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NORDSIP
NORDIC SUSTAINABLE INVESTMENTS

insights

TRANSITIONS & STEWARDSHIP

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the editor's word

Running against the clock, together

As the clock ticks relentlessly towards the carbon neutrality deadlines of the Paris Agreement, where before investors argued about the validity of the case against fossil fuels as stranded assets, we now have regional and global energy transition policies.

With our time running out, the tide has changed. The IPCC has unequivocally endorsed the view that climate change is a man-made phenomenon. The EU's Green deal and its sustainable finance regulatory packages are setting standards for all of Europe while the Biden Administration's commitment to transition towards a green economy is making its way through Congress. Corporations and financial institutions are not just paying lip-service to climate change. They are adopting specific net-zero emission targets and roadmaps.

In this handbook, as with all our publications, we seeks to bring the latest market participants' insights about how sustainable investments work in practice. For this first edition focusing on Transitions & Stewardship, a common thread of collaboration runs through the contributions of a wide range of experienced investors.

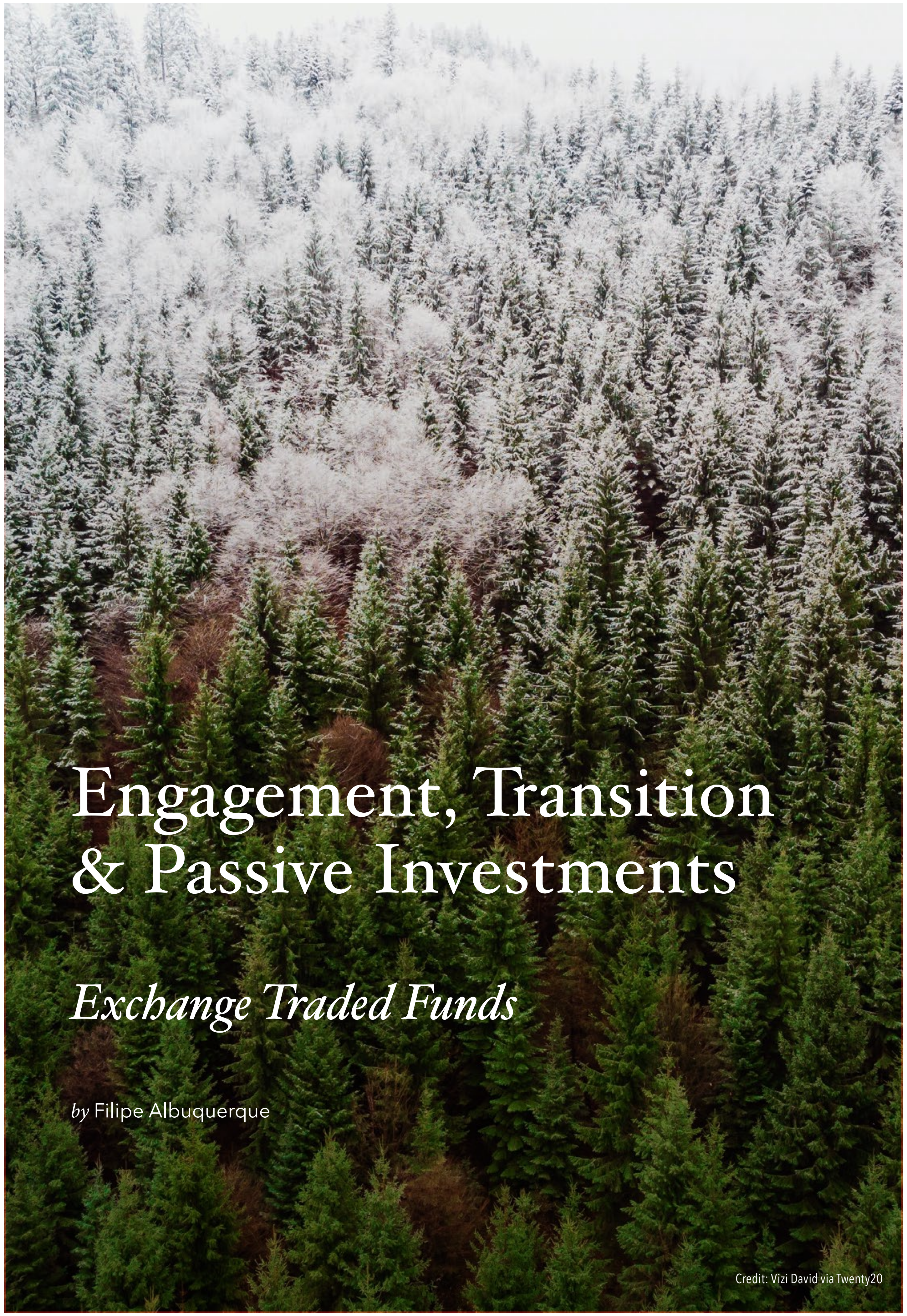
We learn about how engagements and collaborative efforts can be incorporated into passive methodologies to create Paris Aligned indices and ETFs. We dive into the solar power investment opportunities in Southern Europe and the reforms and market mechanisms facilitating them. We explore how real-asset investors must decarbonise to future-proof portfolios and protect themselves against the incoming value backlash against non-net zero properties. We talk to asset owners and hear of their collaborative efforts to nudge asset managers and investee companies towards increasingly ambitious transition goals.

The transition to a more sustainable economy is crucial to successfully meeting the environmental challenges of our times. Investors can choose from a plethora of roads that lead to the net-zero carbon emissions future we have set as our collective goal. The destination is the same and is more expediently arrived at hand-in-hand.

Aline Reichenberg Gustafsson, CFA

Editor-in-Chief

NordSIP



Engagement, Transition & Passive Investments

Exchange Traded Funds

by Filipe Albuquerque

Credit: Vizi David via Twenty20

"Applying our renowned Stewardship and Engagement skills to such exposures that are then offered in an ETF wrapper, allows our clients to benefit from the full value-chain of the Transition to a low carbon economy, both from a portfolio construction as well as an engagement perspective."

Florian Cisana
Head UBS ETF & Index Fund Sales Nordics
UBS Asset Management

According to UBS's recent report, "Engaging with companies to achieve net zero", engagement and proxy voting can be used as important means to influence corporate behavior and accelerate action in those sectors where it is most needed.

Through dialogue UBS also believes it is able to transfer best practices within sectors. The bank's philosophy is to fully understand the business model of the companies it invests in, build relationships with management, provide feedback on current climate performance and provide insights on actions to develop companies' resilience in a low carbon economy.

UBS's Thematic Engagement Program

March 2018 saw UBS launch a three-year thematic engagement program on climate change targeting 45 oil and gas and utilities companies lagging on climate change performance. The companies were selected according to the Swiss bank's proprietary Climate Aware methodology, which focuses on the companies identified as best placed to benefit from the climate change transition. The two sectors were selected due to their prominent climate change impact and their potential ability to provide capital and technologies to solve it.

UBS's engagement objectives are built around the framework of the Task Force on Climate-related Financial Disclosure (TCFD) on governance, strategy, risk management, metrics and targets to ensure that:

- boards are equipped to oversee management in setting and executing a climate change strategy;
- remuneration is linked to climate change targets;
- climate risks are fully integrated in risk management processes;
- business strategies are reflective of robust scenario analysis;
- emissions reduction targets are set for the short, mid and long term and cover all the most material sources of emissions;
- performance against targets is measured and reported;
- advocacy activities with policy makers is conducted in consistency with the achievement of the Paris Agreement.

While the effort started in connection with a specific passive strategy, the engagement project also encompasses UBS's financial exposure to these companies across passive and active strategies in both listed equity and fixed income.

Engagement Collaborations

UBS has been an active member of Climate Action 100+ (CA100+), the largest collaborative effort from institutional investors to fight against climate change, counting on the support of 615 investors, representing over USD 55 trillion of assets under management engaging with more than 167 of the world's largest corporate greenhouse gas emitters.

Over the last three years, the Swiss bank has been part of 29 coalitions in total, 8 of which it led. These represented 60% of the target engagement list.

During the last three years, global climate change goals have evolved from seeking to keep temperatures from rising above 2°C to keeping them well below that level while the focus has shifted to renewable energy and low carbon technologies, phasing out coal and considering the social implications of this transition.

Insights From Three Years of Dialogue

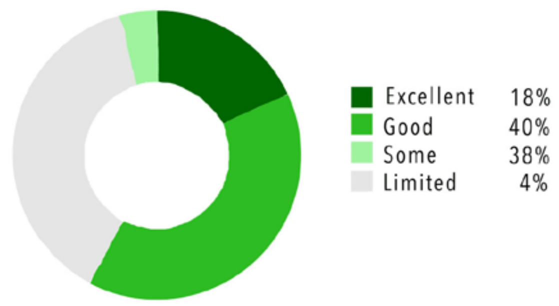
Since 2018, UBS has participated in over 200 meetings with management and representatives of the board of companies in the focus list through both individual and collaborative engagements. It assessed 45 companies and took part in 7 AGM statements on progress made and areas for improvements in collaboration with co-leads within CA100+. It published one investor/company joint statement on climate action in collaboration with co-leads within CA100+ and was one of the signatories of a letter to the EU on the post-COVID-19 green recovery.

The Swiss bank also supported 26 shareholder resolutions on climate change in relation to the focus list of companies as well as two global investor statements to governments on climate co-signed by other investors.

The final analysis shows that more than 58% of companies in UBS's focus list have made good or excellent progress against set objectives. However, there is still a percentage of companies with limited or partial action on addressing the climate change challenge.

