Debating climate transition and net zero investing

Earlier this spring **Tell Media Group**, in cooperation with **Abrdn**, **Allianz Global Investors** and **BNP Paribas Asset Management**, organised a roundtable discussion on the climate transition and net zero investing at Hotel d'Angleterre in Copenhagen. Tell Media Group founder Niklas Tell and Nordic Fund Selection Journal editor Caroline Liinanki moderated the discussion.

By: **Niklas Tell** Photo: **Christer Salling**

The discussion started out with Caroline Liinanki asking the Danish pension fund participants about some of the main challenges when it comes to the green transition.

JAN KÆRAA RASMUSSEN: "There are two general themes or trends that I think are important here. Firstly, it's clear that there's a lot of capital looking for good green projects with a low risk profile and that space is more crowded today compared to only a couple of years ago. Secondly, the world is in need of massive investments in modern climate solutions and the need has grown even stronger after the Russian invasion of Ukraine as we're now talking about energy security in addition to climate change issues. This means that there's an increasing need for more capital willing to take higher risk as opposed to the situation today where most of the capital is looking for low risk green investments."

MIKAEL BEK: "The world has changed following the Russian invasion of Ukraine. With rising interest rates, there's suddenly an alternative for investors looking for low risk investments as we now actually can get some returns in fixed income. As Jan mentioned, the returns on green projects are currently low with a lot of capital chasing the same investments. An investment in a solar park in the US will probably give you a return of some 4 per cent. We need more projects and we need higher returns. Another challenge is the question of what is 'green' but I assume we will come back to that. I would also like to mention that we will probably need support from the government when it comes to new technologies in this space. When the wind market first developed, we had support from the government with guaranteed returns and I'm convinced that helped build that market."

CHARLOTTE MANSSON: "We see a lot of demand around the transition to low carbon models. Investors are looking for indicators to identify companies that have transition plans in place and companies that have delivered commitment at a certain level. I think there's a big opportunity in the transition space where you have existing companies looking to transition to something new."

NIKLAS TELL: GOING BACK TO THE POINT ABOUT A LOT OF CAPITAL CHASING LOW RISK GREEN INVESTMENTS. IS THE MAIN PROBLEM THAT PENSION FUNDS DON'T WANT TO INVEST IN MORE RISKY PROJECTS OR IS THERE A LACK OF INTERESTING THINGS TO INVEST IN?

JAN KÆRAA RASMUSSEN: "The short answer is that there's certainly a lack of a bankable pipeline but it's more difficult to say who's to blame. Some of it has to do with project development. There could be more projects – both in new technology in our part of the world but also projects in emerging markets. It seems to be that the only large investment you can get in that part of the world is through granted finance or some sort of co-investment or catalytic finance structure. But I also think that the perceived risk as seen by investors is too high. I think that was the lessons from investments in renewable energy some 10 to 15 years ago. A lot of pension funds in Denmark thought it was really risky but now we see that it wasn't. We've seen very good returns from those investments and the financial risk has been more comparable to a bond than to some exotic unlisted equity structure."

BLAIR COUPER: "Can I just ask what you define as risk and do you think that the risk parameters used by the pension industry is restricting you from making investments in what's perceived as risky?"

JAN KÆRAA RASMUSSEN: "We come from a defined contribution environment so it's really not about regulation but rather about how one perceives risk when trying to optimise the risk/return profile of the investments. Here I think it's key to identify the future capital flow and that was the secret when assessing investments in renewable energy because you had a fairly secure capital flow. Today, everyone knows that and these investments are competing with mortgage bonds."

DAVID FINGER: "When we talk about challenges and bottlenecks in this industry and what could help unlock that, it very often comes down to permits. That's a huge problem when it comes to both onshore and offshore wind. There's huge potential but it's not happening because permits take forever to go through. Maybe this is changing with the ongoing war in Ukraine but it's something that has been going on for decades. Another element is inflation because it makes your capital investment unpredictable."

