NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

insights

INTEGRATION
CASE BOOK

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the editor’s word

The case for authenticity

As we get back into a semblance of new normal, post pandemic-related restrictions, it looks like the war against greenwashing has finally gone mainstream. Until now, the green whistleblowers were mostly the activist type or the SRI pioneers. Those were practically the only ones who had a legitimate claim on the vigilante stripes.

Now it feels different. Everyone who has had a chance to take a closer look at ESG strategies knows that there are different shades available out there. There is no need to lie to qualify as a greenwasher. You merely need to make some vague (but strong) statements about the world we live in. Without any commitment, defined system or integration in the investment process, however, these statements are just that. Words without consequences.

The purpose of NordSIP, from the start, has been to show and explain what sustainable investing means to different actors in the market. This is also why we have put together this ESG Integration Case Book. Explaining through cases what ESG integration represents for portfolio managers and asset management firms truly helps investors make up their minds about the authenticity of the protagonists.

In this issue, the cases span across investment styles and asset classes. We find out how stewardship makes a difference to a quantitative manager and we look at the constructions of a carbon efficient ETF. We dive into investment cases with Schneider Electric and SolarEdge, as well as the intricacies of three different sector themes: electrification in public equities, renewable energy infrastructure and fintech in the context of microfinance. We also learn how the US is catching up on sustainable investing. The University of Helsinki tells us how they invest in local entrepreneurs, thereby connecting their investment objectives with their own educational and research capabilities. Finally, our collection wouldn't be complete without the interview of a sustainability-focused fund selector, talking about the hunt for authentic managers.

In ESG integration, there is no 'right' or 'wrong'. But there is definitely 'authentic' and 'bluff'. Asking questions and seeking proof is what enables the astute sustainable investor to tell the two apart.

Aline Reichenberg Gustafsson, CFA

Editor-in-Chief

NordSIP

Case #1

Tuning Into Active Engagement in 2021

by Julie Moret

About the Growing Role and Impact of Stewardship on Sustainable Investing

Credit: Maximilian Weisbecker on Unsplash

"In 2020, we withheld votes for certain sitting directors at energy firms ExxonMobil and Chevron and mining company Glencore since we felt they were not responsive enough to shareholder concerns."

Julie Moret
Head of Sustainable Investments & Stewardship
Northern Trust Asset Management

Asset owners and investment managers are striving to reach new goals in sustainable investing as investor appetite continues to rise alongside an increased regulatory focus. These investors are seeking to foster sustainable business practices in their portfolios. Effecting meaningful change while demonstrating that sustainable investing pays off and translates into a long-term, disciplined and tangible commitment to sustainability.

Asset managers possess a key tool to encourage sustainable investment practices: stewardship – which is a combination of engagement and voting. Stewardship provides asset managers with a global opportunity across industries to influence companies towards practices that address the most important environmental, social and governance issues. Using ourselves as an example, in 2020 alone through more than $1 trillion assets under management across 10,000 companies globally, we voted on 148,039 resolutions at 15,681 meetings. We supported 79% of climate shareholder resolutions, according to a ShareAction Voting Matters 2020 report. We conducted 222 engagements with companies where 57% showed progress on milestones and 31% showed substantial progress. Other top global asset managers possess a similar opportunity, with both targeted proxy voting powers and through purposeful engagement with companies based on stewardship priorities supportive of sustainable investing.

Stewardship Priorities

We believe that the long-term financial returns of companies are connected to their strategic environmental, social and governance performance. Our priorities are to influence specific companies' policies and practices to get them to demonstrate a consistent commitment to sustainability.

These are four examples of our key stewardship priorities for sustainable investing:

1. Reduce Climate Risk

Reducing exposure to climate risk is a key challenge for investors and countries. The reduction in the private sector starts with companies that produce most emissions that trap heat in the atmosphere and cause global warming making commitments to become net-zero emissions businesses by 2050 and setting time-bound quantitative targets. Investors seek more measurable action by companies across the most carbon-intensive industries that are largely responsible for global warming. They push such companies to specify their business strategies that gradually reduce carbon emissions to a net-zero stance within the next couple of decades. There is still work to be done to make sure the commitments made by companies translate into delivering those outcomes.

Governance is the core priority since it strengthens accountability to shareholders, clients and other key stakeholders. Investors are seeking governance that articulates boardroom oversight of climate risks and opportunities and keeps management accountable for taking action to reduce greenhouse gas emissions consistent with the Paris Agreement's goals and improve climate-related disclosures.

2. Promote Diversity, Equity and Inclusion

Promoting diversity, equity and inclusion fosters a culture of inclusion in the workforce and in executive ranks. Board diversity occurs when there is an adequate mix of skills and backgrounds on corporate boards. Companies must also improve the quality of their workforce diversity reporting to include not just qualitative information but quantitative metrics of diversity across different levels of employment.

3. Improve Occupational Health and Safety

The improvement of occupational health and safety practices produces better workplace safety for companies and their suppliers. The risks for the majority of lower and middle income workers who cannot work from home during the global pandemic persist. The safety and wellbeing of employees can be achieved when companies introduce flexible work from home arrangements, increase employee benefits and protections, address the physical and mental health of the employees, improve whistleblowing procedures and encourage more board involvement.

4. Align Pay For Performance

Aligning pay for performance is a critical issue of a company's overall governance structure. This goal can be achieved by fostering compensation policies that motivate executives to achieve strong long-term results for shareholders and avoid excessive risks.

> *"Only 30 of the Climate Action 100+ companies have their targets aligned with the net zero pathway by 2050."*

Case Studies on Successful Stewardship

Climate Change: Climate Action 100+ Initiative

The Climate Action 100+ investor engagement initiative was formed in 2017 to engage with companies to address their climate risk — the initiative now has over 617 investors with $55 trillion in assets. Investors have sought more measurable action by companies across the most high-carbon industries. The impact has led to results already — 70% of the 167 companies who represent 80% of corporate greenhouse gas emissions globally have set some kind of long-term quantitative targets for reducing greenhouse gas emissions linked to global warming. However, only 30 of the Climate Action 100+ companies have their targets aligned with the net zero pathway by 2050.

Climate risk is a key long-term investment theme since natural resource stocks remain vulnerable. We have targeted companies and industries that contribute a large percentage to the release of greenhouse gases. We used analytical sources such as the Transition Pathway Initiative, Carbon Tracker and Science Based Targets Initiative and, later, the Net Zero Benchmark (NZB) developed by Climate Action 100+ to assess how well companies are aligned with plans and targets of various scenarios consistent with the goals of the Paris Agreement. The NZB tool has created a much needed robust and comprehensive framework for assessing the strategic commitment of companies and their progress towards the climate goals.

As a result of these collaborative efforts, the six largest oil and gas companies and the four largest mining companies in Europe, along with some of their Australian and U.S. peers, have committed to net-zero carbon emissions by 2050 or earlier. Two U.S oil and gas majors have followed suit. Most of them set ambitious enough greenhouse gas emission reduction targets and disclosed details of strategies and investment plans outlining how they are going to achieve their goals. Further, all European electric utilities have worked to set out plans detailing how they will reduce their exposure to coal and increase exposure to renewable energy.

In 2020, we withheld votes for certain sitting directors at energy firms ExxonMobil and Chevron and mining company Glencore since we felt they were not responsive enough to shareholder concerns and fell short on management of climate risks, including quality of climate-risk disclosure.

In 2021, we withheld votes for directors at all companies that did not meet the critical majority of the climate transition criteria outlined by the NZB.

Occupational Health & Safety: Retailers, Financial Institutions

We engaged with Bank of America, Gap, PayPal and Amazon, among other companies, on the immediate steps they took to protect the health and safety of frontline employees and customers during the earlier months of the pandemic. We also sought answers on how their boards oversaw those efforts and what additional investments they made for the medium-term "return to normal." Companies with directors who sat on multiple boards brought insights from other companies and sectors – Bank of America used lessons from Hurricane Katrina and the California wildfires.

Pay for Performance: Royal Dutch Shell

We withheld votes for Royal Dutch Shell's pay policy at the 2020 AGM because of the lack of strategic alignment between executive compensation and carbon reduction targets. Shell plays a leadership role in climate commitments, however the company's executive compensation policy was 55% weighted to the growth of oil and operations while achieving climate targets composed only 10% of the weighting. Since we hold both stocks and bonds in the company, we voted against the pay policy on behalf of both investors. Shareholders still approved the policy with 93% of votes, however the remuneration committee is developing changes that are more likely to be in line with the feedback of investors. However, the company made efforts to address the investors' concerns and have since introduced the changes to their executive remuneration policy.

Diversity, Equity & Inclusion: Amazon

We met multiple times with Amazon in 2020 to discuss their talent management for their large workforce. The company said their focus was on creating an inclusive workforce and less on the diversity numbers. Their approach to diversity, equity and inclusion is informed by employee groups established to champion underrepresented categories in the organization. The groups wanted to keep the focus on programs to educate and facilitate the leap from mid-to-senior level management for racial, ethnic or gender minorities.

> *"We still seek additional emission-reducing efforts from companies across high-carbon industries, especially energy companies."*

Conclusion

The challenges to investing in companies that demonstrate a lack of clear and consistent commitment to sustainability persist. Stewardship is essential to managing ESG risks and to achieving improved ESG outcomes. We will continue to monitor the goals set by companies, what strategies they are creating, if they meet our sustainability objectives and the level of transparency. For example, we still seek additional emission-reducing efforts from companies across high-carbon industries, especially energy companies. We will continue to use our voice and scale in constructive, relationship driven engagement to influence companies to achieve improved outcomes for our clients

Our role as an active owner of our investee companies means we will continue both our direct stewardship activities and partner with other investors to encourage companies to focus on best practices, standards, data and reporting.

Read our 2020 Stewardship Report.

Case #2

Changing the Landscape of Sustainable Investing, Again

Rockefeller Asset Management Introduces a Complementary Approach to Mainstream Climate Funds

by Filipe Albuquerque

In the quest for sustainable investments, the European Union's regulatory leadership has put the bloc ahead of the rest of the world. However, with a new, climate-friendly administration in the White House, new opportunities are likely to emerge on the other side of the pond. European investors seeking to support these efforts and reap the returns of America's impending green transition will benefit from having a partner overseas to help them navigate the landscape of sustainable investment opportunities.

Rockefeller Asset Management (RAM), an American asset manager with a long track record, a commitment to ESG investing and extensive access to sustainability expertise, is keen to guide European institutional investors through these new opportunities. RAM has been expanding into Europe by leveraging ESG Improvers and thematic equity research capabilities, its 30-year history of sustainable investing, decades of shareholder engagement experience and a unique network of experts and specialists in the field of climate change. Encouraged by this proposition, European and Nordic interest in the asset manager's approach has been on the rise, according to RAM. The firm recently surpassed US$2.5 billion in assets from European investors and launched its third equity UCITS fund, the Rockefeller Climate Solutions Fund, in December 2020.

Rockefeller Asset Management's Proposition

For over 9 years RAM has been incubating its Climate Solutions strategy, designed to benefit from the global efforts to adapt and mitigate the effects of climate change. The strategy, which offers a differentiated, often complementary approach to the widely held larger cap, mainstream climate funds, was only recently made widely available to investors. In addition to the UCITS fund unveiled late last year, RAM launched a mutual fund for U.S.-based investors in July.

Three characteristics differentiate RAM's thematic equity proposition regarding climate adaptation and mitigation solutions, according to Chip Montgomery (Pictured), Head of Business Strategy and Corporate Development efforts across RAM. Montgomery argues that RAM's 9-year track record investing in environmental markets, a "pure-play" global approach, and its scientific network, all testify to the asset manager's credibility in this field.

"RAM stands out from its peers because of its long-standing commitment to sustainable investment, shareholder engagement expertise, and ability to leverage scientific experts to bridge the gap between climate science and investing," Montgomery says. Montgomery highlights RAM's ability to take advantage of its intellectual capital built from over 30 years of global and sustainable investing, to help investors navigate changing waters.

"Rockefeller has a rich history in sustainable investing, dating back to our first mission-related fund back in 1977. Our global ESG track record is 30 years long," Montgomery explains. "Our Climate Solutions strategy, which is only now being broadly marketed to outside investors for the first time, can be traced back nearly a decade. Investors have been drawn to the strategy given our global pure-play approach, meaning we focus on firms with meaningful revenue exposure to key environmental sectors such as renewable energy, energy efficiency, water, waste management, pollution control, food & sustainable agriculture, healthcare mitigation, and climate support services."

"We believe this global equity strategy is differentiated in that it focuses mostly on earlier stage public equities in the field, using the style box the strategy mostly falls into the small and mid-capitalization category and therefore complements the larger mainstream funds currently available in the market with little overlap in holding." Montgomery points to research from Bernstein on ESG Unicorns (startups with a valuation in excess of US$1 billion) supporting this early investment approach and highlights the relevance of early-stage companies seeking to aid in the transition to a sustainable future. "Unicorns collectively represent US$2.9 trillion in equity valuation, with approximately 50% based in North America, followed by Asia and Europe," Montgomery says. According to the Bernstein report, 23% of these Unicorns are companies focused on ESG or meaningfully contributing to one or more of the UN Sustainable Development Goals. "This pipeline of unicorns leads us to believe that more companies producing climate mitigation or adaption solutions will become public in the months and years ahead."