The outcomes of three years of dialogue on climate

Categories	Weighted engagement objectives met	Number of companies	Percentage
Excellent	(76-100%)	8	18%
Good	(51-75%)	18	40%
Some	(26-50%)	17	38%
Limited	(0-25%)	2	4%
Total		45	



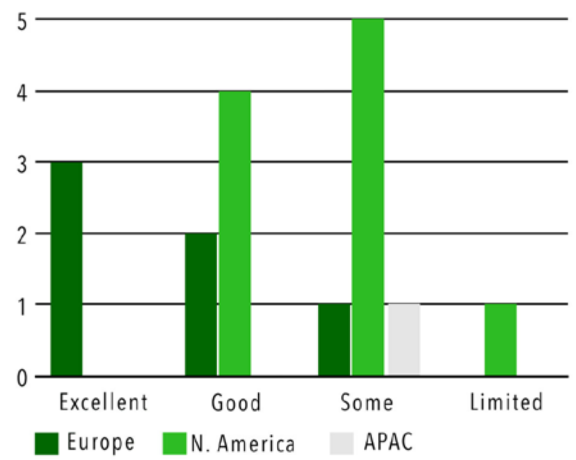
Source: UBS Asset Management. Data as of 30 June 2021

Climate Alignment & Performance

According to the analysis of outcomes conducted by UBS, oil and gas companies in Europe are leading their peers in other parts of the world, while American utility companies are outperforming their peers thanks to state level positive regulatory environments. Sectorally, UBS finds that utility companies are able to align themselves to the transition by shifting the sources of energy used from fossil fuels to renewables faster than their oil and gas counterparts.

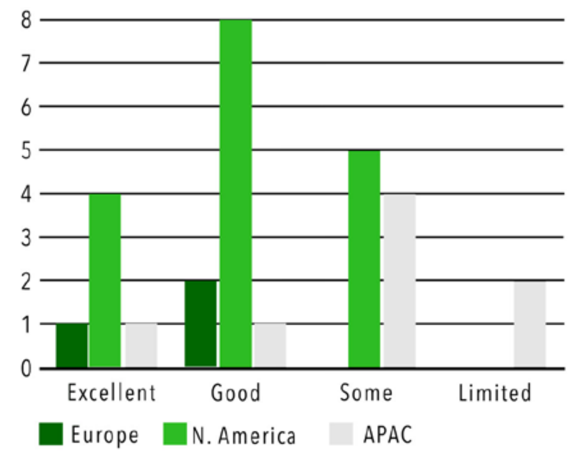
Regarding the progress made by the companies in setting GHG emissions reduction targets, as many as 80% of the companies had strong or partial reduction targets. Only one company on the list did not have any reduction target and more than half of the companies have set a net zero emissions by 2050 goal/ambition. Strong targets are short, mid and long term, are related to all material direct and indirect emissions (i.e., scope 1, 2 and 3) and cover all significant company operations/activities. Utility companies have a higher percentage of strong targets than oil and gas companies.

Regional progress by oil and gas companies



Source: UBS Asset Management. Data as of 30 June 2021

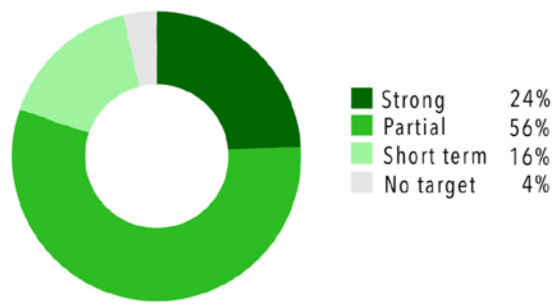
Regional progress by utility companies



Source: UBS Asset Management. Data as of 30 June 2021

To assess companies' climate performance, UBS has focused on current ambitions for increasing the exposure to renewable energy. 29 out of the 45 companies have set goals to increase either the percentage of energy capacity or the total gigawatts produced or the amount of money invested in renewable energy.

Quality of GHG emissions reduction targets



Source: UBS Asset Management. Data as of 30 June 2021

Stewardship and Passive Products

Stewardship in passive products is as important as it is in active strategies, according to Florian Cisana, Head UBS ETF & Index Fund Sales Nordics at UBS Asset Management. "While engagement dialogue is not different between active and passive solutions, the underlying motivations are slightly different," Cisana says.

"In the case of passive strategies, it is important to tackle certain ESG issues which could ultimately have an impact on investor´s portfolio. As a passive portfolio manager, we do not have the freedom to sell and buy stocks at our discretion, but have to track the underlying index. However, through Stewardship we can still manage certain risks we are exposed to in our portfolios. In addition to Stewardship, Proxy Voting is a very effective tool that allows us to express our opinion on governance and the business strategy across all our holdings on an annual basis," Cisana continues.

Both Stewardship and Proxy Voting are applied across UBS's traditional as well as its Sustainable Equity ETF shelf. "UBS has been a pioneer in the sustainability ETF space since 2011. This journey has led us to become the second largest sustainable ETF provider in Europe, with US$32 billion in assets under management, equivalent to a 17.5%[1] market share . As our society has grown more conscious of the need to address climate change and with climate risk considerations increas-ingly becoming a focal point for investors, it became apparent that we needed to incorporate carbon emissions criteria in addition to tradi-tional ESG screens both in our SRI and ESG Universal families. In addition to these benchmark enhancements, we also launched two sets of SFDR Article 9 funds that focus specifically on the transition to a low carbon economy: the UBS Climate Aware Climate Transition ETF and our flagship family of UBS MSCI Paris Aligned ETFs," Cisana explains.

"The philosophy behind these exposures is well-aligned with both the Transition and Stewardship topics, as these indices' overall objective is to promote an orderly transition to a low carbon economy. To achieve that goal, for example, the Climate Paris Aligned Indices exclude some companies as required by the regulation, but, on the remaining part of the portfolio, it applies the principles of Stewardship and Engagement in order to engage with companies and assist them in their transition," Cisana says.

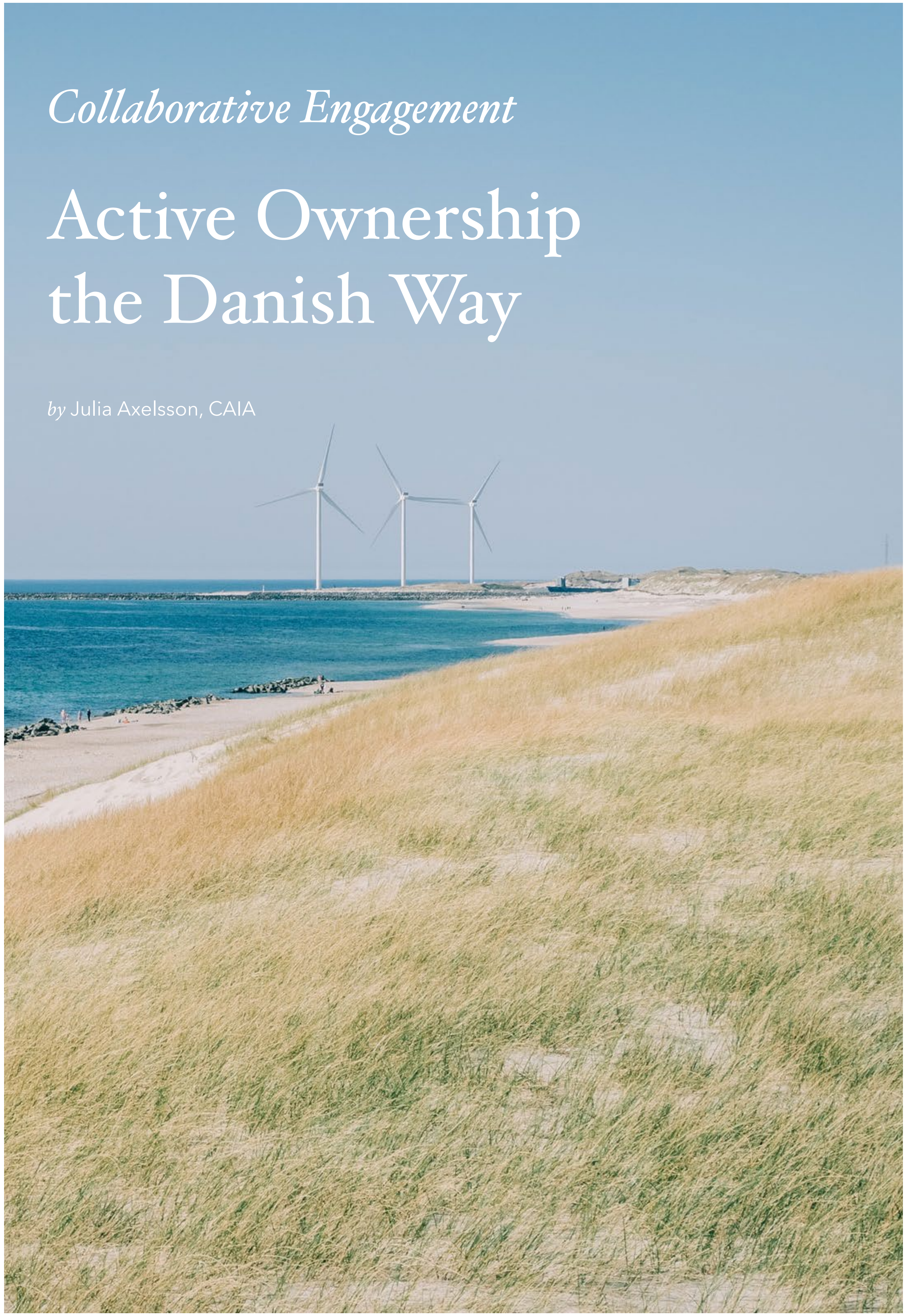
"Applying our renowned Stewardship and Engagement skills to such exposures that are then offered in an ETF wrapper, allows our clients to benefit from the full value-chain of the Transition to a low carbon economy, both from a portfolio construction as well as an engagement perspective," Cisana concludes.

