a pathway to generating income from reviewing a product.

Consultants are seeing more inbound enquiries – whether that's because people can see the problem in real time when they see changes in the weather patterns, or whether the reporting is encouraging people at the trustee boards to say we need more products, I am not sure.

But getting consultants engaged is one of life's challenges in the asset management space and we're hoping that more coverage, more engagement and more education brings them to the table to review product and ultimately commit more money into these products that can help diversify portfolios but also increase nature and climate outcomes.

Wadia: I agree that things are evolving there and it's moving in the right direction. For example, in the last four years, certainly in fixed income, 100 per cent of the new Buy & Maintain mandates that we've launched have had some climate consideration. I'm not saying they all have a net-zero objective, but there will be some sort of climate consideration that is effectively binding

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from an investment perspective. That's quite telling.

Also, we launched a Carbon Transition Global Short Duration Bond Fund in January, seeded by Aon, which provides investors with a truly actively managed global fund that aims to enhance cash returns while supporting the transition to a net-zero world through an explicit decarbonisation objective. Often you launch funds more for a retail/wholesale-type distribution network. Here it was done for a consultant because they were seeing that end-demand from their clients. So, we are starting to see movement in that area.

The role of the asset owner

Chair: How much power does the asset owner here have to change things?

Juliff: There are several levers that asset owners can pull, and one of them is choosing the asset manager. In making that choice, they need to think about many different things – what that asset manager is doing on voting and engagement, for example, and you can judge an asset manager by how they vote on ESG right across their organisation, not just on certain portfolios. Also, if they've got net-zero targets, are they following through on them? Are they escalating their engagements if those engagements aren't working?

As asset managers, there are three ways in which we can pull levers. There's asset allocation – we can invest (or not invest if we decide a company is not moving in the right direction or is not transitioning); there is corporate engagement, which is part of that whole process and then we can escalate that; and there's a third lever that is not being pulled that well at the moment which is policy level engagement and macro stewardship.

We are seeing more focus on this. We're seeing asset managers stepping into this space and it's certainly something that Storebrand has been doing for a while. It's also a space where asset owners can engage as well. For example, in relation to transition planning, we need a policy framework for that; it can't all be on the private sector – there's something for governments to do here as well.

James: I totally agree with the point that choosing the right asset manager is important so that they are aligned with the trustees' values on how they're engaging and voting companies etc. I also agree that Paris-aligned benchmarks aren't ideal for a passive approach because it relies on a 1.5-degree environment being reached and it's just decarbonising today rather than trying to make a real-world impact on those underlying companies that are high emitters of today but have credible plans to transition in the future.

One of the challenges that we have as a master trust in the UK relate to fees. To have a passive mandate with associated lower fees for the listed equity portion is almost a must. You can't get away from that, which is why we still have a tracking mandate against the broader index – the difference is that it's an enhanced passive approach, disinvesting and stewarding assets in the way I described earlier. Where we're going to spend our budget next year is in the private markets/investment solutions space, to try and have an impact in terms of the solutions to drive net zero and/or other environmental and social areas.

So, we are wanting to see new and good private market investment solutions from asset managers for the DC master trust market, recognising that there are fee restrictions that we have and other operational barriers which are very well known in the industry.

Sander: That fee issue is not restricted to master trusts. In DC, it's very clearly about value for money because the members are paying those fees. Then, as a trustee of a DB scheme, we're spending the company's money when we pay asset manager fees. So, we need to be sure that we are getting value for the company's money when we choose particularly active strategies or higher fee-incurring investments. We need to be sure that, if we're going to pay more, we are going to deliver a higher return to compensate.

O'Donnell: I'm in the real asset space and, sitting from the outside looking in, it seems very difficult to effect direct change from an indirect or an equities strategy. We are therefore encouraging the market to take action, to invest into direct asset owners with a clear mandate to effect change on the ground that is effectively regulatorily aligned to fiduciary obligations.

There's so much sustainability capital wrapped up in passive strategies that arguably is or isn't making a difference. It's very hard to get a company to change behaviour in a passive portfolio.

We would like to see more capital recognising that, to make a genuine difference, you have to invest directly into underlying assets that are trying to effect change to drive outcomes that really deliver better planetary returns from a sustainability perspective.

A lot of people are doing passive strategies and wrapping sustainability around them, and we struggle to see how that is really delivering benefit because the companies that you're not

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investing into are still out there doing what they're doing.

Wray: On the fee point, with both DB and DC, it's one of our five asks of government that value for money be expanded from fees to other considerations and this is particularly in mind of unlisted assets and the new government's drive for greater investment in what they call UK productive assets. This is going to be an issue because fees could certainly be a constraint if costs alone are the only consideration.