Casey Clark, Deputy CIO and Global Head of ESG Investments at Rockefeller Asset Management, elaborated on the benefit of leveraging scientific experts. "Understanding the intersection between science and investing is key to our thematic equity research process. Our long-standing collaboration with The Ocean Foundation, a leading scientific non-profit led by Mark Spalding, has helped support our idea generation, research, and engagement process." In several instances, RAM starts looking at and following companies pre-IPO to understand what lies ahead in terms of competition and new products and services.

The Network Effect

The networks of experts available to RAM cannot be overstated, according to Montgomery. "By virtue of the global reputation that the Rockefeller name and brand enjoy, we believe we have access to one of the world's foremost networks when it comes to information on climate change adaptation and mitigation. By investing alongside the Rockefellers, our partners,

Chip Montgomery
Head of Business Strategy
and Corporate Development
Rockefeller Asset Management

in many cases, can gain access to that network," he explains.

"Mark Spalding and his team of experts at The Ocean Foundation regularly advise our portfolio managers and engagement experts, bridging the gap between science and investing," Montgomery adds.

"We also have a large network of specialists that we reach out to when the occasion presents itself. For example, our investors have benefited from our ability to tap the expertise of the Rockefeller Foundation about the future of agriculture, professors at the New York University (NYU) to discuss emerging solar panel technologies, and researchers at the World Resources Institute (WRI) about the potential of hydrogen in the energy transition," Clark adds.

New Investment Opportunities Across the Pond

Despite Europe's leadership, new opportunities are arising on the other side of the Atlantic Ocean. "I believe that U.S. policymakers are starting to make great strides," Montgomery says. "The Administration's commitment to climate policy is real, and it cuts across many aspects of the federal government. There is also a seat at the national security council dedicated to climate change. The focus will eventually turn to policies that will help the U.S. mitigate and adapt to the impact of climate change," Montgomery continues.

"Infrastrcture is one key focus for the Administration," Clark says. "Companies helping to improve energy efficiency, produce renewable energy, offer sustainable agriculture solutions, deliver low-carbon and healthy sources of food, and upgrade the infrastructure stand to benefit," Clark explains.

"Investors should consider whether their investment portfolio is too European-centric," Montgomery suggests. "If America is about to take off with regards to climate adaptation and mitigation solutions, savvy investors want to identify a reliable partner to tap into the market at this early stage and invest," Montgomery continues.

"Our Climate Solutions strategy is well-diversified across regions, including meaningful exposure to U.S.-based companies. As we identify opportunities that arise in the U.S., we are well-positioned to understand them and invest early," Clark adds.

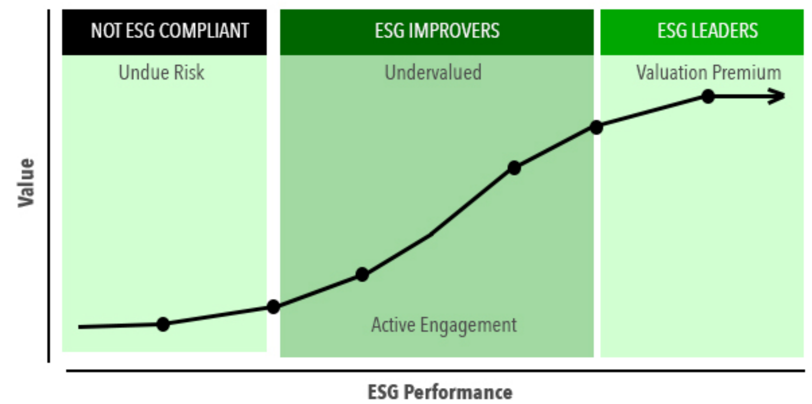
Leaders, Improvers and Thematic Approaches Offer Diversification Opportunities

As European allocators consider diversifying geographically, the appeal of RAM's broad product offering is the range of approaches the asset manager can tailor to investors' preferences and their sustainable investment area of focus. "We believe that asset allocations of the future will have sleeves for thematic strategies, ESG leaders and also ESG improvers" Montgomery explains.

"ESG improvers strategies focus on firms with an improving ESG footprint, complement thematic styles of investing and can help deliver uncorrelated alpha over the long-term. At Rockefeller, our portfolio managers leverage fundamental, quantitative, and engagement analysts to understand companies' ESG trajectory and areas for improvement." Montgomery continues.

Casey Clark
Deputy CIO and Global Head of ESG Investments
Rockefeller Asset Management

ESG Improvers are Tomorrow's Leaders



Source: Rockefeller Asset Management, Serafeim, G. 2018, 'Public Sentiment and the Price of Corporate Sustainability', Financial Analysts Journal, 76 (2); 26-46

"ESG Improvers strategies are different from our thematic strategies, such as Climate Solutions, that invest in companies delivering products or services that are solving some societal challenges," Montgomery adds.

"We believe that we can generate alpha and positive outcomes by identifying ESG Improvers – or tomorrow's leaders – and utilize our shareholder engagement process to drive change and position companies to thrive in a sustainable future," Clark says.

European and Nordic Investors Continue to Lead the Way

RAM's approach, combined with its expertise, positions the asset manager to help guide European investors through the impending U.S. sustainable revolution which Montgomery and Clark foresee taking their country by storm in the coming years. European asset owners' recognition of the value of sustainable investments places them at the front of this queue to tap America's sustainability potential, the asset managers explain. Interest from the Nordic region, in particular, has been encouraging, according to Montgomery.

"European and American investors are at different stages of experience when it comes to sustainable investments broadly, and climate change specifically," says Montgomery. "Europeans and Scandinavians tend to have a clear understanding of the implications of climate change on their investment portfolios. This recognition has spilt over from the public at large to the investment community. According to research published recently by Morningstar, Europe represents approximately 80% of sustainable assets globally. We appreciate the leadership from Europe and the Nordics, and believe that the U.S. will follow," Montgomery adds.

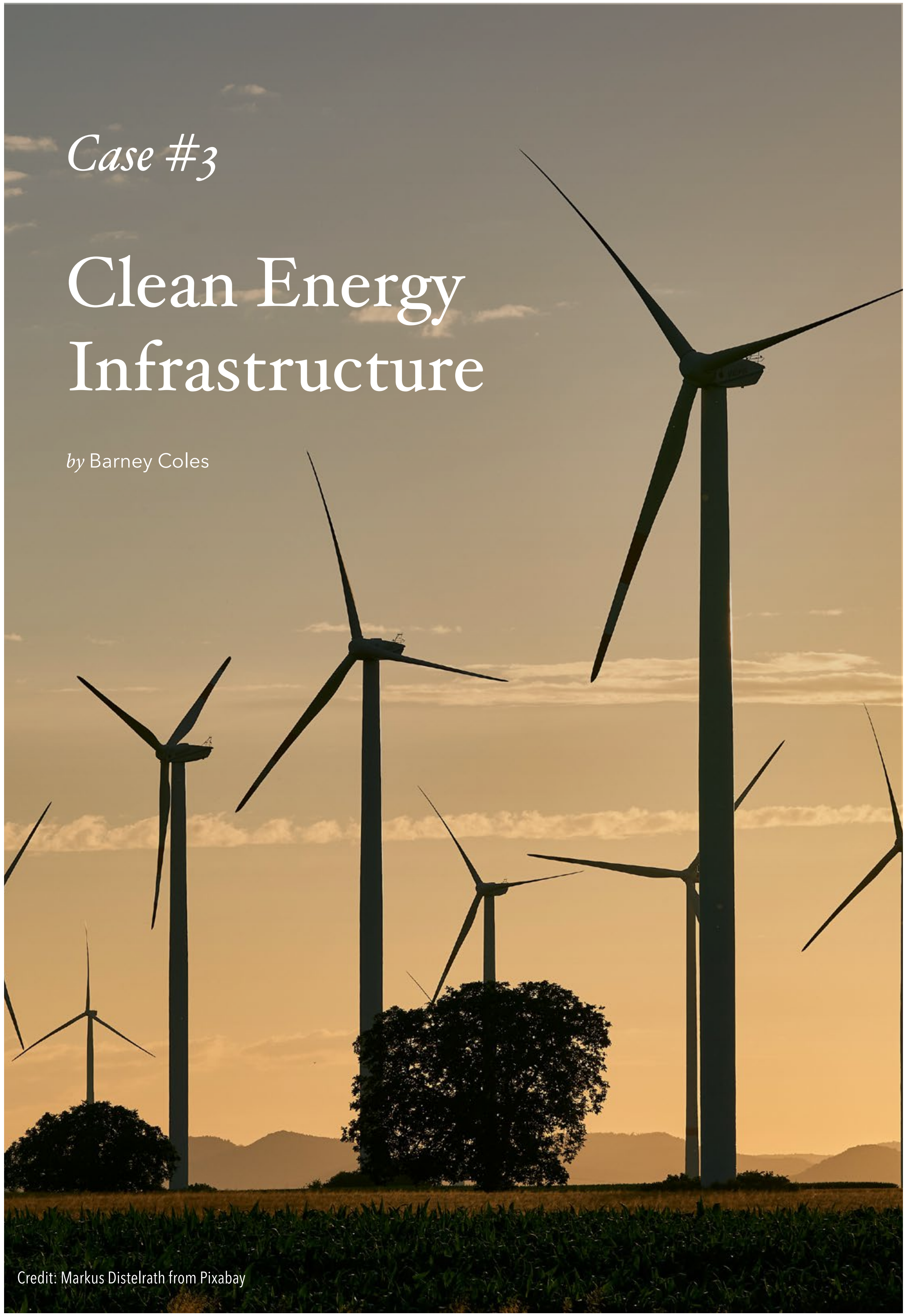
"Unsurprisingly, the Nordic region is a very important opportunity and the focus of our European journey, given the region's leadership on climate change. According to the World Economic Forum (WEF)'s Clean Energy Transition index published in May, Sweden ranks at the top, followed by Norway, Denmark, with Finland ranking in 6th place. The rest of the leading countries are also European. European investors, particularly in the Nordic region, understand climate change, feel its effects and care about it, which means they are acutely tuned to our investment proposition," Montgomery continues.

"Our commitment to Nordic and European investors is going to grow. RAM intends to establish an office in London shortly as a starting point to our European expansion plan. To ensure that we are doing this in a first-class way, it is paramount that we are on the ground, partnering with European allocators and asset owners. I plan to relocate to Europe in early 2022 to establish and forge these relationships. We see that our research and engagement process is already resonating with investors in Sweden, Norway, Finland, and Denmark. We are only just beginning," Montgomery concludes.

Case #3

Clean Energy Infrastructure

by Barney Coles



Credit: Markus Distelrath from Pixabay

Climate change, shifting demographics, and globally recognized standards are a few driving forces that have contributed to the rising importance of Environmental (E), Social (S) and Governance (G) factors in asset management. This, coupled with the ongoing global pandemic, made many institutional asset allocators and investors realize that it is equally important to deliver financial returns and preserve client capital in a sustainable manner.

We believe that sound, fundamental ESG underwriting will translate into meaningful value creation through closer alignment between the objectives of institutional investors, business stakeholders, and society at large. The goal of strong risk-adjusted returns does not require us to compromise our core ESG values.

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Case study

Capital Dynamics R-EYE™ rating system: Longhill onshore wind project in West Lothian, Scotland

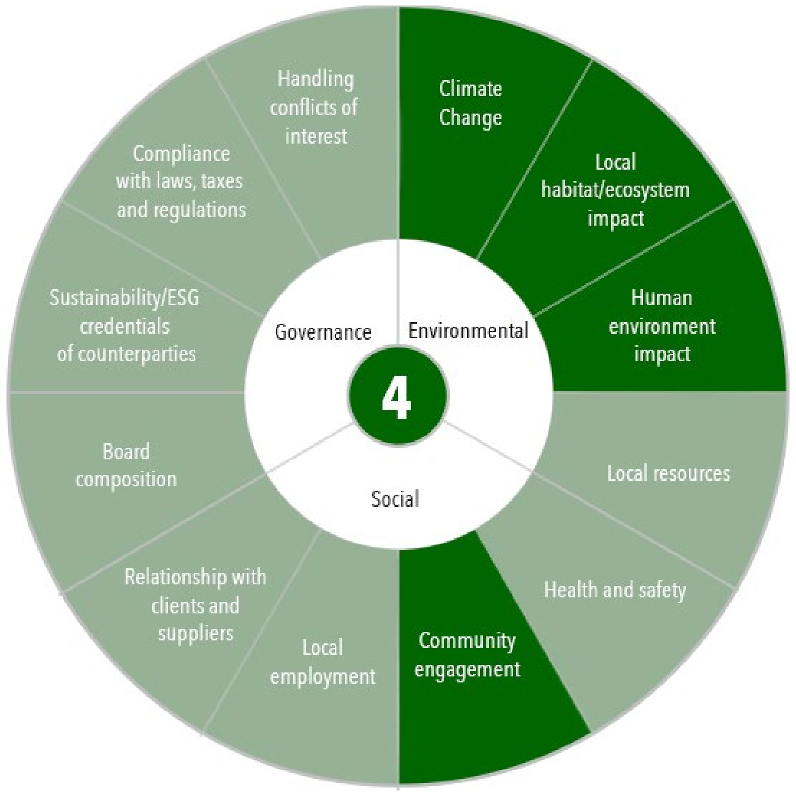
ESG Screening in Action

ESG and responsible investment (RI) principles are deeply rooted in our corporate DNA, and go back to 2008 when we became one of the earliest signatories of the UN-supported Principles for Responsible Investment (PRI). The PRI, the United Nations Sustainable Development Goals (UN SDGs) and other ESG factors are integrated across our investment processes and corporate ethos.