[1] Data from etfbook.com, as of 5th October 2021

Collaborative Engagement

Active Ownership the Danish Way

by Julia Axelsson, CAIA



"It is true that we've still got a long way to go. Yet, for me, it is obvious that as investors are uniting, ESG has really taken off. We can do it if only we can all work together, investors and companies, private and public capital."

With more than 47 billion Euros in assets under management, PKA (Pensionskassernes Administration A/S) is one of the largest administration companies for occupational retirement schemes in Denmark.

PKA is also one of Denmark's most prominent investors in sustainability themes. "It is our members who are the ones to be credited for PKA's efforts to invest responsibly," says Louise Aagaard Jensen, ESG Manager at PKA. She points out that 90% of PKA's 335 000 members, mainly employees in the public, social and health sectors, are women. "Already back in the '90s, the members took the initiative, demanding that we prioritise responsible investments in the investment strategy," she adds.

Green investments, and beyond

A lot has happened since those early days of sustainability awakening. In 2010, PKA made its first dedicated green investment in the Anholt wind farm, clearly manifesting an increased focus on tackling the major challenge of climate change. Fast forward to the present, and the fund's portfolio has grown to encompass private equity investments in solar energy, alternative fuels, and clean technology, as well as infrastructure investments in wind power, eco-labelled real estates, solar plants, and sustainable battery technology. "Our efforts to tackle climate change are about the ability to maximise the pensions that beneficiaries will have in their retirement, but also about the world that they will retire into," explains Aagaard Jensen. "Our green investments have attractive risk-adjusted returns and allow us to have a more diversified portfolio strategy. At the same time, they give us the opportunity to make a positive impact on climate change," she adds.

The green part of PKA's portfolio has recently surpassed 10% of the fund's total assets under management and is expected to grow further to 50 billion Danish kronor by 2025. Impressive as these numbers are, it is essential to remember that the bulk of the fund's money is still invested in traditional stocks and bonds. And PKA's pension funds members are very concerned that these too are managed responsibly. According to Aagaard Jensen, active ownership is the key to meeting the members' sustainability expectations when investing in the broad public markets. "We need to actively encourage and push the companies in our portfolio," she says. "It is hard to imagine how we would reach the objectives of the Paris Agreement if those companies do not commit to change their business model."

Collaboration is crucial

The task is enormous, of course, given the fact that there are more than 3 500 listed companies in PKA's portfolio. Engaging with them systematically and monitoring their progress towards sustainability on a regular basis takes time and human resources. "We are not doing it alone, though," explains Aagaard Jensen. "We have been working with an external partner, EOS at Federated Hermes, since 2013, whose help when it comes to dialogue with companies and voting has been invaluable. Not only because of the extra resources they contribute with, but also because

"It is great to see so many responsible investors getting involved and working together, pushing companies to transition towards a greener and more sustainable future."

they facilitate the collaboration with other investors who have similar demands as we do," she says.

Collaboration seems to be indispensable when it comes to PKA's engagement and stewardship efforts in general. The fund is a prominent member of several investor alliances, notably Climate Action 100+ (CA100+), the UN-convened Net-Zero Asset Owner Alliance (NZAOA), the Institutional Investors Group on Climate Change (IIGCC) and the Paris aligned investment initiative. "It is great to see so many responsible investors getting involved and working together, pushing companies to transition towards a greener and more sustainable future," comments Aagaard Jensen.

The power of active ownership

"We believe in active ownership," asserts Aagaard Jensen. "We know that the moment we divest from a company, we are out of the game. We don't have a say anymore and can't move this company towards the desired outcome anymore," she continues. "As long as there is a dialogue and a portfolio company can show and prove that they are on a journey towards sustainability, then we are willing to support them on their way," she explains.

A case in point is PKA's long-term investment in Danish energy company Ørsted. Over the years, the former Danish Oil and Natural Gas (DONG) has managed to transform itself into a flourishing renewable energy company. In 2017, the company decided to phase out coal for power generation and sold off its oil and gas business. Hence the name change, DONG being inappropriate considering they no longer owned any oil and natural gas assets. Nowadays, Ørsted boasts being ranked the most sustainable energy company in the world for three years running.

Divestment as the last resort

"Even with energy companies, our preferred tool is engagement," says Aagaard Jensen. "As part of the Climate Action 100+ initiative, we have a functioning dialogue with Shell, for instance, and monitor their transition progress closely," she adds. That said, PKA did not hesitate to divest from ExxonMobil a couple of years ago, as the company was not responding to their queries and repeatedly disregarded their requests. "We are patient investors, and we want, above all, to see companies change. However, if a company does not want to engage with us and continues to break our guidelines, we simply have to divest. We need to show them that there are consequences. Otherwise, engagement wouldn't work," says Aagaard Jensen.

Exclusions have a role to play, too, according to her. "We have a zero-tolerance towards coal mining and oil sand companies, for instance. We don't see any point in engaging with them as their core business is difficult to transition to renewables," she explains. "It is important to get out of fossil fuels as quickly as possible."

"It is an exciting time to be working with sustainable investments, and I am quite optimistic about the future," says Aagaard Jensen. It is the growing collaboration between all parties involved that is the source of her optimism, she explains. "It is true that we've still got a long way to go. Yet, for me, it is obvious that as investors are uniting, ESG has really taken off. We can do it if only we can all work together, investors and companies, private and public capital," concludes Aagaard Jensen.

Louise Aagaard Jensen
ESG Manager
PKA

Credit:PKA


Credit: RLTheis via Twenty20

From Real-World Problems to Real-Asset Solutions

How real-asset investors must decarbonise to future-proof portfolios.

by Aviva Investors

Transforming the built environment is critical to decarbonising our economy. Carbon emissions from buildings and infrastructure are responsible for 60 per cent of emissions globally[1].

In the UK, 80 per cent of buildings standing in 2050 will have already been built[2] and across the developing world buildings and infrastructure are set to double by 2060 (the latter is the equivalent of adding a whole New York City every month)[3]. This means we need radical change in how we build and refurbish the buildings, transportation and utility systems we use every day.

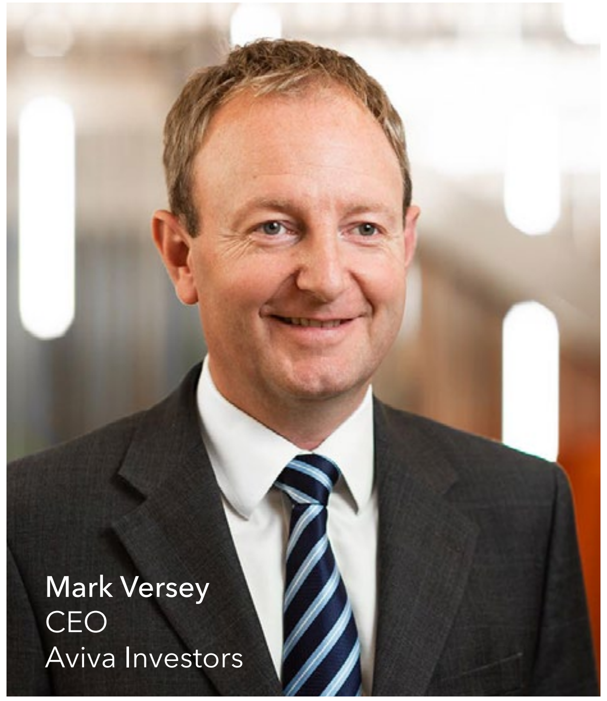
Indeed, the Institute for Government recently warned the UK has still not grasped the scale of the task. It noted: "Meeting the commitment is a more difficult challenge than responding to the coronavirus crisis or getting Brexit done, and will require transformations in every sector of the UK economy, sustained investment over three decades and substantial changes to everyone's lives."

Radical transformation, risks and realigning capital

Achieving net zero is extremely challenging and will not be delivered without radical behavioural and economic transformation. For real asset investors, this means extensive electrification of transport and heating, rapid adoption of hydrogen and the development of affordable carbon capture and storage technologies.

Mark Versey, CEO of Aviva Investors, is under no illusion as to the changes required or the "vital role investors must play in pushing for change on society's biggest issues", especially on climate change.

Darryl Murphy, managing director of infrastructure at Aviva Investors, wants to see more state intervention. "I'm pleased to see we have reached the point where government has been more prescriptive about the kind of technologies it wants to see," he says.


Mark Versey
CEO
Aviva Investors

Although some may see this as controversial, arguing governments should not be allowed to pick winners, we simply don't have time to lose. "We are not going to get there by just letting things evolve. We need much more planning, more focused effort," says Murphy.

Ed Dixon, head of ESG for real assets at Aviva Investors, agrees that government has a significant role to play and wants to see better use of the assets we already have. "A skyscraper in the City of London might be knocked down and replaced with a new one, even though it is in a usable state and could be refurbished. There is nothing in current policy or regulation to prevent that; in fact, the VAT structure privileges 'new'. We cannot keep demolishing 20-year-old buildings to rebuild simply because we want something different," he says.

Real asset investors are used to investing over the long term, so these future changes are relevant now. As the impact on portfolios could come quicker than many anticipate, it is imperative they put in place

Darryl Murphy
Managing Director, Infrastructure
Aviva Investors

detailed and robust net-zero pathways to protect their investments.

But should they increase their appetite for risk to spur the changes needed? After all, net zero cannot be reached without rapid redeployment of capital – meaning investors must embrace this challenge to avoid far more damaging implications from the effects of the climate crisis.

Unfortunately, many people do not understand how to make the changes needed, even though tried-and-tested technologies exist. And yet, the value of properties that cannot achieve net zero without significant upgrades will fall.

Building a sustainable future

This changes the client demand dynamics. Daniel McHugh, chief investment officer for real assets at Aviva Investors, is acutely aware of this. "As a committed investor, acting and supporting the transition to a low-carbon and climate-resilient world is not only consistent with our values, it is absolutely in line with what our clients now expect," he says.