There is also an interesting dynamic between the central government and the regulators. You have independent regulators and that's a good thing, but they're not always saying the same thing.

O'Donnell: And that creates conflict. It creates a conflict between the obligations from a fiduciary respect and where reporting is going, and also underlying member interests from a portfolio construction perspective.

More education perhaps is needed there to try and make sure that the regulation and the fiduciary obligation is moving the same way. There is a global need from a planetary perspective to try and invest in a way that enhances portfolios, enhances climate outcomes and builds resilience against volatility when you think about where the money is going and how it's building value for investment portfolios.

We struggle with that in different engagements. Does somebody have an allocation or not to the space? Do they feel that's an impact bucket that people like to see or are they genuinely changing portfolios? Because just selling somebody's stock because they're not impact-oriented or ESG-oriented or their climate metrics aren't meeting the standards is not really a way to tell them how to change the game. You must hold them to account and have a report that says 'this is what you're doing wrong', as opposed to just selling, or you won't effect change.

Sander: Small pension schemes in particular feel that they're a small voice here. Trying to get their voice heard by some of the global asset managers feels like an impossible task on an individual scheme basis. A discussion we have been having with other professional trustees is around how we can use our collective voices as trustees. Can we even create a collective voice, because we all have different opinions? So, we're working through that at the moment – looking at whether we can, as a collective, become that voice so that we can influence the companies that we invest in or the asset managers that we invest with.

Hill: As a regulator, we welcome the opportunity to engage and would support such an initiative for a collective voice. It's only through engagement that we can better understand the challenges trustees and the wider industry face and their view when it comes to what regulation is actually achieving. The Asset Owners Council and the Investment Consultants Sustainability Working Group are two such groups we engage with that provide a collective voice.

What I'd be interested to hear about are your views and experience when it comes to the real-world outcomes that result from improvements in the resilience of portfolios and investment strategies to the impacts of climate change and nature loss. Are they mostly positive in terms of emissions reductions, reversing nature loss and advancing the transition, or are there any unintended consequences? For instance, moving capital away from firms that are relatively high emitters but play a key role in the transition to net zero?

James: The issue with these climate transition benchmarks is that you are indiscriminately disinvesting from certain stocks and sectors that are high emitters, and there are plenty of other investors around the world willing to buy those. So, you're not actually having the real-world impact that you want to have.

So, if a high-emitting company today, for example, is looking to transition to net-zero, has a plan, and has put it into place, whether that's Scope 1, 2 or 3, then we would prefer to stay invested and engage with them and vote to create the real-world impact that we desire.

Sander: So, it comes down to the question of whether we, as trustees, are able to engage? And it's highly unlikely we're going to be able to engage at a company level. We're more likely to be engaged at a policy level. But moving into policy and politics is not necessarily where trustees feel comfortable. And when it comes to the smaller schemes, where their only option is pooled funds, how do they get their voices heard?

James: That's where the asset manager is important; and the asset manager, possibly even on its own, isn't going to make an impact. It's the collaboration across the entire industry and across global investors that's going to make the difference. So, there is a chain here of alignment. But trustees, even the trustees of smaller pension schemes, can make a difference through the selection of their asset managers.

Wadia: The engagement part is critical, especially in the listed space where you can argue that you're a shareholder, but you don't have a seat at the table in the same way that you would

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in private assets. That's also why it's important that trustees are holding their managers accountable and understanding how they're carrying out that engagement because, if we just say we're engaging, but we don't actually think that we're going to be able to enact the change, it's effectively window dressing.

That's why it is important to think about aggregating your assets to engage at corporate level on behalf of all of the assets, because that is what gives us scale.

It's also about the quality of the engagement. We often get asked how many engagements we have done and, yes, numbers are important, but it's the quality of engagement that is key. We are very open and transparent on this. We have what we call 'engagement with objectives', whereby there's a predetermined challenge or issue that we've identified – it could be environmental, social, etc – and we come up with a list of questions or areas that we would like to see the company evolve on.

We can see that things are developing here just from the types of questions that we get asked from our clients now – they don't just want to know who we have engaged with, how many, what are the themes, but they will ask what were the outcomes, has x,y,z company achieved its aims, and so on.

I'm not suggesting that all of our engagement will be successful. But it's more about the ability to say, yes, we started it and it's progressing or it's not progressing. Then, if it's not progressing, you've got various escalation techniques, disinvestment being the ultimate one, but usually not the preferred option and certainly not the starting point.