Our proprietary ESG scoring system, the R-Eye™, developed in 2018, and implemented across our investment strategies in 2019, helps ensure that the UN-supported PRI principles and ESG factors along with UN SDGs are included throughout the full investment cycle, starting from investment appraisal to post-investment monitoring. Our R-Eye™ rating system scores each potential investment from 5 (strongest ESG score) to 0 (weakest ESG score) based on a set of criteria developed in conjunction with the UN SDGs. This scoring system helps ensure a consistent and transparent approach to RI due diligence.

In February 2021, Capital Dynamics acquired a 50 megawatt onshore wind project in West Lothian, Scotland, which is expected to be one of the largest subsidy-free onshore wind projects in the United Kingdom once operational. The project received a high R-Eye™ score during the due diligence process, which is indicative of the project's positive impact on the climate, environment and local community, among other factors.

Construction of Longhill commenced in March 2021 and is expected to achieve commercial operations in the second half of 2022. The project is estimated to reduce greenhouse emissions by over 2.6 million metric tons during its lifetime – the equivalent of emissions produced by over 550,000 passenger vehicles driven for a year or the electricity to power over 440,000 homes for a year*.



The project's company Board is made up of 40% females and the project will ensure the local habitat is maintained. Longhill will be replanting the trees that have been felled and have leased a forestry area outside of the site to plant trees that cannot be replanted on the existing site due to the windfarm. Memorandum of Understandings have also been signed with three local community groups based within the vicinity of the wind farm. Longhill is committed to contributing a significant portion of its annual revenue to supporting these local community groups. Local employment will be utilized where possible during the construction process and key members of the asset management team managing the wind farm once operational will mostly be based in Scotland or North England.

(*) Source: Capital Dynamics

RI Element	Score	Rationale
Climate change	5	Low carbon generation, large climate benefits
Local habitat/ecosystem impact	5	Longhill will be replanting the trees that have been felled and have leased a forestry area outside of the site to plant trees that cannot be replanted on the existing site due to the windfarm.
Human environment impact	5	The project was granted planning consent with conditions set in place to ensure minimal impact to any human environment, ranging from noise emission to visual impact. These are being abided by as part of the plan-ning guidelines. During construction, there will be a Construction and Environmental Management Plan to ensure minimal impact on the envi-ronment and enhance the site safety. An Ecological Clerk of Work will be appointed to monitor and ensure compliance with the environmental mitigation and management measures to mitigate any negative impact to the surrounding area.
Local resources	4	Resources from the site will be used where possible in supporting the build of the civil infrastructure of the windfarm with agreements in place with the landlords
Community engagement	5	Memorandum of Understandings have been signed with three local community groups based within the vicinity of the wind farm. Longhill is committed to contributing a significant portion of its annual revenue to supporting these local community groups.
Local employment	4	Local employment will be utilized where possible during the construction process. Key members of the asset management team managing the wind farm when it is operational will mostly be based in Scotland / North England

"Asides from the interconnectedness of all these fields, one lesson I learned is to never underestimate human ingenuity."

Case #4

Investing in Climate Change Solutions

Electrification & HVAC

by Filipe Albuquerque

Francesco Conte
Portfolio Manager
JP Morgan Asset Management

Sara Bellenda
Portfolio Manager
JP Morgan Asset Management

Sustainable investors have to navigate a wide range of alternative and often complementary investment approaches. Between passive and active strategies, superficially screened or deeply impactful investments, the spectrum of ESG investment channels is extremely wide.

Another factor to consider, particularly when thinking of the environmental aspect, according to Sara Bellenda and Francesco Conte, portfolio managers at J.P. Morgan Asset Management, is the difference between companies decreasing their carbon footprint and firms helping them decrease their greenhouse gas emissions.

"Solutions are key to our strategy," Conte says, referring to J.P. Morgan Asset Management's Climate Change Solutions strategy, which he co-manages with Bellenda. "The aim of the strategy is to invest into companies that are helping other businesses to decrease their carbon footprint." According to them, Heating, Ventilation, and Air Conditioning (HVAC) and electrification are two of the most promising sectors for investors to tap into these opportunities.

Why electrification and HVAC?

Conte believes that although revolutionary innovations in the pipeline offer much promise, there are plenty of exciting opportunities available for sustainable investors right now. "There are very interesting technological developments that are not yet commercially viable, such as hydrogen or carbon capture. These technologies will surely change the world, but their price needs to come down. Meanwhile, there are other solutions which are readily available at competitive prices," Conte explains.

"Investing in solutions is not about ratings or being leaders of operational practices. It's about the product and the outcomes, which have to genuinely provide a solution for the environment," Bellenda explains. "Our focus is more narrow than that of the wider market that claims to look at sustainable companies. The solutions that a company provides have to be a meaningful component of that company," Bellenda continues.

According to Conte, the theme of electrification is the bond that ties together a lot of the present and future solutions to climate change. "Electrification and HVAC are climate change solutions that are available now. Electrification taps into the trend towards the replacement of oil and gas by electricity from renewable sources, such as wind and solar farms. In the HVAC sector, newer heat pump technology enables the replacement of fossil fuels for heating and ventilation to electric based heating and ventilation. Such a technology is becoming increasingly price-competitive and governments are introducing a supportive regulatory and fiscal incentives," he adds.

"Renewable energy companies provide a channel for asset owners wishing to support pure play efforts. Investing in incumbents moving to renewable energies can also be a channel for investors wishing to support the transition."

Electrification Solutions to Climate Change

From a purely financial perspective, the case for investing in electrification is clear, according to Conte. "We expect electrification businesses, a part of the wider industrials sector, to grow faster than GDP, because there is such a need for their services to help decarbonise the world," he says.

Conte suggests there are many paths to achieving this destination. "Renewable energy companies provide a channel for asset owners wishing to support pure play efforts. Investing in incumbents moving to renewable energies can also be a channel for investors wishing to support the transition."

"France's Schneider Electric is a very prominent name in this sector. But it is not the sole opportunity," Bellenda argues. "Eaton, a US-based large cap company, is another significant provider of electrification solutions. Its activities tap into many markets, including e-charging stations for electric vehicles (EVs) and the provision of electricity for datacentres. Eaton's exposure to this type of demand in terms of growth potential and valuation and its leadership position in this market are very attractive," she continues.

Electrification also provides other investment opportunities, according to Conte. "Aside from companies like Örsted, which focuses on off-shore energy, investors can also tap into a company such as Vestas, which makes wind turbines," Conte says. "Renewable energy, because it is dependent on variable weather conditions, creates volatility in the electric grid, which raises the need for software solutions to manage the peaks and troughs," he adds. These and other trends conspire to increase the burden imposed on national electric grids in the coming years. "Once EV penetration reaches 20-25%, the grid generally will need improvement to be able to withstand the increased demand imposed upon it," he adds.

Speaking of EVs, there are also interesting investment opportunities laying beyond the most famous cases. "Although Tesla might be the most salient name in the EV industry, Volkswagen has also embarked on an interesting journey. The company's response to the Diesel-gate scandal has driven it to improve its internal processes and strategic vision," Conte adds. "In response to the scandal, they have become the leading automotive investor in electrification. Volkswagen has earmarked €37 billion, or half of all its planned investment expenditure between 2021 and 2025 for the development of future technologies such as electrification," he adds.

"One of the lessons that I have learned is that, when a company makes a mistake, such as Volkswagen did, it often responds by setting up the most advanced control systems and risk management processes and adjusting its strategy. Volkswagen's plan is for half of its vehicle sales to be electric by 2030," Conte explains. "This investment strategy is very appealing to investors given ongoing political efforts to align regulation and fiscal policy to incentivise electric car purchases at the detriment of internal combustion vehicles," the portfolio managers note.

The market for high voltage cables is also likely to benefit from the increased electrification of industry. "The distance between the source of the energy and industrial centres increases demand for high voltage cables to ensure efficient distribution of electricity," according to Conte. This is pertinent in Germany where wind farms are located in the north of the country while its industrial heartland is concentrated in the south. The integration of national European electricity grids into a unified system also increases the demand for high voltage cables. "Companies such as Italy's Prysmian and France's Nexans, which control 70% high voltage cable market, stand to benefit from increasing scale of electricity grids," Conte explains.

Increased demand for batteries as a consequence of the increasing prominence of EVs and renewable energy will also play a crucial role in electrification. "There are not enough batteries in the market to satisfy the demand from EVs as well as for the storage of renewable energy. Businesses such as Scatec, a Norwegian company working with renewable energy in emerging markets, can offer solar energy throughout the working day thanks to their use of batteries," Conte says.

Last but not least, companies like Electrolux also have an important role to play in electrification, according to Conte. "Fridges are the largest energy consuming appliance in any household, so there are also energy efficiency gains to be achieved through software solutions by household appliance companies," he adds.

Opportunities in Sustainable HVAC Solutions

According to the portfolio managers, the dominant opportunities in HVAC are heat pumps, ventilation, and air conditioning. "The key element of HVACs, is heat pumps. In a way, this theme is related to electrification. Each time a building replaces a boiler with a heat pump, heating and ventilation of the building becomes electric. Similarly to electrification companies, firms operating in this space are offering not only hardware products, but also software solutions to more efficiently operate buildings," Conte says.

"Heating and ventilation is roughly half of the energy consumption of a building and demand for heating and ventilation is expected to grow by 50% by 2050. By modernising HVAC system companies will not only modernise their building. They will also decrease their overall energy bill therefore reducing overall greenhouse gas emissions." Conte explains. "These companies can provide hardware and software solutions to better manage buildings' energy needs. "The actual type of solutions that these companies provide varies depending on the clients' needs but the competition between them is mainly focused on technology and the type of solutions provided rather than on price," he continues.

"Trane Technology, for example, provides air conditioning solutions to residential and commercial buildings, including hardware, but also after-sale care such as customer assistance and product maintenance. It is a large American company, with a market capitalisation of US$45 billion and operations concentrated in the USA, but also covering Europe and Asia," Bellenda says.

"The company offers a dual investment opportunity to gain exposure to the profits associated with upgrading and refreshing office buildings. Real estate assets will be adjusted to integrate post-pandemic health and safety concerns following the return to face-to-face working conditions. Concomitantly, they are also due to be upgraded to meet more stringent environmental standards," Bellenda adds.

"The HVAC industry is characterised by significant barriers to entry. By continuously raising regulatory standards only the most technologically advanced companies can meet those standards. Global leaders such as Trane, Johnson Controls, Global Carrier and Daikin have the technology to meet these high standards and are naturally shielded against potential competitors," she continues.

The Role of Regulation

Delving deeper into the issue of regulation, Conte is keen to highlight its positive contributions to the industry when it is appropriately designed. "Thanks to human ingenuity when faced with more demanding regulation companies can develop innovative solutions," he says.