That we have placed sustainability at the heart of our real assets business should therefore come as no surprise. And having set our stall out to become net zero across our £47.3 billion real assets platform by 2040, we have also committed to embedding this through multiple layers of the investment process: from asset origination to asset management and ongoing stakeholder engagement.

To ensure these commitments are met with measurable actions, the initiative is supported by five explicit short-term interim goals we expect to be delivered over the next four years to 2025, including:

- Investing £2.5 billion in low-carbon and renewable energy infrastructure and buildings
- Increasing low-carbon and renewable energy generation capacity to 1.5 gigawatts
- Originating £1 billion of climate transition-focused loans
- Creating at least 50 per cent of new pooled strategies with sustainable or impact labels
- Reducing real estate carbon intensity by 30 per cent and energy intensity by ten per cent.

In recognising mass electrification of transport and heating is needed to meet society's growing need for power, we have invested over £5 billion since 2015 in green assets, including solar, wind, energy centres and electric rail. This equates to 730 MW of low-carbon and renewable energy generation capacity in 2020, enough to power a million homes. In 2020, we set a new target to reach 1.5GW by 2025 and have already reached over 900 MW through further investment in on and offshore wind.

From rooftops in real estate to direct investment in renewables within infrastructure and financing large-scale energy projects through private debt, our expertise is helping our economy transition to low carbon, while delivering risk-adjusted returns in growing sectors.

Ed Dixon
Head of ESG, Real Assets
Aviva Investors

Our 2020 commitment to originate £1 billion in sustainable transition Loans by 2025 should also help accelerate the societal transition. We are well on track to meet this target and have already originated in excess of £600 million in just seven months. Borrowers typically receive a financial incentive of around 20 basis points, or £200,000 on a £100 million loan.

Speaking on the transition loans, Dixon says: "Our new proprietary framework is designed to specifically address the climate transition of buildings, which is an area of increasing focus across the real estate market."

Our borrowers are already taking the agreed steps to reduce emissions from the assets against which the financing is secured. This includes retrofitting solar photovoltaic panels, reducing energy demand through more efficient lighting and plant, and undertaking green building certifications.

Sustainable lending ultimately helps reduce the carbon footprint of clients' investments, improves the financial stability of the underlying borrower, and reduces the long-term climate transition risks associated with real estate.

Beyond our own efforts, getting this right will bring many benefits. Collaboration and learning from industry best practice will be critical. Regulation and client demand are driving us in the right direction, but we should also be driven by the knowledge that building a more sustainable future is simply the right thing to do.

Daniel McHugh
CIO, Real Assets
Aviva Investors

Against our nature

Through visual design and simple but provocative messaging, Against our nature aims to playfully remind people of their part in the climate crisis and help them navigate the myriad of psychological and behavioural traps that lie in wait for them.

[Request a free copy]

As Oliver Rix, partner for energy, utilities and resources at Baringa, puts it: "The quality of life should be so much higher. As professionals, we tend to talk in terms of various scenarios, and we compare the risks and costs. Those approaches are needed, but we also need to understand and talk about what it means for people. It's about better air quality, less noise pollution, using land more sustainably, having a well-managed countryside and improving biodiversity."

It is difficult to sum things up any better.

Note: ESG and Climate related engagement, goals and exclusions can vary at the investment strategy and portfolio level depending upon country, jurisdiction and individual client needs.

References

1.Department for Business, Energy & Industrial Strategy provisional UK emissions 2019
2.https://www.ukgbc.org/climate-change/
3.https://architecture2030.org/why-the-building-sector/

Event Summary

Stewardship

Welcome aboard this one way train

by Julia Axelsson, CAIA

Proactive dialogue with companies, reinforced by voting power, can encourage them to improve practices that strengthen sustainability. Recent global events - the pandemic, the pain of racial injustice, wildfires - have ensured stewardship is more important than ever, reminding us of how much we all must do to effect change and improve the world in which we live.

John Howchin
Secretary-General
The Council on Ehtics of the Swedish National Pension Funds

Julie Moret
Global Head of Sustainable Investing & Stewardship
Northern Trust Asset Management

A virtual roundtable discussion on the topic of stewardship organised by NordSIP on September 1st brought together a panel of leading experts from across Europe: John Howchin, Secretary-General of The Council on Ethics of the Swedish National Pension Funds, Julie Moret, Global Head of Sustainable Investing & Stewardship at Northern Trust Asset Management (NTAM) and Oliver Grayer, Programme Leader of the Corporate Programme at Institutional Investors Group on Climate Change (IIGCC).

Insistent, Persistent, Consistent

Following a short introduction, the panellists dive straight into the topic, explaining what good stewardship means to them and the organisations they represent. Since its formation in 2007, the Council of Ethics, a collaborative effort between Sweden's First, Second, Third, and Fourth buffer pension funds, has conducted dialogues with several thousands of listed non-Swedish companies. Many of these dialogues have been constructive and led to tangible improvements. Unsurprisingly, therefore, Howchin stresses the importance of proactive engagement and long-term commitment in his introduction. "Stewardship is very time-consuming, and the changes are often incremental. You have to have patience," reflects Howchin, adding that, unfortunately, the issue has become politicised lately.

Oliver Grayer
Programme Leader,
Corporate Programme
Institutional Investors Group on Climate Change (IIGCC)

"There is, in our mind, an optimal approach around engagement," asserts Moret in her opening remarks. She briefly introduces NTAM's systematic and goal-oriented stewardship process, from identifying material issues that could impact the financial condition of a company to assessing the engagement outcome. "It is incredibly critical to remain both persistent and consistent," she points out, stressing the importance of following through and monitoring progress after initiating a dialogue by raising a concern.

Admittedly, prioritising is slightly easier for IIGCC as the organisation focuses on one material ESG issue only, climate change. The issue itself is enormous, however, given the tightening ecological budget, as Grayer points out. "We support collaborative engagement," he explains. The work is often structured around sector groups, as different sectors face different challenges and follow separate development paths. Gayer also mentions the 'Net-zero stewardship tool kit' currently being developed by IIGCC to assist investors in their engagement efforts.

Transcending Differences

"At the heart of most engagements, we see a common process," says Grayer. All shareholders' engagement work has the annual proxy season as its focal point. Both active and passive investors prepare similarly and go into intensive dialogues before the AGMs. According to Grayer, active and passive managers engage very similarly. Fixed income and equity investors and investors in different regions and markets may have more differentiated approaches.

"Wearing an active-engagement co-owner 'hat' transcends different investment strategies," Moret agrees. For her, it is more important to be clear on the purpose of the engagement, and on where and how one can have the greater impact. "There is strength in numbers," she stresses, advocating passionately for joining collaborative initiative ssuch as the Climate Action 100+ initiative or the Sustainability Accounting Standards Board (SASB) that are particularly well-aligned with NTAM's priorities.

Getting Priorities Right

According to Howchin, choosing where to focus the engagement efforts is not a trivial task. He reflects on the need to prioritise the bigger portfolio holdings, even if some of the issues that smaller holdings are involved may seem very important. For example, there might be an interesting opportunity to engage with Brazilian beef giant JBS on deforestation in the Amazon, but the position held by the fund is tiny. Whereas tech companies which represent very large holdings might offer engagement opportunities on other themes, such as human rights. Balancing those priorities is crucial and efforts need to be put into perspective given the underlying assets, especially when engagement resources are limited.

Howchin, just like Moret, believes that collaborative initiatives, like Climate Action 100+, are crucial to guiding stakeholders' efforts in the same direction. "We are all part of a stakeholder economy, and if you are oblivious to this, you are blind. It is all about stakeholders engaging together," he adds. Working in concert makes it possible to focus on the parts of the economy that are especially challenging to change, such as steel, trucking, cement, chemicals, mining or real estate, for instance, and their respective value chains. For the transition to happen and to preserve the trust in the industry, these difficult challenges can't be left aside. "We need to step up, going from engagement to 'hard-core' ownership," he concludes.

Climate Requires Action

The IIGCC is one of five investor networks who founded the Climate Action 100+ initiative in 2017. Identifying the 100 largest emitters and building groups of investors around each of them to engage for change has been a successful strategy so far, according to Grayer. Over half of the companies have already committed to net zero, about half have carbon targets, and almost 80% produce TCFD reports. The remaining gaps are primarily in emerging markets and among state-owned companies, he adds.

Grayer agrees with Howchin on the importance of engaging throughout the whole value chain. "Despite their ambitious targets, ArcelorMittal cannot get to net-zero steel if there are no buyers for net-zero steel," he explains. He emphasises, therefore, the need for coordinating the efforts, analysing the strategic problems holding everyone back and organising investors to help resolve some of them. Solving such "existential value-chain challenges" is undoubtedly a priority going forward.

Both the Council on Ethics and NTAM are working actively with IIGCC on the Climate Action 100+ initiative and share some of the results achieved. The newly released report on steel is a laudable outcome of the collaboration, Howchin points out. Commodity-tranding and mining giant Glencore is an example of the companies NTAM has engaged with. In 2020 the company committed to achieving net-zero by 2050 and has already enhanced the interim target since. "Engagement and monitoring don't stop there, though," Moret is careful to point out. Once a company has announced a commitment, the process moves to different areas, such as how the company's business strategy aligns with the new target pathway or how the executives' remuneration and lobbying policy fit in that overall strategic plan.

Moving Beyond Climate

At this point, Moret reminds us about the importance of engaging with companies on other sustainability issues, apart from carbon emissions and climate change. She is particularly passionate about social aspects such as diversity, equity, and inclusion which are also a strategic priority for NTAM. Being introduced to the NTAM's executive committee upon joining the firm recently, she was impressed that 65% were ethnically, racially and gender diverse. "I felt that there was not only the rhetoric but also the action behind," she says. According to Moret, setting the bar high for one's own organisation makes it easier to demand the same of investee companies. This inside-out approached has allowed NTAM to successfully engage on board diversity issues from a position of integrity. "In a post-Covid world, everyone will need to reassess their role and how it all fits together," agrees Howchin, speaking about the increasing importance of tackling uncomfortable social issues.