Divestment

Juliff: I agree and, ultimately, some companies aren't going to transition. What do we do with those? Also, some are not listening to asset managers. They're not prepared to engage. So, then how are you managing that risk? That's where divestment comes in.

It also can come in when you've got clear outlined asks for a company – where you say that 'these are our specific issues'. We've had situations where we have divested and then we've reinvested again when those things have been met. So, for us, it's an ongoing process.

We also must think about how we're judging companies that are transitioning or not – increasingly, portfolios are being judged on this emissions intensity figure, yet some of the companies in our portfolio with the highest emissions intensity are the transition companies.

For example, some of our grid investments, which are key to the transition, have much higher Scope 3 emissions than Exxon. So it's about how you're using the data you have available, how you're dissecting it. We find that a lot of the benchmarks integrate Scope 3 emissions intensity and don't invest in some of the grid companies.

Even when you're looking at Scope 1, Scope 2, Scope 3 emissions intensity, Scope 3 emissions is not one single category. There's upstream and downstream, which is another important thing to break apart. Also, how many of those Scope 3 emissions are coming from your solutions portfolio? These are all things we need to be breaking down.

Defining impact

Chair: How can we best explain to trustees the difference between an impact fund and a sustainability fund?

James: If you consider oil and gas companies, for example, there is demand for oil at the moment. So, the way to tackle that is to invest in solutions to have an impact for that – to invest in the green transition, in renewables, in solar, in wind, and so on. You're going to have an impact on the demand side there.

We would like to invest in solutions as well as listed companies. We invest in green bonds, which has a place in the bond allocation of the portfolio, and that's financing the green transition; but we want to invest in more of those real infrastructure assets to make an impact as well. The key is whether these solutions are available to DC master trust investors.

We have spoken a lot about climate change today, but there are other social and sustainable issues that we would like to have an impact on as well. So, both parts of the portfolio are important. But the solutions part, that's probably going to come in a private markets portfolio, and probably where our fee budget is going to go to try and make a difference.

Wadia: I agree there's a distinction between impact investing versus broader sustainability goals. It's like a subset of sustainable type investing and it's around the solutions. Again, some of these companies may be high emitting or they're building solutions to precisely enable others to decarbonise or become nature positive, and so on.

The simple distinction is the solutions part, but it's also the ability to demonstrate and measure that world impact. So, it's not just about decarbonising the portfolio. It's demonstrating that the companies that you're investing in – or the bonds in the case of green or social bonds, for example – are delivering on the impact.

We're definitely seeing more and

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more interest in that area from clients.

Green bonds are interesting in that they are both instruments as part of an asset class and an investment strategy in their own right. We see some clients allocate to green bonds as part of their wider portfolio and then others choose to have a dedicated sleeve to them.

Then, on the listed equity side and the private assets, nature and biodiversity are probably the biggest areas where we're seeing interest because, after climate, biodiversity is the next big thing on the agenda. I do believe that in equities you can build a dedicated biodiversity solutions strategy in a relatively concentrated portfolio. There you've also got to get very granular around the data and analysis, and make sure that you are confident this is all going to deliver the right impact because there's always a risk of greenwashing/impact washing there.

O'Donnell: Sustainability is about limiting negative outcomes and ensuring that you're not creating negative outcomes from the activities you undertake. Impact is about additionality. You can be proactive in delivering impact and still be doing some things that maybe compromise sustainability, like chemical use in farming, but you're balancing the outcomes on a property when you're integrating biodiversity, you're planting more trees, you're planting cover crops to increase soil carbon, all of those things.

Sustainability is also about how you can manage a landscape or manage an asset so that you're not creating negative outcomes and you're not compromising the future of that asset. But impact for us is when you can measure and baseline additionality from a reference point in time and enhance that and track it over time. That's important to how we see investment in the natural capital space; but, more fundamentally, to really get a handle on that and be able to baseline something and claim impact and additionality, you need to be directly controlling the asset. Indirect control doesn't really give you any impact because you're just not creating that additionality through your own actions.

Hill: Going back to the FMLC paper, I'd be interested in your thoughts on whether there is a fiduciary duty challenge for those seeking to invest primarily for impact?

Juliff: An academic recently described this issue like a Venn diagram in terms of the different arms underlying sustainability – there's impact, financial risk management, and values, and they can all meet somewhere, but they don't necessarily always do. So, impact might not be good for financial returns; financial returns might not always be good for impact; and values can sit somewhere else. But somewhere they overlie. That's for trustees to think about in terms of what their objectives are – whether they are impact, financial risk management, values and so on.