ULRIK FUGMANN: "The debate on green investments in the Nordics is very much focused on infrastructure projects and money has, of course, been flowing into these projects during a time when interest rates have been zero. But there's a lot happening before these big infrastructure projects. We shouldn't ignore the public markets and the companies

PARTICIPANTS

- **JAN KÆRAA RASMUSSEN**
  Head of ESG & sustainability at PensionDanmark
- **MIKAEL BEK**
  Head of ESG at Pensam
- **CHARLOTTE MANSSON**
  ESG product strategy & commercialisation at Sustainalytics
- **BLAIR COUPER**
  Investment manager, global equities at Abrdn
- **DAVID FINGER**
  Senior portfolio manager thematic equity at Allianz Global Investors
- **ULRIK FUGMANN**
  Co-head environmental strategies group at BNP Paribas Asset Management

JAN KÆRAA RASMUSSEN
Head of ESG & sustainability at PensionDanmark. Prior to joining the Danish pension company in 2019, he was director of business development at PBU and he has also worked as a chief economist at the Danish confederation of trade unions.

MIKAEL BEK
Head of ESG at Pensam. Before joining the Danish pension company as a senior analyst in 2016, he worked as a senior portfolio manager at PFA Asset Management, Sampension and Sparinvest. He is also a board member of Dansif, the Danish responsible investment association.

CHARLOTTE MANSSON
Senior vice president, ESG product strategy & commercialisation at Sustainalytics. Having worked with ESG for more than 15 years, she has previously held positions at GES International, Ethix SRI Advisors and Reprisk.

that are working on technologies and solutions to help improve the ultimate infrastructure project – be that a solar or a wind park. I really feel that this is a piece of the puzzle that's missing from the dialogue. Part of the problem is benchmarking because pension funds are not incentivised to go into investments with a high tracking error, which these investments by definition would mean."

MIKAEL BEK: "We're not actively taking bets on individual companies as we invest passively in public markets and therefore follow a benchmark. Our active bet in public market is the selection of benchmark and we changed our benchmark a couple of years ago to a climate change benchmark. Also, there's a lot of development going on in constructing new benchmarks."

CAROLINE LIINANKI: IS THAT ENOUGH? ARE YOU ABLE TO CAPTURE THESE NEW TECHNOLOGIES AND THESE NEW COMPANIES THAT ARE HELPING TO DRIVE THE GREEN TRANSITION?

MIKAEL BEK: "No, we're not. Maybe we need to do some smaller satellite portfolios to add more spice."

CHARLOTTE MANSSON: "Do you feel there are enough interesting benchmarks for you to follow or is further innovation needed?"

MIKAEL BEK: "I think further development would be beneficial."

ULRIK FUGMANN: "I think both more development on benchmarks and satellite portfolios are great ideas. When we look at our investment universe – and we run fairly dark green portfolios – and compare to MSCI ACWI, we find that only about 3 per cent qualify as environmental solution providers according to our methodology. One challenge today is that a lot of the indices tend to focus on companies with a low carbon footprint. Netflix doesn't have a big carbon footprint and Google doesn't have a big carbon footprint but a lot of the companies that are solution providers and are important in creating solutions for the climate transition actually have a carbon footprint. By following the index, investors tend to miss out on these."

JAN KÆRAA RASMUSSEN: "We've taken some 10 per cent of our listed equities and put that into two different sustainable portfolios focused on thematic investments. One of these is internally managed and the other is externally managed. So we're moving in that direction. Of course, the development of forward-looking net zero-aligned benchmarks is an important task going forwards. That has not been solved yet. I would also like to come back to the question raised by David on permits and I agree that it's a big problem in Europe and it's important to speed up that process. On an overall level, I would say that we are active on many fronts when it comes to the green transition. When we do direct investments in infrastructure projects, we typically do them with large industrial partners such as Maersk, DSV or for example Volkswagen on batteries. We're of course also active owners in listed companies and we hold a lot of discussions and dialogues with companies on their transition plans. I agree that it's important to look at both the public market as well as private market investments in order to help secure a green transition."

NIKLAS TELL: WE'VE TOUCHED ON CARBON FOOTPRINTS – IS THAT A USEFUL MEASUREMENT AND DOES IT HELP IN REDUCING CLIMATE CHANGE RISK?