Mapping Progress

The discussion moves on to the ubiquitous data challenge that investors face when mapping and monitoring engagement progress. Ensuring that there are enough data points to drive voting policies is, according to Grayer, "ground zero". Supporting shareholder resolutions and exercising director votes has already accelerated. "What I would expect more of in the future, however, is the use of auditor votes," he shares. Although for this to happen, the correct data will need to be collected and the right policies to be written first.

Moret describes how NTAM is attempting to tackle the challenge of monitoring and measuring engagement success. To help structure the process, the firm uses a 'four key milestones' framework. NTAM also uses a proprietary scoring tool, the Northern Trust ESG Vector Score which provide a multidimensional measure on how companies perform on sustainability issues. "These help us fine-tune additional data points and highlight the particular issues and topics for our engagement," she explains. Moret also points out the importance of the work NTAM does with SASB to "provide a greater clarity to corporates around what are the most decision-useful disclosure requirements as there is a myriad of frameworks and approaches".

Sometimes the results speak for themselves, though. Howchin brings up the example of engaging with mining companies to improve the safety of tailings dams after the Brumadinho disaster. With new international standards now in place and more and more mining companies embracing them, hopefully, new disasters can be averted. It takes time, he admits, but mining has been around for 30 000 years, so we shouldn't expect any quick wins. "Our comparison is always divestment," says Howchin, looping back to his opening remarks. "It's easy to divest, whereas the alternative, engagement for change, is very long-term, and you need to be patient." It is precisely what the Swedish pension funds can do, being long-term stewards.

A Call to Action

In their concluding remarks, the panellists get to formulate, as concretely as possible, their call to action. "We are always looking for people to help us operationalise the actions and interventions to achieve net-zero," says Grayer, inviting investors to get involved in the work of IIGCC and Climate Action 100+.

"Don't be scared to build a culture of stewardship, even if it takes time, as there is a lot of inertia in the system," urges Howchin. "And don't let politicians and NGOs hijack what we are trying to achieve here and simplify the message," he adds.

Moret reiterates the need to be focused, persistent and consistent. "Find opportunities where you are able to engage, and not just with corporates, but also with policymakers and regulators," she concludes.

Stephanie Pfeifer
CEO
Institutional Investor Group
on Climate Change (IIGCC)

Image courtesy of Institutional Investor Group on Climate Change

Accelerating the Transition *Through Engagement*

by Julia Axelsson, CAIA

> *"Collaborative investor engagement has the power to drive greater change and encourages a sense of urgency across capital markets when it comes to addressing climate change risk."*

Since its launch in 2017, Climate Action 100+ has quickly become the world's largest investor engagement initiative on climate change, counting more than 615 investors, responsible for over USD 60 trillion in assets under management among its signatories. Between them, these responsible investors are working on ensuring that 167 of the biggest corporate greenhouse gas emitters take the necessary actions to align their business strategies with the goals of the Paris Agreement. NordSIP caught up with Stephanie Pfeifer, Chief Executive of the Institutional Investors Group on Climate Change (IIGCC) and current Vice-Chair of the Climate Action 100+ Steering Committee, to hear more about the laudable initiative.

The origins

"Climate change is one of the most significant financial risks facing investors today – one which cannot be diversified away," states Pfeifer. "Collaborative investor engagement has the power to drive greater change and encourages a sense of urgency across capital markets when it comes to addressing climate change risk," she adds, explaining the rationale behind the Climate Action 100+. The signatories unite around a common engagement agenda: improving corporate governance, reducing GHG emissions, and strengthening climate-related financial disclosures.

"For any entity to achieve net-zero across the value chain, including Scope 3 emissions, cross-sector collaboration is needed to build new solutions and scale investment."

Initially, 225 investors signed up for the initiative at the One Planet Summit in December 2017. "The launch of Climate Action 100+ represented a global step-change in active ownership," recalls Pfeifer. Since then, Climate Action 100+ has experienced over 170% growth in investor participation. Investor signatories now represent over 50% of all global AUM. As shareholders of some of the world's highest emitting companies, they are driving significant change in shaping and accelerating business strategies that align with a 1.5°C world according to the 'Net-Zero by 2050' roadmap outlined by the International Energy Agency (IEA).

Investor signatories believe that engaging and working with investee companies to address the business impacts of climate change is consistent with their fiduciary duty and is essential to achieving the goals of the Paris Agreement. "Global collaborative investor engagement with consistent, long-term objectives sends a powerful signal – directly to companies – that investors want companies to address climate change," says Pfeifer.

The way it works

The 167 companies selected for engagement by Climate Action 100+ account for the majority of portfolio emissions and are therefore critical to the net-zero emissions transition. The initiative coordinates engagements conducted by hundreds of investors with systemic, global, and ambitious objectives through the five founding investor networks: the Asia Investor Group on Climate Change (AIGCC), Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI). Each investor network coordinates regional focus company engagement.

It is, however, investors themselves who are responsible for driving the engagement and developing and implementing company-specific engagement strategies. They determine the focus companies they wish to engage with and the engagement strategy to pursue, supported by the investor networks. The initiative is overseen by a global Steering Committee comprising investor representatives and the heads of the founding networks.

"In addition to supporting investors with their engagements, the investor networks lead regionally focused working groups that support engagement with a subset of priority companies to provide participating investors with resources and help to ensure that engagements are as effective as possible," explains Pfeifer. IIGCC, for instance, the network that Pfeifer herself leads, supports investor-led engagements with 47 European focus companies and works with investors on setting engagement strategies and objectives. "For the 2021 proxy season, IIGCC's priority engagement objectives were 'net-zero by 2050' targets, lobbying disclosure and votes on transition plans," she adds.

Investors also realise that companies cannot fulfil their net-zero commitments alone. "For any entity to achieve net-zero across the value chain, including Scope 3 emissions, cross-sector collaboration is needed to build new solutions and scale investment," explains Pfeifer. Recognising this need led Climate Action 100+ to launch a new workstream this year to support companies to decarbonise their value chains and build out effective climate transition plans. The Global Sector Strategies look at carbon-intensive sectors and the actions that companies must take individually and collectively to accelerate the pace of transition. These reports also include actions for investors and what they can do to support companies, such as investing in new technologies and engaging with policymakers to help break down barriers.

Benchmarking success

Engagement and stewardship are notoriously challenging to measure and monitor. To help evaluate and track corporate climate progress, in March 2021, Climate Action 100+ launched the first iteration of its Net-Zero Company Benchmark. The Benchmark offers the first detailed, comparative assessments of individual focus company performance against the initiative's three high-level commitment goals and defines key indicators of success for business alignment with a net-zero emissions future and goals of the Paris Agreement.

"Through the Benchmark, signatories are outlining engagement priorities and requesting that companies make net-zero commitments and map out short-, medium- and long-term targets for delivering these, including robust climate transition plans and comprehensive decarbonisation strategies," says Pfeifer.

The initiative also maintains a process for flagging shareholder resolutions filed by Climate Action 100+ signatories and tracks the level of support. Six out of 14 shareholder proposals filed by Climate Action 100+ investor signatories and flagged by the initiative won majority votes in the 2021 proxy season. For instance, the vote to replace some of Exxon's board members, which was flagged, won support from many Climate Action 100+ signatories.

Showing results

Climate Action 100+ investor signatories have been important catalysts for climate action and have achieved breakthrough commitments from some of the world's largest corporate GHG emitters. "When the initiative launched in 2017, no companies had set net-zero emission goals," reminds Pfeifer. Meanwhile, a recent BNEF analysis on Climate Action 100+'s focus companies found that over two-thirds have now made net zero commitments.

Pfeifer also highlights a few recent examples of investor engagement driving corporate climate progress. She mentions life science company Bayer that recently published its first climate association review following engagement from investors around lobbying disclosure transparency and directly acknowledging the role of investor engagement through Climate Action 100+. Another case in point is LyondellBasell, one of the world's largest plastics, chemicals, and refining companies. Following constructive engagement with investors, the company recently committed to achieving net-zero emissions by 2050 from its global operations and an absolute reduction of 30% in Scope 1 and 2 emissions by 2030.

"Both investors and companies must walk the talk on their climate ambition and start turning their commitments into action. The next decade is about meaningful and tangible disclosures today, not distant commitments in the future."

Time to walk the talk

"Both investors and companies must walk the talk on their climate ambition and start turning their commitments into action," urges Pfeifer. "The next decade is about meaningful and tangible disclosures today, not distant commitments in the future," she adds. According to her, companies should aim to improve their alignment with the Climate Action 100+ Net-Zero Company Benchmark and publish a detailed decarbonisation strategy so that investors can accurately judge how well companies are planning for the net-zero transition.

The onus, however, is on investors, too. "Investors must be prepared to make tough decisions when companies have not provided adequate disclosures or been ambitious enough in their transition plans," Pfeifer points out. "They must balance the desire to commend companies where they are making progress with the need to hold them accountable when their ambition is misaligned with science-based steps needed to limit global warming to 1.5 °C," she says.

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Investor signatories to Climate Action 100+ believe in the power of engagement and are willing to use their capital to support companies as they navigate the transition. "Investors should continue their constructive dialogue with companies and demand greater ambition, action, pace and scale," Pfeifer concludes.

Responsible Ownership & Engagement

The Power of Fruitful Collaborations

by Emilie Westholm

Emily Westholm
Head of Responsible Investments & Corporate Governance
Folksam

Credit:Folksam

We are convinced that well-managed companies, which integrate sustainability in their business model, over time outperform companies with weak corporate governance and without a focus on sustainability issues.

How does Folksam work with responsible investments?