Biodiversity

Chair: There is a lot more focus now on biodiversity. To what extent do trustees understand it?

Sander: I recently did an internal survey with my colleagues as to what they would like their ESG training to be on, and biodiversity (including what you can invest in) came high up on that list. However, there's almost nothing coming though from investment consultants on this. Right now, trustees want to know about it; want to better understand it; how to invest in it; what it's going to deliver; and also, how you measure it.

Wadia: I agree there is that demand coming through from trustees – I have never done so many biodiversity trustee trainings as I have in the past six months.

It's a topic we've been talking more on, we've been active in the space for a while and it's something that we share with our clients globally. But, specifically in the UK, it seems to have ratcheted up the agenda.

Chair: Why should pension investors care about it?

Wadia: There are two main reasons. One, there's a financial material risk of not considering it. In 2022, the World Economic Forum assessed that about 50 per cent of global GDP depends on high-functioning biodiversity. That explains what the systemic risk can be over the long term.

Also, there is a climate/biodiversity nexus – climate change is creating biodiversity loss and biodiversity loss isn't helping cool the planet. So, that interdependency is there. Therefore, if you have pension schemes that have made net-zero commitments, however hard or soft they may be, then they need to start, as a scheme, incorporating biodiversity thinking into their investment approach if they are going to meet their net-zero goals.

Chair: Do schemes know how to invest in it?

Wadia: I see two main approaches there. One is, looking at it from that aggregate portfolio level across large, core asset classes (fixed income and equities for example), around assessing your portfolio: Where do you have high exposures, low exposures? Can you measure your biodiversity footprint? Where do you want to engage? What do you want to exclude? For example,

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we have a deforestation policy on the exclusion side. That's the benefit of something that can be done at an overall portfolio level.

Then, if you want to have a more targeted approach to supporting the biodiversity transition, there it's nature capital, clearly, on the private asset side, and forestry would be another area too.

Then, in the listed space, we feel comfortable that we can manage dedicated biodiversity equities strategies at this juncture. There's enough depth in the investment universe, although we're typically going to invest in mid/smaller companies that are enabling that transition.

Then in fixed income, you do have things like blue bonds, but the issuance is so small that you couldn't build a well-diversified portfolio out of it if you wanted. Green bonds are interesting because actually, by investing in green bonds, you are addressing biodiversity, but it's very hard to target the percentage because the percentage of the project targeting biodiversity in green bonds can go from less than 10 per cent to more than 90. So, the purity is much harder to measure.

Juliff: In response to the question of 'how do you invest in it'? We're all invested in it. It's more a case of how we manage the risks around it. The foundation of integrating biodiversity into investment decisions for us lies in the risk assessment framework. We've been working on, in particular, the LEAP (Locate, Evaluate, Assess and Prepare) approach through the TNFD, using tools like ENCORE (Exploring Natural Capital Opportunities, Risks and Exposure), which are high level. Looking at total portfolio exposures, where our impacts and dependencies are. Then we've worked with NGOs and other providers to try and improve the data available such as on the Forest IQ dataset, for example.

So, it's about having these engagements in the market, talking to the companies and the data providers about how we get better data. Then, again, how we use that data.

We brought out a new nature policy, for example, several years ago where we said there were certain areas that we didn't want to invest in – deep sea mining was one of those. So, we would divest on that basis. So, it's about having all these different levels of how we're thinking about that nature risk and how we're addressing it.

A lot of it, for us, also comes back to this question of policy engagement.

O'Donnell: The unfortunate reality is that it's very difficult to invest into biodiversity-positive outcomes in the current markets. Nearly everywhere people are investing to reduce the decline of biodiversity; and I'm not aware of a regulatory structure to encourage positive investment into biodiversity that is not an offset for biodiversity loss of some form. That is disappointing and challenging. The scale of the market is not big enough to warrant somebody building a product that is purely oriented around biodiversity. Again, it comes back to impact and additionality and stacking this into outcomes. You've got to invest with an awareness that you're unlikely to get a direct return from the biodiversity initiatives that you undertake, but you've got to see them as value creating in the long term in the context of global decline, which they are. But it has to be in conjunction with meeting the other needs of a portfolio.

Bringing new capital into the sector is really challenging without a regulatory environment to support positive investment in biodiversity. Whether it's the UK government or somewhere else, they've got to step up and say, 'we are going to create a market and a regulatory demand for biodiversity credits that stimulates investment from the institutional side in order to generate a return from biodiversity' increase and it's not there yet.