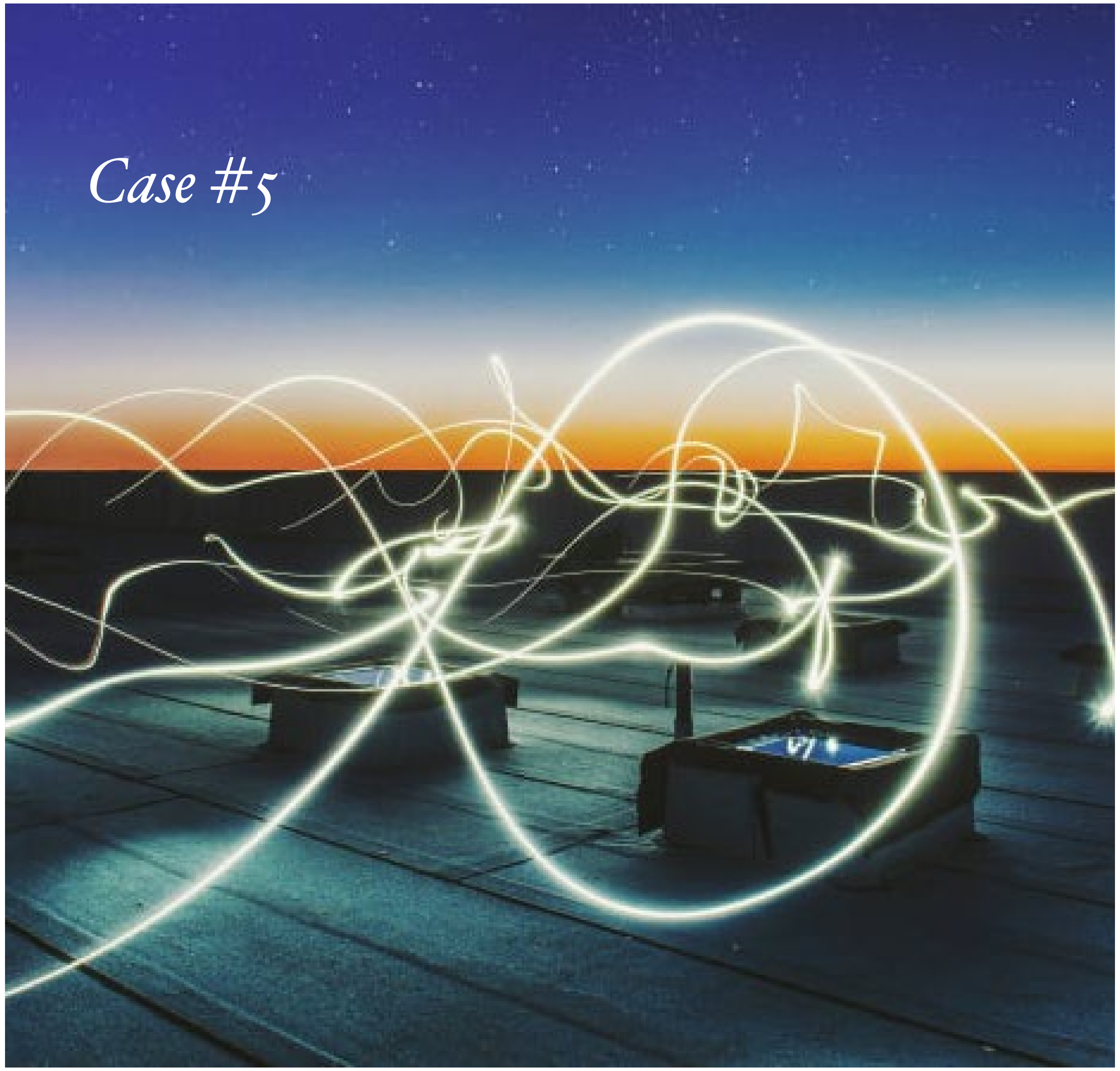
"Europe has the highest environmental regulations in the world, it is therefore not surprising that many global companies develop new technologies for the European market which are then sold in the rest of the world. Although many of the leading HVAC companies are based in the USA, our understanding is that they tend to develop new products in Europe because the regulations there are more stringent. Those products are then sold worldwide. European regulatory stringency is actually a fuel for technological innovation," Conte explains.

"The same is true of environmental regulations. Companies are having to push the limits of their capacity to find new and better environmental solutions in their European activities because of all the climate change mitigation regulations coming out of Brussels," Conte adds.

The Road Ahead

According to Bellenda, disclosures are going to remain the dominant themes for investors in climate change solutions. "From a research perspective it is both exciting and challenging to try to overcome the data difficulties in this field. It requires engagement to get access to corporates, find more about their business model, how the company works and understand the implications of their approach to environmental and social factors. ESG disclosures will play a very important role going forward, particularly for small cap corporates' ability to access investors," she argues.

Finally, Conte is hopeful regarding the pipeline of innovative solutions expected to become commercially viable in the future. "Asides from the interconnectedness of all these fields, one lesson I learned is to never underestimate human ingenuity. Solar power was dismissed as expensive for many year and is now a perfectly affordable technology. Today, hydrogen seems to be where solar power was a decade ago. Whether it is the technological frontier or environmental regulation, companies will find a solution," he concludes.



Schneider Electric
and the Power of Strategic Vision

by Filipe Albuquerque

The views expressed are those of the interviewee at the time of writing. Other teams may hold different views and make different investment decisions. The value of investments may become worth more or less than at the time of original investment. While any third-party data used is considered reliable, its accuracy is not guaranteed. For professional, institutional, or accredited investors only.

"We invest in companies with a history of high returns, a great business model and stewardship that perpetuates that return profile into future generations."

Yolanda Courtines
Co-Portfolio Manager, Global Stewards Fund
Wellington Management

Over the years, the financial community has developed a wide range of approaches to the integration of ESG factors into investment processes. Although some of these processes have become standard steps in the construction of investment portfolios, the final stock selection for an active manager still relies on an in-depth understanding of the dynamics of an investee company and the journey it is on.

According to Yolanda Courtines, co-Portfolio Manager of the Wellington Global Stewards Fund, Schneider Electric offers an interesting case study in how strategic vision can reverberate throughout an organisation to improve returns and reduce risks. Schneider is particularly interesting in that it operates in an industry naturally relevant for climate change mitigation, making sound stewardship and governance even more vital to investors and society.

The stewardship and governance approach

With almost three decades of experience in the financial industry, Courtines's career has spanned roles across several large investment banks as well as the World Bank. "Throughout my career, I have had a broad set of global experiences, focusing on emerging markets as well as European banks, both on the sell and on the buy side," Courtines says.

"Of all the approaches to investing that I have witnessed, I concluded that focusing on long-term good governance, building sustainable franchises and strengthening risk controls are some of the best drivers of profits over time," she explains.

When the time came to set up the Wellington Global Stewards Fund with her co-portfolio manager Mark Mandel, Courtines's stewardship focus became a guiding principle. "We focus on investing in companies that marry a history of high returns and a commitment to stewardship. We own great business models with strong stewardship that in our view can perpetuate that return profile for future generations," Courtines adds.

The Global Stewards Fund

The Wellington Global Stewards Fund has a low turnover, a very long-term investment horizon and takes a highly selective, best-in-class approach to ESG investing, aiming to hold no more than 50 different stocks in the portfolio. "Sustainable investing can be pursued in a wide range of different ways," Courtines argues. "We think of the integration of ESG into the Global Stewards Fund as protecting and building value for the future. We look for practices that are sustainable for the business model and really take care of all stakeholders."

The Global Stewards Fund takes a balanced approach to portfolio construction with exposures across the main sectors of the economy, she explains. "We wanted industrial exposure to companies that were not locked into traditional CO_2-heavy approaches and were able to adapt to the energy transition. We apply scorecard criteria to stock selection and look for companies with a strong ESG profile focusing on the metrics that matter to us. We think our inclusive approach makes us very different from the average sustainable fund in the market that relies on exclusions and screens. We focus on companies that are already excelling, have a track record of being good stewards and, in our opinion, have the necessary edge to achieve sustained returns over the long term," Courtines says.

ESG in Wellington's investment scorecard

Wellington's Global Stewards Team uses a proprietary scorecard for its investments which reviews both quantitative and qualitative aspects, including returns history and a range of governance, social and environmental factors. The stewardship part of the scorecard focuses on ESG factors distributed among three main categories: executive strength, board empowerment and stakeholder engagement and transparency.

Courtines highlights executive strength factors such as the tenure of the CEO, the employee turnover at all levels of the company and the degree of diversity at top executive levels as relevant to the Fund's strategy. "We are looking for companies with the right incentives, where executives' compensation, including that of the CEO, is aligned to appropriate outcomes over relevant time horizons," she says. "Another important consideration is whether there is a purpose or strategic messaging that resonates and is repeated all the way through the company. The consistency and focus of this 'tone from the top' is also very important."

At the board level, the focus is on empowerment, with competent, responsive and independent directors providing challenge in the boardroom and setting the long-term strategy for the company. "If executive strength and board empowerment are right, everything else falls into place," says Courtines. "If a company's messaging is from a marketing department that is ticking boxes on ESG criteria, it is not going to get the same performance as if that drive came from the board and the executives."

Beyond these two governance factors, Wellington's stewardship approach also tackles environmental and social challenges. "Stakeholder engagement considers how firms treat the environment, as well as how they lead on social and diversity factors, manage talent retention and partner with their supply chain and community and how we measure their culture," Courtines says.

Stewardship on the ground

Operationalising these considerations requires data analysis and on-the-ground engagement. "For data to be informative, it's necessary to know how to ask the right questions and do the due diligence. We will also consider the view of third-party ESG data providers, but we will not follow their opinion blindly. We consider bottom-up data and put it in the context of the company, thinking about materiality and internal and external validation of our opinions on each one of those topics," the portfolio manager explains.

On-the-ground engagement is crucial to generating those insights, according to Courtines. "We would not be doing our job without diving deeply into the drivers behind the data points. We commit to one executive- and one board-level meeting annually for each of our holdings. In reality, we meet with companies five to seven times a year, for earnings sessions, board-level meetings, ESG meetings and supply chain meetings. It's on those occasions that we can ask specific questions about the firm that inform our scorecard and investment decisions," she adds.

ESG case study: Schneider Electric

"When setting up the Fund, we were looking for companies that help their industry move forward in innovative ways. The electrification sector and Schneider Electric — a forward-looking company which is thinking about the industry a decade ahead, instead of where it has been — are a very good fit with our approach," Courtines explains.

Schneider Electric is a French energy solutions company operating in the low voltage space between electricity transmission and use. With a €87.7 billion market capitalisation, it is one of the leading industrial companies in Europe, on a par with Siemens and Legrand. Over the last five years, Schneider has expanded from being a provider of electric products to adding more digital solutions that help its customers reduce their carbon footprint and their energy bill. "In many ways, Schneider's business is a natural choice for a sustainable investor," Courtines argues.

According to her, Schneider's story fits well into the Fund's stewardship framework. "We've owned Schneider since the early days of the Fund's life, investing in June 2019. It is a strong margin business generating returns on equity in the low teens. As there is room for it to grow in scale and add more value to the solutions they are already providing, we see strong potential for their earnings and returns to increase," she explains.

"Schneider provides the products and services to support the last-mile delivery of electricity and the smart solutions for how it is consumed; it helps data centres run 24/7, supports smart buildings, and improves energy efficiency for industrial uses. Among other services, Schneider ensures the stability of power supply as the grid becomes more complex and uses more renewable energy from solar panels or wind turbines," Courtines says.

"Schneider's services help its customers reduce their carbon footprint and have a more positive impact on the planet. The company fulfils all the criteria that we look for when we do our screens for both returns and stewardship. It has been a top 10 contributor to the Fund and, given its present trajectory, we expect it to remain a positive contributor in the future," she explains.

Courtines argues that Schneider is one of the most holistic fits with the Fund's investment approach. "In addition to aligning with all our key scorecard metrics, the oversight, the strategic vision and the long-term culture are also handled extremely well at this company. There is no such thing as a perfect company and ESG is not a static concept. The bar is constantly moving, but we think that Schneider stands out as a good example of what we are looking for. We want companies to be transparent, science-focused in their targets and driven to continue to excel," Courtines adds.

Strategic leadership at Schneider

Courtines underscores the value of resilience and adaptability. "Schneider Electric stands out among its peers because of its focus. After Jean-Pascal Tricoire took over as CEO of Schneider Electric in 2006, the company began a strategic shift to increase exposure to the themes of electrification and automation. That helped drive its approach to talent, to solutions for its customers as well as its investments over the long term."

Referring to the importance of "tone from the top" in a company's executive leadership, Courtines highlights the clarity of purpose provided by Schneider's vision of electrifying for the future. "The driving force in this journey is the company's clear focus on helping its clients electrify. To do this, Schneider seeks to be close to customers to help provide solutions to reduce their environmental footprint and ensure customer satisfaction," she says.

The implications of Tricoire's shift in strategic focus percolated throughout the company, according to Courtines. One of his main strategic focuses was local empowerment through a distributed management model, with talent and power spread locally across Schneider's various regions of operation. "The regions are staffed to meet the end demand. Decision making is locally distributed and connected globally. The model is very powerful and allows the regions to communicate with each other while also engaging proactively with local customers and supply chains," she explains. This helped reduce supply chain disruption post-COVID.