Folksam has a long tradition working as a responsible owner. Our vision is that our customers should feel safe in a sustainable world. And this vision runs through everything we do. We are convinced that well-managed companies, which integrate sustainability in their business model, over time outperform companies with weak corporate governance and without a focus on sustainability issues.

To us, having responsibility as a main driver for investment decisions, it is our way of contributing to the challenges we, as a world, face today. Through our investments and active ownership we can make a difference that is much larger than just our own direct impact.

Sometimes it is said that responsible investments generate lower returns than "ordinary" investments. Do you agree?

This might be true in the short term. If you don't care about the environment, your employees or the other people affected by your business or if you make products with really bad quality you might create higher profits here and now. But in the long run, we are convinced that taking responsibility for people, the environment and acting ethically right will pay off and generate better results also in the wallet.

There are plenty of examples where customer demand and preference also reward companies that are transparent and show how their sustainability work is conducted. Consumers of today want to make active decisions and take a stand via their purchases and that includes intangible things as well such as where to place your retirement funds or choosing home insurance. In order for companies to gain loyal customers and for us, as a mutual insurance company, to show that we listen to our owners, it is also important to take other values than instant return into consideration. That is, of course, crucial to us but it can be paired with long term yield as well as respect for human rights and environmental consideration.

What aspects of responsible investments will become more important in the future?

The last few years we have seen a world that has finally woken up and realized that we need to do something about the climate challenge. But only caring about the climate is not enough. Human rights and anti-corruption are just as important and cannot be separated from each other. A responsible company is acting in the best interest of the whole ESG spectrum. This is also why I prefer "responsible investments" instead of "sustainable", I think responsible holds so much more and that we as asset owners, and the companies we hold, have a responsibility that goes beyond what sometimes is included in the word "sustainable". Being responsible imply that we are facing the same challenges as our portfolio companies when it comes to climate change for instance. Folksam is one piece of the puzzle but we cannot improve things on our own. Neither can the companies and as an active owner we can function as a support and sounding board. I believe that is taking responsibility beyond supervising and reprimand our holdings on their work.

Rather than picking certain issues I think all aspects of responsible investment will be of

As an asset owner, we share our customers views, and also our competitors views. One fantastic unique thing in the investor community is the way we work together since we have the same common overarching goal.

great importance. Two aspects though that are not always highlighted are tax fairness and anti-corruption. In my view, those are fundamental to be able to deliver everything else. Responsible investment includes pretty much everything embedded in the SDGs like modern slavery, just transition to fossil free societies, green technology, diversity and so on and all of those require substantial investments. We simply cannot afford to lose money to corruption and illegal tax planning. As asset owners we want to be agents of change and start the conversations with our portfolio companies on all of those aspects.

Can you give a few examples of how you work with responsible investments at Folksam?

At Folksam we have a variety of strategies when it comes to responsible investments. We exclude a few sectors based on values or risk. For example we don't invest in tobacco or gambling and we have excluded parts of sectors with high risk related to climate change such as oilsands and coal. We also choose to invest more in what we think is more sustainable, like green and sustainable bonds. We have also increased our holdings in SSAB, the steel maker, since we believe that its process of making steel production fossil free is exactly what the world needs. Last, but not least we work as active owners where we in short have dialogues with companies either with other investors or by ourselves and we vote at AGMs and file resolutions. Earlier this year we wrote to Amazon about labor rights and the rights to unionize together with Öhman Fonder among others.

Looking back ten years, have the dialogues you have with companies changed in any ways? Are the companies more responsible today?

The dialogues we have today are very different from say 2007 when I started at Folksam. Back then, we often found ourselves explaining that sustainability did not mean charity and that we absolutely cared about the profits and that for us, sustainability was a way to make sure that our customers would get their pensions the day they retire and that the world they retire in is a world they also would like to live in. This discussion rarely takes place these days and in general most companies have realized why being responsible is good for business. But, we still have a long way to go.

And looking forward, where is Folksam in ten years?

Great question. I think, and I hope, that Folksam will continue the journey that once started a long, long time ago where the customers' interests are in focus. As an asset owner, we share our customers views, and also our competitors views. One fantastic unique thing in the investor community is the way we work together since we have the same common overarching goal. If I should mention one of these team works I would say Nordic Engagement Cooperation (NEC) that we founded in 2008, where Folksam works with PFA and Ilmarinen. Working together was pretty uncommon ten years ago, but I believe that it is where we have the most potential. The financial sector has a huge possibility to make a difference, and by working together we take responsibility for this possibility.

Principles for Responsible Investing

The 3 Pillars of Stewardship

by Emmet McNamee & Paul Chandler

Stewardship's first time in the sun came over a decade ago, in the wake of the global financial crisis. That crisis stemmed from a failure of ethics and compliance within financial institutions, and a failure of governments who had favoured deregulation and a laissez-faire approach to the financial sector. Yet gradually attention turned to investors, whose failure to sufficiently oversee investee companies – and at times their hunger for short-term results – contributed to the excessive risk-taking which precipitated the crisis. That realisation prompted a rethink of the role investors that should play in corporate governance, and was the motivation behind the UK publishing the world's first stewardship code in 2010.

Investor stewardship has evolved since then. Voluntary codes have spread to markets in most continents and have grown in sophistication. Stewardship has also moved beyond soft law instruments and is now increasingly recognised as a component of investors' fiduciary duty.

Importantly, from the perspective of rebuilding trust in the financial sector, stewardship has also been the source of some of responsible investment's most positive real-world impacts. The Platform Living Wage Financials has successfully achieved higher wages for workers in the developing world. The Investor Mining and Tailings Safety Initiative

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Principles for Responsible Investment (PRI)

implemented standards to try to prevent the recurrence of a disaster which killed 270 people in Brazil in 2019. And most notably, Climate Action 100+ has successfully pushed for some of the world's largest emitters to commit to net zero emissions by 2050.

These examples are evidence of the potential that effective investor stewardship offers. Yet they are also the exception rather than the rule. Too many investors take an excessively narrow view of the risks that their portfolios face, and do not use their full range of influence to improve sustainability outcomes. Investors face a number of systemic risks today, many of which could make the 2008 crisis pale in comparison, with climate change being the obvious example. To tackle these risks and to contribute to a more sustainable world, investors need to improve three aspects of their stewardship.

1. Direct investee stewardship

The default stewardship tools that investors rely on are engagement and, for listed equity investors, voting. Investors' use of these tools to advance sustainability outcomes has been evolving, particularly over the last 12 months or so. Investors are more prepared to escalate when engagement efforts have been unsuccessful. Support for ESG-related shareholder proposals has risen sharply. Input is increasingly being sought from beneficiaries on how the institutions that are managing their money should be casting their votes.

One area where investors have been slower to support change has been on the composition of investee boards of directors. There are question marks over how well-positioned corporate boards are to take advantage of the sustainability-related shifts on the horizon. For example, while net zero commitments continue to proliferate, only 0.2% of Fortune 100 directors have specific climate expertise.

Yet despite low levels of board expertise and growing investor assertiveness when it comes to shareholder resolutions, voting patterns on director elections has remained fairly constant. The support for directors at Russell 3000 companies has hovered around 95% for the past few years, while a little over 40 directors this proxy season have failed to receive a majority of shareholder votes. Opposition to directors' re-election tends to be based on "pure" governance concerns such as board independence, diversity, or overboarding (where a director sits on an excessive number of company boards).

Many in the responsible investment community have cheered the recent shake-up of the ExxonMobil board in the Engine No 1-led campaign as heralding a step-change in how investors approach ESG laggards. While encouraging, the circumstances of that proxy battle – a highly risky, well-resourced campaign focused on a company unusually open in its disdain for ESG concerns – are unlikely to be frequently reproduced.

Investors and proxy advisors should re-evaluate their voting policies for director elections, proactively shaping boards that are ESG-competent rather than holding directors accountable for failures after the fact. Investors should also consider how they can collaborate to nominate suitably-qualified alternative candidates. The shareholder-led nominating committee common in some Nordic countries could be a model here for other jurisdictions.

2. Market Stewardship

It is increasingly clear, however, that a reliance on direct investee stewardship alone will be insufficient to prevent many of the systemic risks that investors face. While assertive engagement and voting may lead companies to commit to net zero emissions by 2050, actually achieving the goals of the Paris Agreement will require higher carbon prices and real economy decarbonisation policies. Investors that are serious about shaping positive sustainability outcomes will need to consider engagement with a broader set of decision-makers.

PRI's reporting data has shown continual year-on-year increases in the number of signatories that engage with policymakers, primarily focused on financial sector reforms. Yet the depth of that engagement varies wildly, and engagement on real economy issues such as climate or human rights policy remains relatively shallow.

Perceptions of what constitutes leading stewardship over the coming years is likely to increasingly favour advocacy efforts, as investors push for fair pricing of externalities and changing the rules of the game to increase the prevalence of those fabled "win-win" situations.

Beyond policymakers, investors should also look to standard-setters, service providers and membership associations to evaluate their alignment with investors' own stewardship objectives, and engage where there is a perceived conflict.

3. Collaboration

Stewardship by nature suffers from a collective action problem, where almost everyone benefits regardless of their own contribution (or lack thereof). This is doubly true of efforts to change how markets and economies operate, where investors' efforts to advocate for policy and regulation shifts are likely to be felt through overall market performance rather than the more easily measurable alpha.

Getting around this requires an enhanced commitment by investors to collaboration and the pooling of resources. Initiatives such as Climate Action 100+ are a great start, however collaboration can and should go further to better resource efforts focused on more assertive stewardship at investee level, and on public policy change on ESG issues.

Investors should consider the role of commercial service providers and non-profit associations who engage investees or policymakers on behalf of a group of clients or members. By pooling the resources of many investors, these organisations can better resource the efforts for each engagement focus company or government, and thus be more effective at making progress.

Outside of formal collaborations, investors can also work to build stronger relationships with peers to share insights that strengthen the effectiveness of efforts carried out by all.