BLAIR COUPER: "It's a limited measure as we only really have decent data for scope 1 and 2 and if you're focusing on reducing that number, you will typically avoid manufacturers and these will include the companies that manufacture the things we need in order to manage the transition. Also, if you would go for a really low carbon footprint based on scope 1 and 2, you would probably

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– Jan Kæraa Rasmussen, PensionDanmark

invest a lot in banks but then you have to ask yourself who they are supplying capital to and who they are investing in. Scope 3 data is patchy at best but the jump we really need to make is to scope 4, which is about avoided emissions."

CHARLOTTE MANSSON: "We supply carbon footprint data and one frequent topic of conversation with clients is what do you do with the information if an analysis shows that a majority of the carbon footprint comes from 2 per cent of the portfolio, for example. So to answer your question, this is not enough to capture the climate risk in your portfolio. The carbon footprint should probably be seen as a snapshot that gives you an indication of your current exposure."

ULRIK FUGMANN: "As many have said, it's not a perfect measure that will give you all the answers and that's why we're talking about handprint instead of footprint. What we mean by that is focusing on what the companies do. So I'm less interested in Exxon lowering their carbon footprint marginally than finding a solutions provider that will really help us get to net zero.

BLAIR COUPER: "Here, I also think it's important to look at green revenues and ask if it's more interesting to invest in a large cap with some 20 per cent green revenues or invest in a smaller company with 100 per cent green revenues. Which will have the biggest real impact?"

DAVID FINGER: "When we talk about the carbon footprint, I don't think it makes sense to only have a snapshot and compare one portfolio to another. Over a certain period of time, you do get an indication but then you can always question if investing more in finance and tech and avoiding manufacturers is the right path. However, as active managers, engagement as well as pushing companies to provide a credible path towards net zero is important."

CAROLINE LIINANKI: THESE CHALLENGES AROUND CARBON MEASUREMENT – WHAT DOES THAT MEAN WHEN IT COMES TO THE GOAL OF ACHIEVING A NET ZERO PORTFOLIO?

JAN KÆRAA RASMUSSEN: "The problem with all the metrics we have talked about is that they are backwards looking and what we're trying to do is change the future. You need some sort of forward-looking methodology, especially when it comes to heavy emitting companies and sectors. The transition pathway initiative is useful input but it's not ready to stand on its own yet, so we have to combine it with our own assessment."

BLAIR COUPER: "One challenge with transition pathways is that it's painted as one line where in fact it's highly uncertain and will depend on regulatory and technology developments. You really need scenario planning to understand which kinds of risks you're willing to take with regards to different pathways as an investor."

CHARLOTTE MANSSON: "Just to comment on the data and the fact that a lot is looking backwards, which is correct. In some ways, we're stuck in the past. There are, however, a lot of things happening and we do look at commitment levels and capex and we also use some predictive modelling and AI in order to provide a more forward-looking picture."

BLAIR COUPER
Investment manager, global equities at Abrdn. He joined the asset manager in 2014 and moved to the global equity team as an investment analyst in 2018. He is currently a portfolio manager for the global innovation fund as well as the global climate and environment fund.

DAVID FINGER
Senior portfolio manager thematic equity at Allianz Global Investors. He joined the company in 2006 and became part of the European research department in 2008. He is currently responsible for metals & mining strategies and the Allianz smart energy fund.

ULRIK FUGMANN
Co-head of the environmental strategies group at BNP Paribas Asset Management. Before joining the company in 2019, he was CIO and co-founder of North Shore Partners. He began his career at Goldman Sachs in London, where he spent 11 years investing thematically.

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> *– Mikael Bek, Pensam*

MIKAEL BEK: "We have to remember though that three years ago, we had nothing and now we have a lot. Things are moving in the right direction and I'm actually optimistic when it comes to data."

CHARLOTTE MANSSON: "As you say, a lot of things are happening and being part of Morningstar, we have access to millions of datapoints. We actually have a data 'lake' where we can go fishing when we need to put together solutions and when we don't have the data, we're able to influence the development of standardised reporting frameworks by responding to regulatory consultation processes. We're also able to put some kind of pressure on companies to start reporting in a more coherent way because the data goes into our ratings, which is then used widely by investors."