James: It is such a wide-ranging topic also which makes it challenging for all trustees. We have tried to break it down – deforestation, for example, is a big focus for them. They've got a target for net-zero deforestation by 2030.

In the listed equity portfolio, they want to engage with companies on this issue. Cardano, our in-house fund manager, has set up a collaboration group using a company called Satelligence, which is looking at satellite images of deforestation around the world and then linking those images to supply chains for companies – and some very large companies (it's palm oil that is the focused product) – and then using that within their engagement with those companies.

Chair: What's the regulatory perspective here?

Hill: The Department for Environment, Food and Rural Affairs (Defra) is leading on TNFD and how that will be integrated in the future. We engage regularly with their team.

But in terms of where we sit as TPR, it's very much about using frameworks such as LEAP to take stock of where schemes are in terms of their exposure to nature loss, as part of a holistic risk

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management approach. Then looking at what action to take to address the risks and pursue opportunities to invest, such as nature-based solutions. But one criticism has been that there isn't a strong enough pipeline of investable nature-related projects for the UK.

O'Donnell: There's no regulation to support demand.

Sander: From a smaller scheme perspective, they will have limited governance budgets – they may not have the governance budget therefore to look at biodiversity necessarily separate from climate change. So, having a fund that is sustainable that covers both is where we'll most likely invest.

Wray: The PLSA will shortly be publishing guidance on TNFD and, yes, there is always scope for us to do more but, whatever the PLSA does, it cannot overcome some of the fundamental difficulties here – for example, an earlier PLSA survey found that 60 per cent of trustees say that data is the biggest challenge when it comes to climate. And for biodiversity, it's even more difficult!

Some of the approaches outlined already today are helpful – you can be more qualitative about it and look at what the processes are and accept that data is going to be difficult unless you're prepared to narrow down to a particular sector like forestry, for example. But the PLSA and others cannot create data where it's hard to get at the moment.

Juliff: In terms of climate and nature, we see them already as interdependent. So, aside from just having a TCFD report, we now have a climate and nature report. So, we have our climate scenario analysis and then we have our nature impacts and dependencies assessment. We have a deforestation policy – and there is data there. There's the new Forest IQ platform, for example. They've got data on over 2,000 companies on links to deforestation – that's relatively new. But there's enough data there for us to start looking at what companies are doing, where the risks are and address some of those risks.

The other point about governments, to quote our CEO Jan Erik Saugestad as he was preparing to negotiate for a more enabling environment for business to protect nature at COP16 recently, is that it's not just about supporting positive activities, but about making sure that national policies don't support activities that harm nature. Globally, we see at least $400 billion annually in environmentally harmful subsidies.

O'Donnell: But the economic exploitation of landscapes has been happening since the beginning of time and, without regulation to stop it, and without pension funds/institutional investors saying 'we want to take some positive action, we know we've got to do this in the context of meeting our other objectives', and encouraging the consultants to get out there and find the products that can deliver these objectives, nothing will change. There needs to be a concerted effort to allocate capital to deliver positive outcomes as it relates to climate/nature/biodiversity.

It would also be great for government to start to push people in that direction alongside their other fiduciary obligations. It won't happen from an investment point of view. You've got to create the demand so that the market can deliver the supply.

Wray: On the point of fiduciary duty, though, actually the retention of fiduciary duty more or less unamended is something that, as an industry, we've tended to advocate. And while it has always been said that part of being a good fiduciary is taking sustainability into account, it is not a requirement that sustainability is uniquely added to fiduciary duty. So, moving away from that would be quite a significant shift.

Sander: Also, none of these sustainability issues are without risk. So, if we think of fiduciary duty as managing performance in consideration of risk, there's no conflict there. The biggest issue perhaps with fiduciary duty is being able to say it's not just looking at it in terms of what exists now, but it's looking also at future risk. It's that timeframe that is the biggest challenge we need to overcome.

O'Donnell: I'm not saying regulation on the institutional demand side should be increased. What should be recognised is that without some regulation to create demand for nature positive credits, you can't access investment opportunities that would be suitable for institutional capital coming into the space. Inherently, once market demand is created, then institutional capital will come in on the supply side to support people developing nature positive assets.

Wray: It is indeed a multi-faceted issue with multiple challenges – you have highlighted regulation shortfalls; we have already talked today about data constraints; and the need for better education is another.

James: Fees is another issue for master trusts. We have a budget that we can spend on these types of assets, but it is a limited budget, needs specific solutions designed for DC investors. Those are coming along. But still, in all of these solutions, whether it's natural capital or climate change solutions, the availability of product for the right fee isn't there with large choice at the moment and that will evolve over time.