As the global economy hurtles towards the limits of our 1.5°C carbon budget, starts to surpass planetary boundaries in our natural systems, and grows ever more unequal and polarised, investors must summon more confidence in using their voice and their votes, not just their investment decisions. While progress is evident and heartening, much more must be done and done together.

The Principles for Responsible Investment is the world's leading proponent of responsible investment. In 2019 it published Active Ownership 2.0, a framework for the more ambitious stewardship needed to deliver against beneficiaries' interests and improve the sustainability and resilience of the financial system as a whole.

Solar Photovoltaic

Riding the Energy Transition Wave

by Filipe Albuquerque

As the world races towards net-zero CO2 emission goals, the European Union has set an ambitious agenda for the upcoming decades that supports investments in renewable energy sources. Investors with a keen eye on the future of the continent are looking to profit from this wave of change.

Dario Bertagna
Managing Director
Co-Head of Clean Energy
Infrastructure
Capital Dynamics

Credit:Grégory Roose for Pixabay

"We are seeing more and more news about natural disasters all over the globe," says Dario Bertagna, Managing Director and Co-Head of the Clean Energy Infrastructure team at Capital Dynamics, a US$15 billion asset management firm focusing on mid-market corporate private equity and credit investing, and clean energy infrastructure.

"The severity of extreme floods in Germany and Western Europe, the alarming number of wildfires in the US and the hottest summer in the history of Europe with Italy reportedly reaching almost 50°C are all signs of a fundamental structural problem."

As a result, European policymakers have moved global warming to the forefront of their agenda. "Europe wants to establish itself as the first carbon-neutral continent in the world. This means that the policy environment across Europe will remain accommodating for renewable energy," Bertagna adds.

An Accommodating European Policy Environment

To this end, the European Commission increased the CO_2 emission reduction targets. The latest Green deal, and the "FIT for 55 package" in particular, set a number of new ambitious goals, including a minimum 55% reduction of greenhouse gas emissions by 2030 compared to 1990, and net-zero by 2050. The package also includes reforms for the carbon pricing market and a number of regulatory reforms, including changes to the Energy Efficiency Directive and the Renewable Energy directive.

"Renewables will largely benefit from the new polices as we are seeing an increase in momentum in the sector. As of today, about 40% of the capacity mix is generated from renewable energy sources. The balance is provided mostly by gas, nuclear, coal and a very small amount of oil."

"If we fast-forward to 2030 we can expect renewable energy to account for about 50% of the generation mix. Renewables will almost entirely replace coal, oil, and nuclear to some extent. By 2050, renewables are expected to be the dominant energy source, representing 75% of the generation mix."

"In the short term, this shift will create a scarcity of operating assets across Europe, particularly after the end of the subsidies regimes, at a time of incredible demand for renewable electricity and renewable assets," Bertagna says.

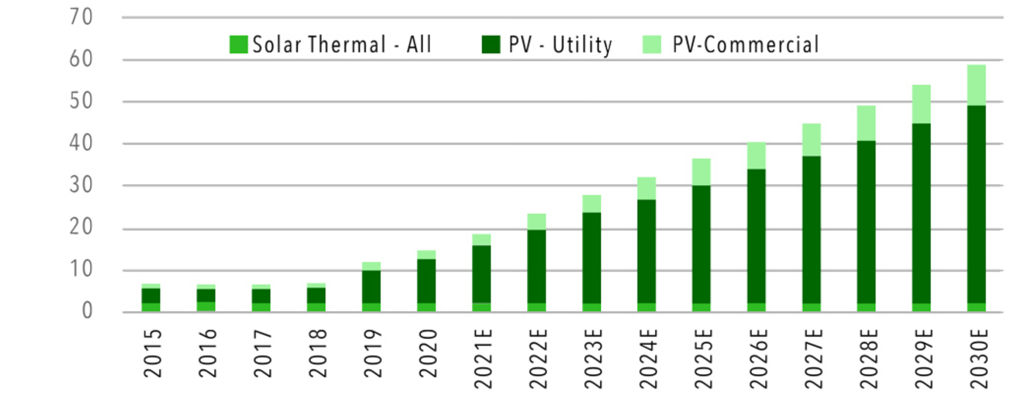
The Rise of Power Purchase Agreements

"We believe that this dynamic will increase the value of renewable assets and favour players with an already secure pipeline of assets, particularly assets benefiting from Power Purchase Agreements (PPAs), which mimic the cash flow structures of subsidised assets. We also believe that asset owners will be able to benefit from more attractive PPA terms," Bertagna adds.

A PPA is a supply agreement between two parties, usually between a power producer, such as a solar plant or a wind farm, and a customer, such as an electricity consumer, a corporation or a trader. The PPA defines the conditions of the agreement between the two parties, such as the amount of electricity to be supplied, the duration of the contract and the price, which normally is fixed.

"Since it is a bilateral agreement, a PPA can take many forms and can be largely different from one to another. Certain PPAs for instance push the volume risk on the producer while others on the consumers. For instance, we talk about 'pay as produce PPA' or 'base load PPA' depending on the arrangement around the contracted volume and who is taking the risk. In general, PPAs can be used to reduce price risks and volatility for both suppliers and customers," Bertagna says.

Solar PV capacity outlook in Spain (GW)



Source: CEI Team internal analyses, Market advisor, Publicly available information, BNEF as of August 2021

The general market environment in Europe is making PPAs more popular according to Bertagna. "If we step back and look at how we reached the current renewable energy penetration we can see a trend. Although up until 2015/2016 most investments were backed by subsidies, the cost of renewable energy technology has decreased significantly. Subsidies for new projects are largely unnecessary and have been replaced by PPAs," he explains.

The number of PPA contracts more than doubled in the last three years, according to Bertagna. "2020 was a record-breaking year in terms of new contracts signed worth almost 4 Gigawatts (GW) in PPAs, up from the previous record of 2.5 GW announced in 2019," he adds.

The Allure of Southern Europe

According to Bertagna, Italy and Spain are currently among the most attractive European markets for investments in renewable energy. "Both countries benefit from high solar irradiance, which is favorable for solar investments in the post-subsidy world. Both the Italian and Spanish governments are also very supportive of renewables, particularly solar energy," he says.

"Spain is one of the fastest growing markets in Europe when it comes to renewables, and they have very ambitious targets. Meanwhile, Italy is the second largest solar market in Europe after Germany," Bertagna explains.

However, Italy and Spain are very different markets. "Italians also have very ambitious targets, and they plan to achieve 52 GW of solar PV and 19 GW of wind by 2030. The majority of the photovoltaic (PV) solar plants will be on a smaller scale. Compared with Spain, Italy does not have the same availability of vast flat land. Therefore, projects tend to be smaller," Bertagna continues.

The Spanish Appeal

One of the key appeals of Spain is the country's government support of renewables, according to Bertagna. "Between 2020 and 2021, they introduced a number of new reforms. In particular, in April this year they approved a new Law for Climate Change and Energy Transition (LCCTE), which was endorsed by almost all parliamentary groups," he adds noting that Spain's solar sector is expected to grow from the current 17 GW to 60 GW by 2030, mainly thanks to solar energy.

The main goal of the LCCTE is to achieve carbon neutrality by 2050. Interim goals include pushing renewable energy to represent at least 74% of the country's electricity generation by 2030 and a reduction of emissions in Spain by at least 23% vis-à-vis 1990 levels.

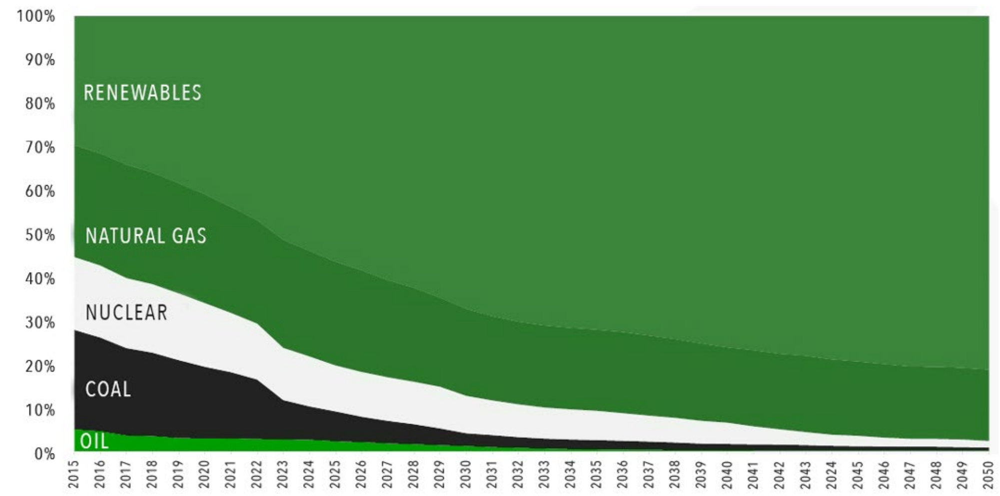
According to Bertagna, other supportive measures include upgrades to the grid connection to ensure that there is sufficient grid capacity for the renewable projects, new regulation designed to allocate capacity exclusively to upcoming projects, and a reform of administrative processes to aid developers.

"Over €240 billion of investment will be required by 2030 to achieve these targets. A great number of projects are currently in development over the next two years. Capital Dynamics entered into an agreement to acquire ready-to-build assets from a local developer with a visible pipeline," Bertagna explains.

PPAs and Solar PV in Spain

According to Bertagna, Spain is one of the most interesting PPA markets in Europe. "PPAs play an important role in Spain's Solar PV market," he explains. "The government abolished Feed-in-Tariffs (FIT) retroactively in 2013 and replaced them by a new capacity payment mechanism. The issue with FITs is that the price that the government was paying was unsustainable and caused a so-called 'tariff deficit'," he says.