ULRIK FUGMANN: "It's all about data these days and it's almost as if it's a data war. However, I also think that simple is good and by asking some simple questions when you look at a company, you can come a long way. Is the company providing a product or service that in some way helps improve the environment? That's one type of company. The other type of company is one which has environmental potential – for example a steel company that could produce steel in a more carbon-efficient way. I think this is a good way of framing one's thinking. We're not going to get to net zero if we only focus on companies where there's a potential to lower the carbon footprint. I do think we need to make investments in the companies that will provide the products and services that will actually take us to net zero. To me, it seems as if there's confusion between low carbon investing and environmental impact investing."

CHARLOTTE MANSSON: "I have to disagree a little bit because I don't think it's that simple. When you're looking at a company's net impact, you can have a company that's providing a fantastic product or service with a positive impact but they're producing it in a way that violates several SDGs, or whatever framework you're using. I therefore don't think it's that easy any longer to determine what's a 'good' or 'bad' company."

DAVID FINGER: "Something that has to be standardised going forward is SFDR and what's classified as an Article 8 or Article 9 fund. You might have human rights problem in China in the solar value chain, for example. Would that still classify to be part of an Article 8 product? We really need common ground on this as we're far from having that today."

JAN KÆRAA RASMUSSEN: "I think this is why the EU regulation is fairly comprehensive. Nobody wants to be in invested in a company that has high environmental scores if it's very bad when it comes to human rights issues, for instance. One example of a conflict is when you invest in forestry. You will have the best climate impact in a growing forest, so you will harvest regularly to have a good growth. However, if you want to optimise for biodiversity, you should probably just let it grow and never harvest. I think the regulation from the EU is comprehensive and it's working for us."

BLAIR COUPER: "I have to disagree on that. I don't think it's working at all. With SFDR, what we see is that asset managers have realised that they can only raise money if they have an Article 8 or Article 9 fund. What that means is that we now have funds that perform deep ESG due diligence and are greener than green that are classified in the same way as funds trying to be something they're not. To me, it's almost like sanctioned greenwashing. When it comes to the EU taxonomy, we have people deciding what's green and what's not and it becomes a bit strange when we have natural gas classified as a green investment."

MIKAEL BEK: "I think the good thing about the taxonomy is that it creates a level playing field because today, I might say something is green and you might say something else is green. In Denmark, we have to report on our green investments and the media has looked into that and it's all over the place. Hopefully, we will all report in a similar way when we have the taxonomy up and running."

DAVID FINGER: "I would disagree because if you have a global portfolio, a European solution really won't help unless you have data available through a third party that's able to bridge that gap. I think it will take some time until you have data transparency across the whole universe."

ULRIK FUGMANN: "We're now even talking about including the defence industry in the taxonomy due to the invasion of Ukraine and I think that shows the danger of the taxonomy. I think you see the problem from the different views around this table where asset managers are critical. When we make investment decisions and when we dig into the details of individual companies, you see these inconsistencies."

MIKAEL BEK: "I certainly agree that metrics are more important than assessments – we use data providers for the data and not for the rating. I agree that there are many difficulties with the current EU regulation but I do think that the framework is promising. We would like it to be more forward-looking and focus more on capex rather than revenues, for example."

ULRIK FUGMANN: "Do we really need the EU to tell us what's green?"

MIKAEL BEK: "Yes, I actually think we do."

ULRIK FUGMANN: "I think there are elements to the taxonomy that are great but it's not rocket science to define what's green. Once you have come up with what you're trying to achieve, I don't think it's that complex."

CHARLOTTE MANSSON: "I don't think we should forget who's sitting around this table. You're all very advanced in these questions but I meet a lot of investors that really need help in framing what's green and what's not."

MIKAEL BEK: "Hopefully, we will also avoid greenwashing with a common framework."

BLAIR COUPER: "As I said earlier, I think it's the other way around. Because the SFDR is so vague, it's actually encouraging greenwashing because it's up to us as asset managers to define what's a sustainable investment."

JAN KÆRAA RASMUSSEN: "In the medium term, the question is what will have the biggest impact on mitigating climate change and helping the green transition – a well-managed Article 8 fund that also invest in high emitters and where the manager through active ownership tries to lower the carbon footprint or a very clean Article 9 fund? As a climate-friendly investor, I think we should be able to do both."