The value of good governance

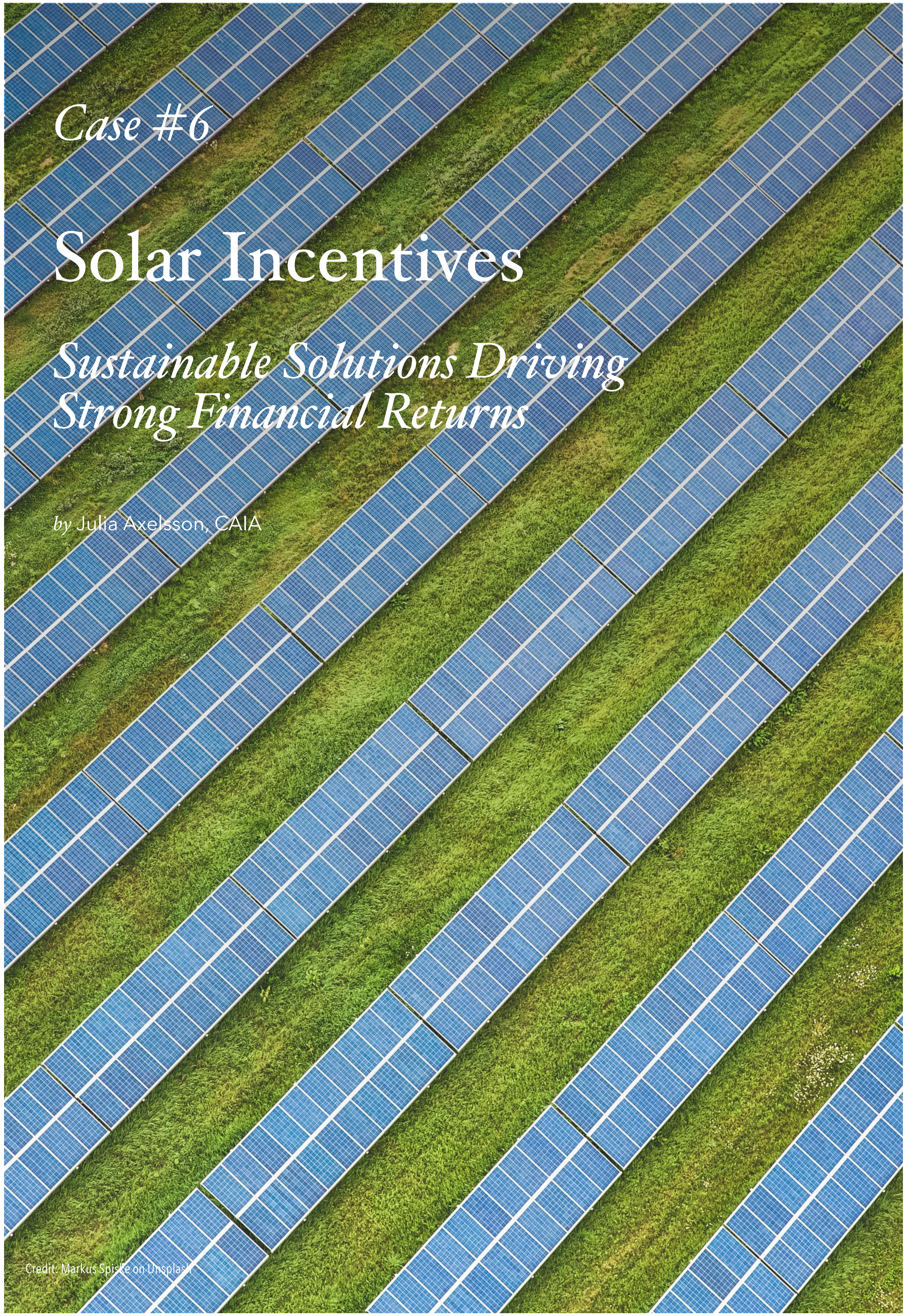
"When it comes to people, Schneider's clarity of purpose ensures it can manage and build a strong talent pool across regions. Despite its decentralised nature, Schneider's focus on communications ensures open channels of exchange between teams to build value, understand local markets and have that depth of skill extend through to the supply chain to find solutions," Courtines says.

Courtines notes that Schneider has also increased diversity at the executive and board levels. "We believe that diverse representation is additive to a company's position of strength. When Tricoire joined, of the top 1,000 executives across Schneider, only 3% were women, a figure which has increased to 27%. The board also has a more diverse make-up, be it on gender or background as well as on the skill sets that they bring. The lead independent director is experienced and has the CEO's confidence to set the board's agenda. Although there is no separation of Chairman and CEO at present, the company discusses its openness to separate those functions in the next four years," the portfolio manager explains.

The COVID-19 test

Schneider's decentralised approach yielded results in the first half of 2021, when the global economy suffered significant logistical and supply chain disruptions and dislocation, according to Courtines. "This was one of the things that came through from the strength of that governance model. As with its other stakeholders, Schneider had leaned into its supply chain, partnering and developing close contacts and sharing a long-term vision, which allowed it to find proactive solutions that helped it defend its margins in the first half of 2021. Schneider looked much stronger than many of its peers on that front."

Courtines believes that doing good paid off during the pandemic. "What COVID-19 taught us was that we were right to focus on companies that were treating their stakeholders well, and who had earned their trust before the COVID-19 period. As a result, companies like Schneider had less of a drawdown in revenues and managed their financial returns during that period better than their counterparts that did not have a similar strategic ESG focus," she concludes.



Credit: Markus Spiske on Unsplash

Case #6

Solar Incentives

Sustainable Solutions Driving Strong Financial Returns

by Julia Axelsson, CAIA

Oskar Tijs
Senior Portfolio Manager
NN Investment Partners

Paul Schofield
Head of Sustainable &
Impact Equities
NN Investment Partners

Sustainability has always been centre-stage for Dutch asset manager NN Investment Partners (NNIP). The philosophy behind it is simple: "As a responsible investor, we aim to improve our clients' returns and the world we live in. Because it matters, and it works." A lot has happened in the twenty years since the launch of NNIP's sustainable equity strategy, yet the basic approach has not changed dramatically. The focus is still on finding tomorrow's winners: high-quality companies with sustainable businesses and a strong competitive position that are aware of their role and responsibility to society and act accordingly.

With such a mindset, it must be difficult to single out just one sustainable investment in the portfolio to showcase what a successful ESG integration looks like at NNIP. After careful deliberation, however, Paul Schofield, Head of Sustainable & Impact Equities and Oskar Tijs, Senior Portfolio Manager, make up their mind. The case they want to talk about is SolarEdge[1], a smart technology company that is best known for pioneering an innovative way to collect and manage energy in solar systems.

Why SolarEdge?

"We see renewable energy, and specifically solar, as an area of continued strong growth in the energy transition value chain," explains Tijs. "We are looking for winners within the chain, companies that can grow with sustainable solutions while having an economic 'moat', resulting in an attractive return on invested capital. SolarEdge ticked all these boxes when we entered in 2016, growing rapidly and gaining market share while increasing its margins with distinctive products protected by patents," he adds.

In 2009, SolarEdge launched an intelligent inverter solution for photovoltaic systems, maximising power generation while lowering the cost of energy produced. This cost-efficient solution has allowed the company to gain a sizeable residential market share in the US, Europe, and Australia. The model is also scalable, which opens opportunities in the commercial and large-scale utility markets. "It is a rare solar play that combines strong growth with consistent high return on capital," says Tijs.

SolarEdge IPO-ed on NASDAQ in 2015 and has since shown significant growth in revenue and gross margin. By now, NNIP is hardly alone to have discovered this company, so perfectly positioned to aid the global sustainable energy transition with its innovative technological solutions. In hindsight, SolarEdge seems like an obvious sustainability play, yet it was probably not when NNIP stepped in to become one of SolarEdge's biggest shareholders back in 2016. So, what is it about NNIP's idea generation process that enables it to zoom in on future winners like SolarEdge early on?

Looking at the chain

Finding high-quality, sustainable businesses that can stand the test of time is not a quick or straightforward process. It means being selective: narrowing down the investable universe step by step until you reach a well-rounded portfolio. And NNIP has developed a consistent and repeatable approach to do that. An initial raw screening excludes from the very start companies that don't align with NNIP's norms-based restriction criteria as well as those that aren't transparent or score poorly on ESG metrics. In the next step of the process, a detailed financial analysis of the remaining companies, conducted with the help of the HOLT® database as a screening tool, reveals the most interesting opportunities to look at. "We refer to these high-quality businesses as 'sustainable compounders', given the long-term compounding effect of their positive economic and societal characteristics," explains Schofield.

The unique feature of NNIP's approach, however, is perhaps the way analysts and managers both focus on value chains rather than on traditional industries and sectors. "When I think about energy, I don't just consider energy companies. There is so much more to it," says Schofield. Apart from traditional oil and gas energy companies and renewable ones like solar and wind-panel producers, the energy value chain also includes companies that make the components for these industries. Most of the non-traditional energy companies are typically in the industrials, materials, and IT sectors. As a result, the coverage for the energy value chain is much broader than simply traditional energy companies and their service providers.

Looking beyond sector constraints makes it easier to discover which part of a value chain creates the most profit and which companies are in the sweet spot. Moreover, analysts who are not constrained by traditional sector definitions are better equipped to locate potential growth opportunities. From the vantage point of overlooking the entire value chain, they can also identify and assess new trends and find new data sources.

Beyond ESG scores

Back to SolarEdge, it is easy to see how the stock made it through the sophisticated screening process and caught the attention of an analyst back in 2016. Financially screened as a 'sustainable compounder', it is also a perfect fit for one of the value chains that NNIP has a particular focus on, 'Energy Transition'.

Yet had they chosen to solely trust external ESG ratings at the onset, SolarEdge might not have made it into NNIP's portfolios. "A few years ago, the company scored quite poorly," recalls Tijs. "Mostly because their ESG reporting was not good enough for the rating agencies."

According to NNIP, although external ESG scores are helpful as an initial filter, they are insufficient for identifying truly sustainable companies. They are usually backward-looking, and there is not always a logical or material link between the scores and a company's behaviour and business model. There is also a significant bias towards larger companies with the resources to produce high-quality annual sustainability reports. Proprietary research is, therefore, crucial to locate truly sustainable companies with potential for additional alpha.

Dealing with companies means dealing with people, so engagement is also vital in assessing non-quantitative idiosyncratic risks related to corporate behaviour. "We talk to the CFO of SolarEdge every quarter at least," says Schofield. This regular and frequent follow up is partly a matter of gathering material information, but it also means engaging to improve disclosure on ESG issues. In SolarEdge's case, the company has relatively recently started producing ESG reports, nudged by investors like NNIP. Consequently, their external ESG rating has improved a lot, too.

Long-term commitment

SolarEdge has been a stellar performer in NNIP's portfolios for years now. So, could it be that it has already played out its role, and it is time for the managers to move on to other, more attractive opportunities? "The SolarEdge business case is still intact," explains Tijs. "Yes, we've had to reduce our holdings slightly, for risk-management reasons, but as long as we believe in the company, it remains a good fit within our portfolio," he adds.

Schofield says that he is continuously impressed by how SolarEdge's R&D department is driving innovation, resulting in 348 awarded patents and 266 patent applications filed until the end of 2019 alone. Even more impressive, however, is the company's sustainable impact. "Based on the installations until the end of 2019, SolarEdge estimates an annual avoidance of 12.6m tons of CO_2," he points out. Driven by the additional installations in the past 6 quarters, the volume should have increased to an avoidance of some 20m tons of CO_2 annually until June 2021, according to him.

"We apply a high-conviction approach that seeks out companies with high and resilient long-term returns and a meaningful sustainable impact. It results in portfolios with a rather low turn-around," says Schofield. "We invest for the long term," he concludes.

[1] Disclaimer: For illustration purposes only. Company name, explanation and arguments are given as an example and do not represent any recommendation to buy, hold or sell the stock, or in any way invest in these companies. The security may be/have been removed from portfolio at any time without any pre-notice.

Case #7

Manager Selection

Finding Authentic and Credible External ESG Managers

by Filipe Albuquerque

Credit: bluebudgie on Pixabay

As asset managers continue to respond to institutional investors' growing demand for ESG products, understanding what separates a credible partner from one who does not win a mandate is crucial for managers seeking to survive in an increasingly competitive sustainable finance environment.

Anders Bertramsen, Head of External Products at Nordea Asset Management, singles out five ESG challenges underlying external manager selection. The overarching solution to overcoming these hurdles is to focus on authenticity and assessing the credibility of a manager's commitment to ESG, he argues. One recurring factor he highlights is how much ESG investors at all levels actually do their due diligence and how much they delegate instead. Although there is no silver bullet, an awareness of the need to thread the thin line between excessive dependence and independence is key.

"For European Equity funds it is easy to find a product that has a very low carbon footprint, because they operate in an investment universe where it is a lot easier to find such opportunities."

Anders Bertramsen
Head of External Products
Nordea Asset Management

Challenge # 1: General ESG Data

Although data is at the core of all investment decision-making, it is particularly relevant for sustainable investors, for whom the overall data coverage and quality is a challenge. "ESG data can be complex and difficult to collect. The issue emerges due to companies' different reporting and disclosure capacities, which feeds into the quality of the fund level data and the credibility of their sustainable investment claims," Bertramsen says.

"For example, it is not always obvious how much of a fund is included in the calculation of a portfolio's weighted average carbon intensity measure, which is a proxy for the carbon footprint of a fund. Some providers will only publish the value for this indicator if they have information for at least 70% of the fund's holdings, but others do it differently," Bertramsen explains.