Projected Fuel Mix European Electricity Generation



Source: Bloomberg NEF

"At their peak FIT were almost 6 times higher than merchant prices. From an equity owner perspective, any cut to a tariff of this magnitude has a significant negative effect on the revenues that a plant generates. PPAs offer a solution to that particular problem. They are one of the reasons we have not invested in subsidised assets in Spain in the past," Bertagna adds.

"PPAs, as opposed to FITs, trade at a price which is lower than the merchant prices, equivalent to a 15-20% discount. The result is that even in a worst-case scenario where a PPA offtaker fails to maintain its contractual obligations and defaults on the PPA, a plant can still sell the power to the market, without losing any money," Bertagna continues.

Although the Spanish government still offers some form of subsidies, Bertagna argues that PPAs are still better value, because of their flexibility and the opportunity to monetise additional revenues streams and public support, such as the €600 million government backed FERGEI fund. Until 2020 about two-thirds of PPAs were signed with utilities, traders and energy suppliers, while from 2021 about 60% of PPAs are expected to be signed with corporates benefitting from the FERGEI fund, according to Bertagna.

A Leader in Italy

Capital Dynamics is among the top owners of solar assets in construction in the Italian subsidy-free market. "Other players include utilities, developers and smaller managers. If we exclude Italian utilities, we are a leader in the subsidy-free solar market," he says.

To leverage its leadership position as the second largest Solar PV market in Europe, the Italian government has decided to focus on administrative reform. "The Italian permit process is quite slow and cumbersome. Fortunately, in June 2021 the Italian government issued a new decree, called the 'Decreto Semplificazioni', to help streamline the authorisation process," Bertagna continues.

Progress has also happened on the PPA front. "Until recently, 5 years was the longest contract available in the market. Now, it is common to negotiate at least 10 year fixed-priced PPAs," he adds. There is a growing demand from corporates utilities and traders to contract clean power from renewable energy providers via PPAs, according to Bertagna. "Although some subsidies are still available in Italy, the lack of available projects led the last auction to not reach its target capacity," Bertagna adds. Effectively there is mismatch between projects in construction and demand for PPAs, he explains.

Applying the Lessons Learned in the UK

Capital Dynamics' investments in Southern Europe were informed by its previous experiences. "We began our European journey in the UK, positioning ourselves as one of the leaders in the construction-ready space," Bertagna says.

Similar to other European countries, PPAs have replaced the subsidy regime in the UK, which hosts one of the most mature markets in Europe, and is driven by an increased number of corporates looking to achieve their ESG and sustainability goals, according to Bertagna.

"We were an early mover in the country and have become one of the leading players in that market. We built very strong relationships with local developers to access bilateral deals at above-market returns, and have robust partnerships with offtakers, enabling us to acquire a large portfolio of assets," he adds.

"We took the same approach in southern Europe, securing a very attractive pipeline of construction-ready assets at above-market returns and negotiating PPAs to sell our power at a fixed price with long-term agreements with the goal of building a de-risked portfolio," Bertagna concludes.

Event Summary

Investing in Change

Selecting & Managing Transitioning Companies

by Julia Axelsson, CAIA

"It is really fascinating to see how we are converging on what we want. As an active manager, it is our job to help navigate our clients through a world in flux. Engagement is, therefore, core to our investment process, and we've been doing it since 1999."

Andrew Parry
Head of Sustainable Investment
Newton Investment Management

Johan Florén
Head of Communication and ESG
AP7

For many, responsible investing is about avoiding certain companies, be it for ethical reasons, reputation management or risk mitigation. With the fast integration of ESG in the investment process and increasing investor engagement, there is a growing awareness that transitioning companies can and need to be a part of the solution. Moving from exclusion to transition can be tricky, however. Change needs to be appropriately identified, managed, and measured, from idea generation to divestment.

To better understand what it takes to successfully invest in transitioning companies at every stage of the investment process, NordSIP organised a webinar on August 26th. The event brought together Kristofer Dreiman, Head of Responsible Investments at Länsförsäkringar (LF), Johan Florén, Head of Communications and ESG at AP7, Andrew Parry, Head of Sustainable Investment at Newton Investment Management, and Thomas Miedema, Investment Manager at Walter Scott. Newton and Walter Scott are part of BNY Mellon Investment Management.

Thomas Miedema
Investment Manager
Walter Scott

From exclusions to transitions – a question of principle

Kicking off the discussion, Dreiman briefly describes how the integration of ESG at LF has evolved historically, shifting focus between exclusions, inclusions, and active ownership. "We, as many of our peers in the Nordics, started by excluding companies, primarily those involved with thermal coal and unconventional oil and gas extraction from our portfolios in 2015," he explains. In 2019, LF's board of directors adopted a 'climate-smart vision', vowing to align the company's portfolios with the 1,5 degrees trajectory of the Paris agreement by 2030. It quickly led to the realisation that exclusions alone would not be enough to reach the ambitious goals. The same year, 2019, the first transition criteria were introduced, initially applied to utilities. This forward-looking approach means that if a company is deemed to be in transition and thus contributing to a more sustainable future, it can still be a part of LF's investable universe.

"I think you have to take a step back and ask yourself: if these are the means, what is the end," says Florén in his introductory statement. "We want to contribute to real economy effects." As a responsible institutional owner, AP7 has a duty to help investee companies develop and transition, he reasons. "The alternative, a blanket divestment, is more or less redefining your investment universe," he said. He then explains that even AP7's exclusionary black-listing strategy could be viewed as a form of engagement, incentivising the companies to change. "We are prepared to reinvest if they shape up," assures Florén.

"We are looking for quality growth companies which are generally aligned with areas of the economy that are growing and have a sustainable future."

For Miedema, the truly long-term horizon in Walter Scott's long-only equity portfolios means he views each investment as a partnership with the investee company. "We are looking for quality growth companies which are generally aligned with areas of the economy that are growing and have a sustainable future," he explains, adding that for such companies, a sustainable transition comes relatively easy. There are, however, investment opportunities to be found even with companies facing a more challenging transition path. Leading engagement efforts to assist such companies in their transition is precisely where he sees his role as portfolio manager and investor.

"It is really fascinating to see how we are converging on what we want," adds Parry, commenting on how asset owners and asset managers seem to come together on engaging with transitioning companies. "As an active manager, it is our job to help navigate our clients through a world in flux," he continues. Although divestment might be an option for an asset owner, an active manager who selects 40 or 50 stocks to invest in, has de facto already excluded most of the investable universe, Parry points out. "Engagement is, therefore, core to our investment process, and we've been doing it since 1999," he says.

Looking for opportunities in transition

Achieving true impact often means owning some of the most challenged businesses, like steel, cement, utilities, the automotive industry, Parry continues, moving on to identifying opportunities and selecting the right transitioning companies. Parry sees "three deltas" investors can benefit from, in this fascinating focus area: the delta of engagement, the reallocation of capital into more sustainable activities and the potential for a lower ESG risk premium.

For AP7, with more than 3000 companies in the portfolio, actively selecting specific transitioning companies is not an option, comments Florén. Yet, the investment opportunity created by transition as a theme is there. AP7 segments companies is in three categories: leaders, laggards and those in-between, the so-called 'slip-streamers', he explains. "If you are looking for change, clearly the group in the middle is where you have the big potential to contribute," he says and goes on to point out that focusing on that group might be much more rewarding than just selecting companies with high ESG scores.

"Sometimes we would ask a manager to divest from a company that is on our restricted list, but sometimes we would also change our view, presented with sufficient evidence and arguments. It's quite a pragmatic approach."

Kristofer Dreiman
Head of Responsible Investments
Länsförsäkringar

At this moment, Dreiman joins the discussion from the slightly different perspective of a manager selector. Naturally, adding one more layer between the asset owner and the investee companies further complicates the quest for targeting transition, yet it is not an excuse for inaction. "At LF, we evaluate both the firm-wide commitment to responsible investing of the asset managers we choose to cooperate with, but also ask them to showcase and prove what kind of change has actually been achieved linked to the various sustainability strategies they apply," he says. Managers can end up on LF's observation list or lose their mandate altogether if they cannot explain or mitigate an ESG misalignment within a reasonable timeframe. "Sometimes we would ask a manager to divest from a company that is on our restricted list, but sometimes we would also change our view, presented with sufficient evidence and arguments. It's quite a pragmatic approach," he explains.

When patience is a virtue

A pragmatic and long-term approach is what Miedema and his colleagues advocate, too. He provides the example of investing in China Light & Power Company to illustrate the long-term nature of a successful engagement process. Getting to know the company well over many years, collecting all the data, regularly talking with management, trying to understand and challenge them is the only way to accelerate their transition, according to Miedema.

Speaking of utilities and trying to help them change, the regulatory framework and other issues need to be considered, Parry remarks. "We have to understand the limitations of engagement, too," he adds. "We can't make a bad company a good company. That's the responsibility of the management." He agrees with Miedema on the necessity of a long-term investment horizon. Patience is a virtue in sustainability, he insists. "There are no quick fixes or easy wins as an active

According to Florén, there is still room for improvement in evaluating the effect of engagement. He also reiterates that setting clear intermediate goals makes it easier to follow up and assess the result.

Divining the future

In their concluding remarks, the panellists take a leap beyond the typical 'energy transition' to explore other potential change-related investment themes for the future. Miedema sees the importance of circular economy growing even more going further. For Parry, the space to watch is the 'S' in ESG. The social dimension will become much more internalised in investment decisions, according to him.

As expected, Florén declines to reveal the next big theme for AP7. He does, however, express an opinion that the importance of and the interest in voting will be growing and taking on a new direction.

Concluding the session, Dreiman agrees with Parry on the growing importance of the social dimension and chooses 'just transition' as a future theme to watch out for. He is also careful to point out that for investors, a clear priority going forward would be to do their homework and define both short-, medium- and long-term 'smart' objectives.

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