ROUNDTABLE – CLIMATE TRANSITION & NET ZERO INVESTING

> "I think some of the hidden risks lie more in the social and human rights space as those might be areas we miss when we focus a lot on how to solve the climate transition"
>
> *– Blair Couper, Abrdn*

DAVID FINGER: "But I still think it's very important for the regulation to be more precise and that you face regulatory scrutiny if you don't follow the framework. Today, the problem is that the framework is not clearly defined and the only thing you risk is being called out by media and others for greenwashing."

CAROLINE LIINANKI: COULD ONE ARGUE THAT IF YOU'RE AIMING TO ACHIEVE NET ZERO – NOT ONLY IN THE PORTFOLIO BUT ALSO IN THE REAL ECONOMY – YOU SHOULD FOCUS ON ARTICLE 8 RATHER THAN ARTICLE 9 FUNDS?

BLAIR COUPER: "I think it's very important to differentiate between low carbon footprint investing and climate solution investing because a company that's providing a solution to the climate transition will typically manufacture something and will therefore have a carbon footprint. You need to look at the whole of the company and the end result because maybe the product they provide more than offsets the carbon from the production. However, we're still lacking the data on net impact."

MIKAEL BEK: "We must also not forget that a lot of pension funds are under pressure from their members to divest from fossil fuels. That pressure is high in Denmark."

BLAIR COUPER: "It's not black and white because if you take companies involved in oil and gas, they're probably some of the best placed to develop new technologies in, for example, hydrogen because of the expertise they sit on. They're involved in areas that are bad but also sit on the expertise to help the transition and if you completely cut them off, we risk missing that development."

NIKLAS TELL: WOULD IT BE BETTER IF WE DIDN'T HAVE STANDARDS AND THE TAXONOMY AND INSTEAD SIMPLY LOOKED AT THE POTENTIAL END RESULT OF AN INVESTMENT?

ULRIK FUGMANN: "Of course we should have standards but I also think that a lot of investors haven't spent enough time thinking about the outcome they want. I would be massively in favour of investing in all the bad stuff if you have amazing engagement and can influence the companies to improve. But I also think that we're not investing enough in climate solution technologies and the reason is that big institutional investors typically follow broad benchmarks and these companies only take up some 3.5 per cent of the MSCI ACWI. The solution would be customised benchmarks that gives these companies a higher weighting, which in turn would lower the tracking error and make it more acceptable to institutional investors. The other solution would be if allocators are not only rewarded on the outperformance but also on the impact of the investments they are making."

CHARLOTTE MANSSON: "I think we're seeing a second wave of index creation. The first wave was mostly about screening out all the 'bad' companies or sectors whereas we're now seeing more innovation and more niche focused indexes."

JAN KÆRAA RASMUSSEN: "I think we're all fairly active owners and if you look at an initiative such as Climate Action 100+, it has demonstrated progress in heavy emitting sectors through a collaboration between asset owners and asset managers. I think that's a good reason for why we should still be invested also in high emitting sectors. That said, we will focus more on climate leaders and there will be companies that we don't invest in but the assessment of companies has to be about what they're promising to do going forward and about their willingness to change and not so much about the history."

NIKLAS TELL: WHAT ARE YOUR THOUGHTS ABOUT POTENTIAL HIDDEN RISKS WITH FOCUSING TOO MUCH ON THE CLIMATE TRANSITION?

MIKAEL BEK: "We of course have a fiduciary duty and diversification is important, so it could be a risk to focus too much on one theme."

JAN KÆRAA RASMUSSEN: "If we define this whole space and also include green technologies and solutions, then I don't think we're investing too much but rather too little. The risk here is, of course, that we don't know which the winning technology will be."

ULRIK FUGMANN: "That's a great segue into why it's important to invest actively rather than passively in this area. I do agree that the key risk in this area is that we probably have technologies that will not stand the test of time."

BLAIR COUPER: "I think some of the hidden risks lie more in the social and human rights space as those might be areas we miss when we focus a lot on how to solve the climate transition."

CHARLOTTE MANSSON: "I agree – not having a just transition is probably one of the bigger risks that we're facing."

DAVID FINGER: "Another risk is that we must not forget that this is a generational issue and it's not about the next 12 months. The transition will be around at least throughout my professional career, so it's more of a marathon than a sprint."