It is also not very easy to make comparisons across funds according to Bertramsen. "For European Equity funds it is easy to find a product that has a very low carbon footprint, because they operate in an investment universe where it is a lot easier to find such opportunities," he adds.

"The same is not true for a fund specialising in Indian equities, which is a very dirty asset class, with a lot of industrial companies emitting a lot of CO_2. The same is true for US high yield. It's really difficult to find low emissions because energy is 13% of the index. It's important to think in relative terms, not necessarily in absolute terms. Comparing a European Equity fund with its Indian or US High Yield counterparts does not necessarily make sense," Bertramsen continues.

Challenge #2: Fund ESG Data

Moving from the issues with company data up to the fund level, fund selectors are directly faced with the lack of data consistency Bertramsen explains. "When we analyse funds and managers, we have a traditional search process and we look at their approach, their philosophy, return and risk performance, business measures and ESG," Bertramsen says.

"Focusing on ESG, we consider sustainability assessments of fund managers by third party data providers. However, although we consider these as one of many inputs and are not tied to their conclusions because they vary a lot," Bertramsen adds, referring to the well-known issue of subjectivity in ESG assessments.

"The quality and price of ESG data are important issues, but people can also inflate what they do. We want to work with the asset managers that we believe truly integrate ESG into their investment process."

"The ESG ratings of the same fund will differ significantly between different data providers. The coefficient of correlation is about 40%. A similar comparison between credit rating agencies will normally yield a correlation of over 90%. The credit rating provided by S&P will normally match that of Moody's. An MSCI ESG rating is not guaranteed to look the same according to Sustainalytics. There is correlation, but the individual ratings differ quite a bit," Bertramsen explains.

The incomplete coverage of data from third party providers is another important factor. "Once the focus shifts to smaller less liquid names, such as the ones in a high-yield manager's portfolio, we know that the data coverage from these ESG data providers is not going to be as thorough," Bertramsen continues.

Challenge #3: Overreliance on Third-Party ESG Data Providers

The correlation problem rears its head again when managers decide to apply ESG exclusions, according to Bertramsen. "If this were a credit rating criterion, the consistency of assessment across data providers is such that it wouldn't really matter which credit rating would be considered. However, given the low level of correlation across ESG ratings, the choice of ESG data provider will be material in determining whether a company is excluded or not," he says.

"Implicitly, such a fund manager is delegating its investment decision to a third party data provider. That is an example of an extremely weak approach to ESG integration. If ESG really is important, you don't delegate it to a data provider. Fund managers need to do their homework otherwise they are not adding value," Bertramsen adds. "Ironically, this is not only a problem for asset managers. A lot of institutional investors follow the same approach to fund selection, setting a threshold below which fund managers cannot invest," he remarks.

In that case, investors might as well go passive, which according to Bertramsen is also an issue. The subjective nature of an ESG rating will interfere with the so-called independence of a passive ESG fund's investments. "Implicitly, a passive fund is endorsing one ESG rating over another, which raises the question of why that rating was chosen. At the investment level, the ESG integration questions becomes one for the index and its methodology, not the fund," Bertramsen explains.

"A fund manager that collects data from several third party ESG data providers before reaching its own conclusion is much more appealing to a fund selector. I'm much more interested in being approached by a manager that has done its due diligence and argues a third party provider has made a mistake on its assessment and that they intend to position themselves in expectation of a future ESG rating change," he explains.

Challenge #4: The Cost of ESG Data

Another problem Bertramsen highlights is that the complexity of ESG analysis puts a steep price tag on sustainability services. High prices are fuelled by the actual costs of data collection, market segmentation and regulation, he argues.

"On the one hand, the low hanging fruit of ESG data has already been picked up. The easy data has already been collected. The added information is actually quite expensive to collect, which explains some of the reasons for the high price of ESG data. On the other hand, this is also an oligopolistic market with very few and large players," Bertramsen says.

The use of third party ESG data is also a fine balance. "While complete reliance suggests a fund manager is not actually serious about ESG integration, the absence of any external ESG data will also raise some eye-brows and risk signalling that the manager is being cheap about ESG which suggests they are not serious enough to invest in the necessary tools." According to Bertramsen, knowledge of these dynamics gives data providers the opportunity to demand high prices.

"Not only is it expensive to collect and maintain this data, the segmented nature of the ESG data market contributes to the costs facing asset managers. The inability to rely on a single data provider also contributes to the cost of ESG. For the smaller and medium-sized asset managers, ESG costs are making it increasingly difficult to compete," Bertramsen adds.

Regulation also plays a role, according to Bertramsen. For example, the advent of the EU's Sustainable Finance Disclosures Regulation (SFDR) carries the added responsibility for managers to collect and disclose data on 14 Principal Adverse Impact (PAI) indicators by 2022. "A lot of asset managers will look to third party ESG data providers to calculate these metrics instead of collecting it themselves directly from the portfolio companies. There is a cost to paying for adhering to the regulation. Companies such as Sustainalytics, MSCI, and Dow Jones are in an arms race to see who can develop the broadest coverage package for its clients," Bertramsen explains.

However, the situation is not hopeless. "In my opinion, smaller managers should focus less on volume, and instead concentrate on quality. If they target a smaller investment universe, they will be able to provide an internal rating for a more niche set of companies. This would allow them to not rely on third-party data providers," Bertramsen suggests

Challenge #5: Credibility

"The quality and price of ESG data are important issues, but people can also inflate what they do. We want to work with the asset managers that we believe truly integrate ESG into their investment process. To overcome these challenges, we have a proprietary questionnaire and scoring methodology, which allows us to produce an in-house assessment for each manager based on the issues we actually want to discuss with them," Bertramsen says.

However, to get a real feel for whether that is the case or not, Bertramsen argues there is really no alternative to talking to as many people in the investment team as possible. "The lead portfolio manager will tell a good story, because he is a good salesman. But you want to talk to the credit analyst and have him explain how he does his job, whether he is also responsible for the ESG analysis, how and what his interaction with the centralised RI team works."

When talking with the RI team, Bertramsen is also mindful of whether their work is credible. "We focus on the people the manager claims are in charge of integrating ESG into the investment process and into the business analysis. Four ESG analysts covering 200 companies is unrealistic. The same is true for engagements. We want to know how the fund's team carries out its responsibilities and whether it makes sense. This is how we establish whether a fund manager is actually credibility," Bertramsen adds.

Bertramsen says it all comes down to a simple question: "Do we believe in them? – That is really all that matters." This can be subjective of course. "Ultimately, what that question tries to establish is whether they really are integrating ESG into their investment process. If a fund says that ESG really matters to them, then I want to know that this is not just the lead PM saying that. It's important to know that that is true for all the people providing input into that decision-making process," he says.

Conclusion: What Funds Need to Do

Bertramsen wants portfolio managers to emphasise the need for a strong attachment to ESG at their investee companies' senior management level. "At the portfolio management level, its important to see that they can explain what they do and why they included a specific company in the portfolio. It also has to trickle down to the sector analyst or the credit specialist. If they say they do engagements, we want to know whether the PMs engage or whether it is conducted by a centralised engagement team."

"I personally, like a combination. The business analyst follows a company on a daily basis and knows it inside out. The engagement specialists are better at the engagement part but they don't know the company as well. The two combined will know more than each separately," he adds. "This is how we know that they will invest in it as a strategic priority in their vision," Bertramsen concludes.

Case #8

Building a Carbon Efficient Sustainable ETF

by Willem Keogh, Head, Passive & ETF Investment Analytics, UBS AM
& Davide Guberti, Passive & ETF Investment Analytics, UBS AM

As climate change has risen to the top of investors' agendas UBS has continued to evolve, enhancing its existing ETF offering, adjusting benchmarks, launching Paris aligned ETFs and most recently unveiling the ESG Universal Low Carbon Select ETF family. In our experience, a few bad names from traditionally polluting industries are responsible for the majority of portfolios' carbon intensity.

What drives the carbon footprint of a portfolio?

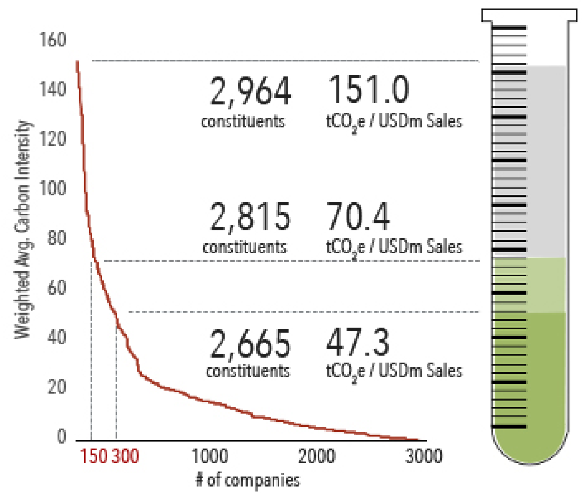
Taking MSCI ACWI as a starting universe, we can analyze the Carbon Intensity of each company in order to understand what the key drivers of the portfolio's carbon footprint are. In figure 1 we highlight the 10 companies with the highest carbon intensity (Scope 1 + Scope 2 t CO_2e / USD m Sales) and we can see how these few names, despite having a relatively small weight (~50bps, keeping in mind that ACWI has ~2960 constituents), are contributing 5.42% to the MSCI ACWI Weighted Average Carbon

Figure 1: MSCI ACWI – top10 companies by carbon intensity

Rank	Company	GICS Sector	Weight-MSCI ACWI	Carbon Intensity	Contribution to Wtd Avg Carbon Intensity
1	Electricity Generating PLC	Utilities	0.00%	20,439	0.44%
2	NTPC Ltd	Utilities	0.01%	17,451	1.97%
3	China Resources Power Holding Co Ltd	Utilities	0.01%	15,428	1.07%
4	Huaneng Power International Inc	Utilities	0.00%	13,505	0.34%
5	Huadian Power International Corp Ltd	Utilities	0.00%	12,490	0.07%
6	China Power International Development Ltd	Utilities	0.00%	12,270	0.04%
7	CK Infrastructure Holdings Ltd	Utilities	0.01%	11,936	0.28%
8	SDIC Power Holdings Co Ltd	Utilities	0.00%	11,635	0.70%
9	China Resources Cement Holdings Ltd	Materials	0.00%	11,529	0.10%
10	Saudi Electric Co	Utilities	0.01%	11,002	0.40%
		Subtotal	**0.05%**		**5.42%**

Source: MSCI BPM, MSCI ESG Manager, UBS Asset Management. Data as of 31st August 2021.
This information should not be considered a recommendation to purchase or sell any particular security

Figure 2: Illustration of carbon intensity per constituent (MSCI ACWI)



Source: MSCI BPM, MSCI ESG Manager, UBS Asset Management. Data as of 31st August 2021. For Illustrative purposes only.

Intensity (WACI), which is quite high. This confirms that a limited number of names are responsible for the vast majority of the carbon intensity in a portfolio, suggesting that we could substantially improve the carbon profile of a portfolio by performing targeted exclusions.

By being able to identify and exclude the most carbon intense names, we could achieve certain climate-related objectives while maintaining the risk-return characteristics of the initial portfolio.

What is the definition of a "highest emitter"?

We have seen in the previous section how the carbon footprint of the portfolio is influenced by a relatively small number of companies. What is less intuitive is how to define the threshold for exclusion that balances the trade-off between carbon footprint reduction and portfolio representativeness.

In order to illustrate this problem, in figure 2 we show the marginal contribution to Weighted average carbon intensity of each company in the MSCI ACWI. All the constituents of the portfolio are sorted in descending order based on their carbon intensity (Scope 1 + Scope 2 t CO2e / USD m Sales) and the red line shows the rolling WACI, obtained by recursively excluding the most carbon intense company remaining in the portfolio. The steepness of this curve indicates the marginal benefit of each exclusion, and it can help us understand the optimal cut-off point based on the number of exclusions.

In the chart we highlighted two potential thresholds for the highest emitters: the worst 5% and worst 10%. Taking the latter as an example, a 10% threshold means that the 10% companies with the highest carbon intensity are classified as "highest emitters" which, out of the ~2964 of MSCI ACWI, amounts to 296 companies excluded. As shown in the chart, removing these 10% highest emitters reduces the portfolio constituents to 2966, but has a substantial impact on the carbon emission which is reduced by almost 70%.

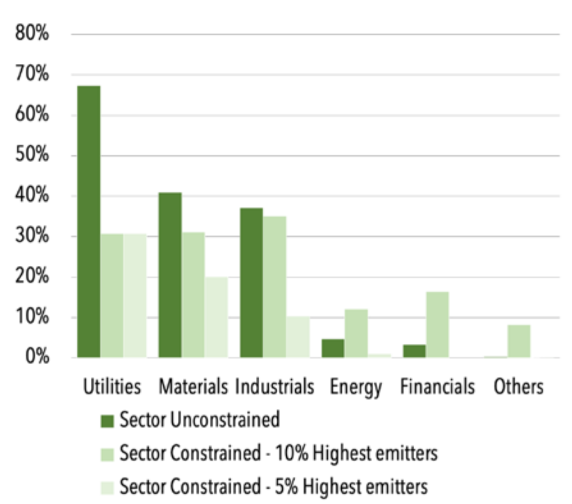
Similarly, by excluding the worst 5% emitters (~148 companies) the WACI decreases by ~50%. Both these examples confirm how a limited number of targeted exclusions can substantially improve the carbon emission profile of a portfolio.

Figure 3: Carbon intensity by sector

Company	Maximum Carbon Intensity (t CO2e / USDm Sales)	Weighted Average Carbon Intensity (t CO2e / USDm Sales)	Sector Weight
Utilities	20,439	2,074.5	2.7%
Materials	11,529	815.8	4.9%
Energy	3,782	566.8	3.1%
Industrials	4,750	122.1	9.8%
Real Estate	878	119.6	2.6%
Consumer Staples	1,544	53.3	6.8%
Consumer Discretionary	1,367	35.4	12.2%
Information Technology	1,677	34.8	22.7%
Healthcare	1,466	24.4	11.9%
Financials	2,500	16.2	14.0%
Communication Services	229	15.7	9.4%
OVERALL		**151.0**	**100%**

Source: MSCI BPM, MSCI ESG Manager, UBS Asset Management. Data as of 31st August 2021.

Figure 4: "Highest Emitters" exclusion – sector capping



Source: MSCI BPM, MSCI ESG Manager, UBS Asset Management. Data as of 31st August 2021. For Illustrative purposes only.

The challenges of a practical implementation

As described in the previous section, it is apparent how a few companies drive most of the carbon intensity of a portfolio, making this concept of "highest emitters" intuitive and relatively easy to apply at first glance. Nevertheless, it is important to note how the companies flagged as highest emitters belong essentially to a couple of sectors: Utilities, Materials, Energy and Industrials. This is to be expected, as the business model of an Utility or Energy company tend to be, by nature, more carbon-intense compared to sectors like Financials or Communication Services. As shown in figure 3, the average Utility company is likely to have higher emissions than the highest emitting IT or Communication Services company.

Given these large sectoral differences in carbon intensity, a "blind" exclusion simply based on the company's carbon emissions would cause certain sectors to be almost entirely excluded from the portfolio.

Looking at figure 4, we can see how an exclusion of the 10% highest emitters from MSCI ACWI would remove almost 70% of the "Utilities" sector and 40% of the "Materials" sector. In order to mitigate this problem, we have introduced a capping threshold which, within each GICS sector, limits the number of exclusions only up until a maximum of 30% of the weight of that sector in the portfolio. In case this limit is reached for any sector, no further securities are excluded from that sector. The capping on the maximum weight excluded helps, up to a certain extent, to keep a sector allocation that is the most in line with the initial portfolio as possible granted that the carbon emission improvement remains the first objective.

Another positive outcome of the sector-constrained exclusion approach is that it allows us to keep the most carbon-efficient company within each sector, while removing the laggards of each sector. As shown in figure 4, thanks to the 30% capping, the fewer exclusions in the Utility, Materials and Industrials then spill over to other sectors like Energy and Financials, where the least carbon-efficient are removed as well.

Additional exclusions and selection criteria

The concept of "highest emitters" and their exclusion is a cornerstone of two families of ESG ETFs offered by UBS: the MSCI ESG Universal Low Carbon Select family, and the MSCI SRI Low Carbon Select family. The former aims to be a "core-replacement" that achieves certain ESG and carbon objectives while limiting the tracking error. The latter instead looks to select only the crème de la crème of companies from an ESG perspective, and is suitable for investors with more restrictive exclusion criteria as well as having ambitious ESG goals. For this reason, in the ESG Universal Low Carbon Select family the worst 5% emitters are excluded while in MSCI SRI Low Carbon Select, being a "darker green" approach, the threshold for exclusion is set at 10%.

As shown in figure 5, the severity of the "high emitters" filter is not the only differentiating factor between these two ETF families. Other differentiating factors pertains to the exclusion criteria, with the "light green" (ESG Universal Low Carbon Select) excluding a selected set of business activities while the "dark green"(SRI Low Carbon Select) has a more comprehensive and stricter set of exclusion.

The last key difference between these two approaches relates to the ESG selection, with the "light green" approach that aims to reweight companies in order to increase the allocation to ESG Leaders and ESG Improvers, while decreasing the weight assigned to ESG Laggards

Figure 5: Various degrees of sustainability

	MSCI ACWI	MSCI ACWI ESG Universal Low Carbon Select	MSCI ACWI SRI Low Carbon Select
Business-involvement exclusions	–	Essential	Extensive
High-emitters exclusions	–	Worst 5%	Worst 10%
ESG selection	–	ESG Reweighting	Best-in-class selection
Number of constituents	2964	2503	523
Tracking error 5-year (annualized)	–	89bps	249bps
Weighted Average Carbon Intensity (tons CO2e / USDm sales)	151	70	47
ESG Quality score	6.24	7.42	9.70

Source: MSCI BPM, MSCI ESG Manager, UBS Asset Management. Data as of 31st August 2021.

and to companies with deteriorating ESG profiles. On the other hand, the "dark green" has a best-in-class ESG approach which selects only the top 25 % ESG rated companies per GICS sector.

As shown at the bottom of the table, these different screening criteria drive sustainability characteristics (ESG Score and Carbon Footprint) as well as the tracking error.

UBS ETF – different shades of green

Our shelf offers our clients "different shades of green": some funds use a light-green screening approach that excludes only a limited number of controversial business activities as well as ESG laggards (e.g. ESG Universal Low Carbon Select, S&P 500 ESG), while other products have a dark-green approach that selects only highly rated companies and excludes a broader list of controversial business activities (e.g. SRI Low Carbon Select, S&P 500 ESG Elite). Our sustainable shelf also covers Fixed Income, with several products on Corporate bonds developed with Bloomberg. Next to the large families of ETFs, through the years we have also developed more thematic exposures like Sustainable Bank Bonds or Gender Equality, as well as starting with Fixed Income sustainable ETFs already in 2015. These products are all classified as Article 8 funds under SFDR.

Our family of Paris-aligned ETFs are classified as Article 9 funds under SFDR. The aim is to support investors in reducing their transition and physical climate risks, benefit from opportunities arising from the transition to a lower-carbon economy, while aligning with the EU Paris-Aligned Benchmarks minimum standards.

If you would like to get in touch with UBS ETF, please contact:

***Florian Cisana**, Head of ETF & Index Funds Sales Strategic Markets EMEA, UBS Asset Management*
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Case #9

Fintech

Investing in Sustainable Microfinance

by Filipe Albuquerque

Since its invention in the 1970s, microfinance has helped improve livelihoods, address poverty, promote employment, and support the growth of microenterprises. Its deployment presents an appealing investment opportunity, characterised by relatively stable returns, uncorrelated with traditional asset classes and by generally low levels of volatility.

Nevertheless, country-specific risks and credit worthiness concerns need to be integrated into the investment process. Investors in microfinance institutions need to be mindful of the processes these institutions have implemented to ensure the sustainability of their returns as well as the quality of support they provide their borrowers.

Tim Crijns
Portfolio Manager
Triodos Microfinance Fund

"Our analysis focuses on both negative screening as well as positive impact assessment. We minimise exposure to polluting sectors, disreputable practices or controversial industries."

"Our priority is to alleviate poverty and improve financial inclusion, not to invest in technology for its own sake. However, over the last years, we have noticed that technological solutions can increase the reach of microfinance solutions."

Microfinance is a natural channel to support the UN Sustainable Development Goals. "1.7 billion people remain without access to financial services around the globe and two-thirds of small and medium-sized businesses in developing countries have unmet financing needs. Microfinance offers people the opportunity to start a business and access education, energy, care and housing," explains Tim Crijns fund manager of Triodos Microfinance Fund..

Investing in Microfinance

"Triodos Microfinance fund was launched in 2009 by Triodos Investment Management, a full subsidiary of Triodos Bank. It invests in financial institutions that provide access to finance for underserved client groups and promote access to basic needs. Many of these financial institutions use responsible financial technology to accelerate last-mile distribution to the end clients," Crijns explains. At the end of August, the fund managed a €441 million portfolio invested across more than 40 countries in Eastern Europe, Asia, Latin America, Africa and the Middle East, mainly invested in senior debt and private equity.

"The perception is often that it is very risky to invest in emerging markets, but you need to know where you invest in and properly understand the context," Crijns argues. Monitoring the loan books of financial institutions, for example, provides good insight into the quality of the organisation. That is not to say that there are no risks at all, but Crijns argues there are several dynamics that mitigate these investment risks. "The uniformalisation of financial services across the world has been of some assistance with mitigating systemic risks. National central banks in emerging markets are increasingly more aligned with standard global financial practices. Basel II and Basel III requirements are being implemented everywhere," he explains.

"However, alignment on expectations is the crux of the matter. Local microfinance institutions have to display both the management capacity to inspire business confidence but also a genuine interest and care for their customers. That's why we focus on long-term relationships supported by robust on the ground due diligence in all our investments" Crijns says.

"We find that local microfinance institutions typically have reliable management capacity," Crijns argues. "Nowadays, we find that our counterparts in emerging market institutions are generally very well educated and speak the same technical language as us. In parallel, they also speak the same language as the people on the ground in their own country. Not only do they have the financial expertise, they also understand local market dynamics better than we could ever hope to," he adds.

Investing from the Netherlands, Triodos Investment Management tries to close the gap by ensuring that the managers liaising with on the ground microfinance institutions are experts on these markets. "We have 20 nationalities in our investment team. So, for example, the relationships with our investments in Peru are managed by a colleague who worked for an SME bank in Peru, came to Rotterdam to do an MBA, and now works with us," Crijns explains.

Finding the microfinance institutions

Investing in microfinance is different from investing in SMEs in developed countries because the physical, cultural and regulatory distance widens the data gap, according to Crijns. Given the risks and the asymmetries of information, one of the most challenging hurdles for microfinance investors can often be to find relevant partners. "Developing a network is a crucial part of overcoming this challenge. When our investment managers visit a country, they are not confined to engaging with investee institutions. They will also visit the central bank and local associations for microfinance, to create and maintain important relationships," Crijns argues. "Having a track record is very important and can help build a reputation that bridges the gap and allows us to attract partners rather than having to search for them ourselves," he adds.

In the past years, Triodos Microfinance Fund's portfolio has diversified from pure microfinance institutions towards broader financial institutions that offer larger loans to small and medium-sized enterprises. The fund has also built up an impactful financial technology (fintech) investment portfolio. "We see fintech as an important tool for greater financial inclusion, as it is instrumental in reducing operating costs, increasing efficiency, and reaching people in remote and rural areas," Crijns explains.

ESG Analysis for Microfinance

According to Crijns, ESG integration into microfinance investing is not a mere box-ticking exercise. "Our analysis focuses on both negative screening as well as positive impact assessment. By doing so, we minimise exposure to polluting sectors, disreputable practices or controversial industries," he says.

"Based on our experiences since the early 1990s, we have built a tool that enables us to benchmark sustainability performance across all regions. The tool generates a score that provides us an estimate of the positive impact that a local microfinance institution has made. This tool covers a range of topics, including specific programs for women, the provision of financial training, the level of transparency on the terms of the loans that they provide and programs to limit environmental impact of their loans," Crijns adds.

Triodos Microfinance Fund's efforts also benefit from an integrated data hub where investee companies can submit their reports in order to facilitate data collection and management. This type of digital solution simplifies the investment process tremendously and allows us to comply more easily with the requirements following new regulatory

"When our analysts visit a country, they are not confined to engaging with investee institutions. They will also visit the central bank and local associations for microfinance, to create and maintain important relationships."

frameworks such as the EU's Sustainable Finance Disclosures Regulations (SFDR).

Case Study: EVs in Sri Lanka

Triodos Microfinance Fund lent €2.5 million through a subordinated debt facility to Citizens Development Business (CDB) Finance in Sri Lanka. CDB is a Licensed Finance Company founded in 1995 which serves close to 90,000 customers and has a national network of over 70 branches. "As a subsidiary of one of the largest insurance companies in Sri Lanka its mission is to provide access to finance for the country's underserved population, to create financial empowerment, social inclusivity and environmental consciousness," Crijns explains.

In its efforts to find solutions to advance the green economy, CDB has set itself the target of becoming the leader in rooftop solar and sustainable EV financing in Sri Lanka by 2025. For its vehicle leasing activities it aims to provide finance for hybrid/electric vehicles. "This is the company people reach out to if they want a loan to lease a Tuk Tuk taxi," Crijns says.

"As part of this plan, CDB has pushed its borrowers to start focusing on hybrid or electric Tuk Tuk taxis. It's important to bear in mind the specific conditions on the ground when trying to pursue environmental issues. So while the focus in Sri Lanka was on electric and hybrid vehicles, for other investments in other places the clean energy focus might be different. The solution has to respond to a need that is pertinent on the ground given the journey of the local community," the portfolio manager says.

Case Study: Fin-Tech Solutions in South Africa

"One of our fintech investments is in Lulalend in South Africa, an online lending platform for small businesses," Crijns adds. Access to finance remains one of the key challenges for small and medium-sized enterprises (SMEs) in South Africa, according to Crijns. "Transaction costs, a risky environment and a lack of understanding of the SME business environment keep mainstream banks away," he explains.

According to Crijns, Lulalend works towards bridging this funding gap, by providing fast, affordable loans to SMEs neglected by the South African banking sector. The platform focuses on businesses with an operational track record of at least one year and an annual revenue of more than ZAR 500,000 (EUR 30,000).

Entrepreneurs can apply online for free by filling in some basic details. Lulalend makes a lending decision in minutes and, if approved, can provide loans worth ZAR 20,000 to ZAR 1,500,000 (EUR 1,200 to EUR 92,000) within 24 hours. Clients repay in standard instalments over six months. "Lulalend is a great example of the ability of fin tech to contribute to microfinance," Crijns adds.

Triodos IM recently published a paper that explores the benefits and pitfalls of fintech for financial inclusion, highlights Triodos IM's investment approach and sheds a light on Triodos IM's next steps as impact investors in this rapidly evolving and dynamic industry.

Fintech has the power to impact lives in a meaningful way, according to the report. Triodos IM believes that partnerships that leverage traditional banks' scale and the innovative capabilities of fintech companies are key to promote financial inclusion.

Credit: Tapio Haaja on Unsplash

Case #10

Local Impact

The Case for Responsible Early-Stage Investments

by Julia Axelsson, CAIA

"Our investment horizon is infinite, and our philosophy is based on science."

Anders Ekholm, PhD
Chief Investment Officer
University of Helsinki

The largest, highest-ranked, and oldest university in Finland, the University of Helsinki, is also one of the richest. It manages assets worth almost two billion Euros, some tracing back to the mid-18th century, like the ones donated to the university by lieutenant Erik Ekestubbe in 1745. The university's assets include around 600 million Euros in security investments and more than one billion Euros worth of real estate.

Where history meets science

"Our investment horizon is infinite, and our philosophy is based on science," explains Anders Ekholm, PhD, Docent and Chief Investment Officer of the University of Helsinki. Year after year, the goal is the same: to distribute 3% to research and teaching and accumulate an additional percentage in real terms. The annual expected return for the security portfolio is, therefore, on average 4% plus inflation.

True to its academic traditions, the university maintains a sound scientific approach towards investing. Acknowledging that public financial markets are highly efficient, one of the most thoroughly tested hypotheses in financial economics, means that there needs to be a significant reason to deviate from full diversification and minimal costs. "Sustainability or valuable proprietary information are typically such significant reasons," explains Ekholm, pointing out that these are precisely the two main areas that the investment management of the University of Helsinki chooses to focus on.

Sustainable beta

"Sustainability has been an integral part of our investments at least since 2012, when our current CFO Marjo Berglund, the founder and former chairperson of Finland's Sustainable Investment Forum (FINSIF), took the helm," says Ekholm. In 2019, the University took the next step by introducing a set of principles for responsible investments. These have already been fully integrated.

Systematic exposure to equity risk premia, which comprises the bulk of the portfolio, is achieved through investing in sustainable index funds. Each of the equity funds has an ESG policy which typically encompasses both exclusions and engagement. A continuous dialogue with the fund managers aims at advancing the ESG integration further. "We managed to reduce our carbon footprint radically, taking a leap towards carbon neutrality in 2030, through completely divesting from fossil fuel production in 2019-20, and simultaneously allocating significantly to green bonds," points out Ekholm.

"Our start-up companies draw from the human capital of our bright students, who perhaps can feel the pulse of the moment and see the future a bit better than we do."

Locally grown impact investments

"The only pocket in the financial market where we believe that we have valuable proprietary information is our research-based spinout companies and student-initiated start-up companies", says Ekholm, reminding us of the economic rationale behind the university's impact investment strategy.

Although a relatively small part of the portfolio, these investments make a world of difference to the budding entrepreneurs that benefit from them. "In unlisted investments, we typically invest at a very early stage, when capital is the most difficult to attract," explains Ekholm.

The spinout companies in the portfolio are based on intellectual property rights, especially patents invented and incubated at the university. These companies attack big and challenging questions, such as curing cancer or data security. "We leave operations to the entrepreneurs but provide guidance and support with legal work, governance, communications, and funding. We particularly stress sustainability, and only invest into companies we believe will affect society positively. Hence, we stress the projected environmental, fiscal and social footprints," states the university's investment plan for 2021-2022.

Early results

The first student start-up programme, HELSEED, was organised in 2020. More than twenty teams participated in the programme, which generated great interest among various stakeholders. So far, the University of Helsinki has invested in two companies, Evergreen Viherseinät Oy and Evexia Oy. And there is more to come, according to Ekholm: "This year we hope to see even more ideas for student start-ups, and hopefully more investments as a result."

"We have seen some great outcomes already with our spinouts, manifested by stock exchange listings or trade sales, and there is much more to come," Ekholm says proudly. Albeit that a transformation from unlisted to listed is a welcome outcome for the investee companies, it is far from trivial when their largest investor needs to exit. Liquidity is typically limited for newly listed smaller companies. Therefore, the university has developed a particular strategy for gradually decreasing its holdings to serve the company's interests best. The availability of other strategic investors that could assist the company better, the position size, market liquidity, as well as several other factors play into this equation.

Perhaps the most important outcome of the HELSEED programme, however, is its impact on shaping the mindset of young entrepreneurs. "Our start-up companies draw from the human capital of our bright students, who perhaps can feel the pulse of the moment and see the future a bit better than we do. Given that one of our main objectives as an institution is to increase the human capital of our students through education, it feels quite natural to help them in realising that potential after their studies. At the same time, we try to help them build a better future world, as it really belongs to them," explains Ekholm.

Looking at the big picture

"I believe that sustainability should and must be viewed holistically," reflects Ekholm. "That includes viewing it from the baseline and relative to the objectives of each investor. For us, sustainability includes making sure that our investments cover our liabilities to our university, partners, society, and environment."

The CIO does not deny the contradictions inherent in investing responsibly. "On the one hand, we believe that strict cost control is essential for financial sustainability. Investing in green bonds, on the other hand, is important for generating positive environmental impact. Hence, our liabilities can at times be conflicting and require compromises based on holistic judgement," concludes Ekholm.

about our partners

Capital Dynamics

TRULY INVESTED.

Capital Dynamics is an independent global asset management firm focusing on private assets, including private equity (primaries, secondaries co-investments), private credit, and clean energy infrastructure. Created in 1988, the Firm has extensive knowledge and experience developing solutions tailored to meet the exacting needs of a diverse and global client base of institutional and private wealth investors. As of Q2 2021, Capital Dynamics oversees more than USD 15 billion in assets under management and advisement1, and employs approximately 160 professionals globally across 13 offices in Europe, the Middle East, North America, and Asia. Capital Dynamics is a recognized industry leader in responsible investing, receiving the highest marks from the UNPRI for its Strategy & Corporate Governance, and investment strategies. For more information, please visit: www.capdyn.com

PRI Principles for Responsible Investment

Top rating (A+) for Clean Energy Infrastructure Strategy

GRESB INFRASTRUCTURE Sector Leader 2020

Highest ranking for commitment to sustainability

1As of June 30, 2021. Assets Under Management are calculated based on the total commitments as of the final closing date for all funds currently managed by Capital Dynamics, including amounts that have been distributed. Assets Under Advisement includes assets for which Capital Dynamics provides services such as reporting, monitoring and risk management.

NN investment partners

NN Investment Partners (NN IP) is a Dutch asset manager active in 37 nations and manages €300 bln AuM. As a responsible investor, NN IP aims to improve clients' returns by looking beyond financial performance. Responsible investing and putting capital to work is integral to NN IP's investment strategies and approach. NN IP allocates all of its investments in a responsible manner, contributing to a more sustainable world. ESG criteria are integrated in 74% of NN IP's AuM, the goal is to increase this to 80% by 2023. In 2020, the UN PRI awarded the NN IP a rating of A+ for its responsible investing and ESG integration approach.

At NN IP over 40 different nationalities make up the workforce, underlining the belief cognitive diversity leads to smarter teams and better decision-making. NN IP cares about what matters most to stakeholders. Putting resources to use for the wellbeing of customers, the advancement of communities, the preservation of the planet, and for a stable, inclusive, and sustainable economy is of utmost importance.

J.P.Morgan
Asset Management

J.P. Morgan Asset Management, with assets under management of USD 2.5 trillion (as of 31 March 2021), is a global leader in investment management. J.P. Morgan Asset Management's clients include institutions, retail investors and high net worth individuals in every major market throughout the world. J.P. Morgan Asset Management offers global investment management in equities, fixed income, real estate, hedge funds, private equity and liquidity.

JPMorgan Chase & Co. (NYSE: JPM) is a leading global financial services firm with assets of USD 3.7 trillion and operations worldwide. The Firm is a leader in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing, and asset management. A component of the Dow Jones Industrial Average, JPMorgan Chase & Co. serves millions of customers in the United States and many of the world's most prominent corporate, institutional and government clients under its J.P. Morgan and Chase brands. Information about JPMorgan Chase & Co. is available at www.jpmorganchase.com.

NORTHERN TRUST
ASSET MANAGEMENT

Northern Trust Asset Management is a global investment manager that helps investors navigate changing market environments, so they can confidently realize their long-term objectives. Entrusted with US$1.2 trillion of investor assets as of June 30, 2021, we understand that investing ultimately serves a greater purpose and believe investors should be compensated for the risks they take – in all market environments and any investment strategy. That's why we combine robust capital markets research, expert portfolio construction and comprehensive risk management to craft innovative and efficient solutions that deliver targeted investment outcomes. As engaged contributors to our communities, we consider it a great privilege to serve our investors and our communities with integrity, respect, and transparency.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc., Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K., NT Global Advisors, Inc., 50 South Capital Advisors, LLC, Belvedere Advisors LLC and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

about our partners

ROCKEFELLER ASSET MANAGEMENT

Rockefeller Asset Management, a division of Rockefeller Capital Management, offers equity and fixed income strategies across active, multi-factor passive, and thematic approaches that seek outperformance over multiple market cycles, driven by a disciplined investment process and a highly collaborative team culture.

With over 30 years of experience in global investing and ESG-integrated research, we pair our distinctive worldview and long-term investment horizon with thorough fundamental research combining traditional and non-traditional analysis generating insights and outcomes not commonly found in the investment community. As of June 30, 2021, Rockefeller Asset Management had $12.5B in assets under management. For more information visit https://rcm.rockco.com/ram.

Triodos Investment Management

Triodos Investment Management connects a broad range of investors who want to make their money work for lasting, positive change with innovative entrepreneurs and sustainable businesses doing just that. In doing so, Triodos Investment Management serves as a catalyst in sectors that are key in the transition to a world that is fairer, more sustainable and humane.

Triodos Investment Management has built up in-depth knowledge throughout 30 years of impact investing in sectors such as Energy & Climate, Financial Inclusion and Sustainable Food & Agriculture, and also invests in listed companies that materially contribute to the transition toward a sustainable society.

Triodos Investment Management is a globally active impact investor and a wholly-owned subsidiary of Triodos Bank, with 750+ investments in over 50 countries and EUR 5.4 billion in assets under management (as per end of December 2020), entirely invested in impact strategies in all asset classes.

UBS

UBS Asset Management is a large scale investment manager with a presence in 23 countries. We offer investment capabilities and investment styles across all major traditional and alternative asset classes.

Our goal is to provide you with access to the best investment ideas and superior investment performance. We serve institutions, wholesale intermediaries and wealth management clients.

Across each of our traditional investment areas we have established a general approach to environmental, social and corporate governance. We are signatories to initiatives such as the Principles for Responsible Investment and the UK Stewardship Code.

WELLINGTON MANAGEMENT®

Tracing our history to 1928, Wellington Management is one of the world's largest independent investment management firms. With over US$1.2 trillion in client assets under management as of 31 December 2020, we serve as a trusted investment adviser to more than 2,300 institutional clients and mutual fund sponsors in over 60 countries.

Our comprehensive investment capabilities are built on the strength of rigorous, proprietary research and span nearly all segments of the global capital markets, including equity, fixed income, multi-asset, and alternative strategies. As a private partnership whose sole business is investment management, our long-term views and interests are aligned with those of our clients. Our commitment to investment excellence is evidenced by our significant presence and long-term track records in nearly all sectors of the global securities markets.

ESG

NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

ESG Integration Case Book 2021
Handbook Series
September 2021

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