Challenges of implementation, impact and global consensus

At the beginning of the year, **Tell Media Group**, in cooperation with **Allianz Global Investors**, **BNP Paribas Asset Management** and **American Century Investments**, organised a roundtable discussion at Hotel Kämp in Helsinki with Finnish investors, focusing on climate change policies. 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 noting that climate policies are ever-evolving with increased knowledge and better access to information. She then asked the investors about how some of the first versions of climate policies compare to those of today and what have been the key developments and achievements over the years.

ANNA HYRSKE: "They looked very different from today. When the responsible investment industry started to take form at the beginning of 2000, especially in the Nordics, it was very much about screening and exclusions. It was very black and white and we didn't really talk about engagement. Also, the term responsible investment didn't exist and everything fell under the umbrella of ethical investing. That was problematic in itself for institutional investors that didn't have faith-based values as their core operational framework. I think it has been an impressive development so far. When it comes to climate policies and regulation, we need to recognise that it needs to start somewhere. The first version of anything is rarely the perfect version. Even our accounting standards were not built in one day. Some came in 1920s and we are still seeing changes and to me, it's therefore perfectly natural that we're seeing changes also in this area. Carbon accounting may look like it's all over the place and that's because it is. We know some of the problems, such as Scope 3, but if we don't try to calculate what we can, we will not find the solutions. It's very easy to stand on the sideline and be an expert. If you go and watch a game of professional football, you will have 10 000 people in the stands who think they are better than the players on the pitch. But you really need to be on the pitch and play."

MATT CHRISTENSEN: "If we go back some 20 years, it was all about disclosure and all the parts of ESG were very separate. I remember a time when the governance people wouldn't talk to the social and environmental people, so we've come a long way. The challenge now is getting the whole industry to not just disclose things, which is hard enough, but to define how we implement different policies, for example how to reach net zero."

ANNA VARPULA: "I think initially we focused very much on the risk and return analysis and, of course, the carbon footprint. Now, we also need to consider and find measurements for the outcomes and the impact of the investments. In addition, we also have more science-based data and targets today."

ANNA HYRSKE: "How to talk about and measure the impact is far more interesting than just talking about the policies. What are you actually achieving with the policies you have?"

GABRIELLE KINDER: "Implementation of low carbon initiatives has been made harder in the past by the fact that we've been chasing a moving target. Some eight years ago, working as a consultant, we were trying to help companies reduce emissions by 10 per cent and this was seen as huge success at that time. We've come so much further today with much greater ambition and a consensus around reaching net zero. While a consolidation around a target is a huge help for policies, we also have to remember that zero is a very small number and it leaves no margins for error."

SARAH BRATTON HUGHES: "I will challenge that a little bit because I don't think there's a consensus of net zero on a global level. Especially if you bring the US into the equation. I also think that we will move beyond the focus on net zero and that the 'carbon-at-all-cost' agenda is probably not the way we should look at it. It was the right thing to start with but we should be looking at implied temperature rise rather than just emissions and we should be looking at best in progress. Not every oil company will survive but if we simply screen all of them out today, we will screen out the Ørsted of the future. My worry is how we engage the rising anti-ESG movement. Take Texas for example. If Texas was it's own country, it would be fifth in the world based on the clean energy it produces but it also has a big oil industry with skilled workers. What Texas has right now is a just transition problem, so we need to make them part of the solution and not simply exclude them, because we aren't going to be able to decarbonise without them."

ANNA HYRSKE: "We've had a lot of acronyms in this industry for a long time and SRI used to be socially responsible investing and now the ECB is referring to it as sustainable and responsible investing. Words do matter so maybe we need to refer to ESG as energy, social and governance going forward to get people on board. I actually didn't think ESG carried such a weight but recently, a US senatorial candidate stated that he wanted to abolish ESG ratings because ESG was seen as a threat to the US economy."

SARAH BRATTON HUGHES: "Texas and Florida have made the headlines on this but there are 26 states in the US that have current or proposed anti-ESG regulation today. That's more than half of them. However, on the other side of the coin, we have states reintroducing divestment bills again."

MIKA LESKINEN: "This whole debate around ESG is very strange to me. Some two-thirds of the current PRI signatories have signed up in the last five years or so and if you would ask them, I don't think everyone would give you a good explanation of what ESG means. And if you switch on CNBC, you will hear people debating ESG who seem to have no clue what they're talking about – at least from a Nordic perspective and how we define, think about and talk about ESG."

CAROLINE LIINANKI: WHAT ARE SOME OF THE MAIN CHALLENGES WHEN SETTING UP A CLIMATE POLICY TODAY?

MATT CHRISTENSEN: "One big question is who should pay for it. I live in France, a country that a couple of years ago tried to implement a low carbon policy and the result

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ANNA VARPULA
Director of responsible investment at the pension company Elo. She joined Elo in 2021 from Sp-Fund Management Company where she was a responsible investment specialist. Before that, she spent close to five years at VER, the State Pension Fund of Finland, as a responsible investment adviser.

ANNA HYRSKE
Principal responsible investment specialist at the asset management division of Bank of Finland. She joined the central bank in 2020, having spent more than 20 years at the pension company Ilmarinen, predominantly as its head of responsible investment.

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Chief investment officer of S-Pankki since March 2019. Before taking on his current role, he worked as its head of responsible investments. Prior to joining S-Pankki, he spent more than 18 years in different roles at OP, including the positions as head of ESG and head of equities.

was protests – the yellow vest movement. People in cities thought it was great and people outside of cities thought it was terrible and the question was who should pay for it. Part of the challenge we're faced with in setting climate change policies as investors is one of short term versus long term. It's something that politicians face as well. And given the length of the voting cycle and the very long-term nature of climate change policies, it's a risk for a politician to put forward a policy that's helpful for the climate because it will probably cost money in the short term and therefore not something you get re-elected on."

GABRIELLE KINDER: "I think another challenge is that policies are not specific or sectoral enough. One great example of a climate policy that worked well was the Montreal Protocol, which was signed in 1987. It was niche and primarily looked at chlorofluorocarbons but its specificity was its strength. Policy makers worked with the industry to find alternatives for halogenated hydrocarbons and it's an example we should learn from. Today, we have a mix of policies where some are working and some not so much. The EU taxonomy shows great promise, even if it's complex. Then we have policy schemes that are less specific, such as the EU ETS carbon trading scheme. It was great for the power industry initially but it has been expanded to industrials and other high-emitting industries, potentially without providing a chance to adjust. I think the one size fits all approach can be difficult when it comes to climate policies."

CAROLINE LIINANKI: ANNA, WHAT ARE SOME OF YOUR MAIN CHALLENGES AS A PENSION COMPANY?

ANNA VARPULA: "One size does not fit all would describe it the best. We invest, of course, across different asset classes and strategies and they all need slightly different approaches. At the same time, we have common top-level goals and ambitions. It's also a question of data availability. We have more data on the listed equity and corporate bond side, so it's easier to start there and then move step by step to the other asset classes."

ANNA HYRSKE: "As a central bank, we have a slightly different portfolio compared to many other investors in that we sit on a lot of sovereign bonds. Yes, we were bold and brave enough to go for a net zero goal with all the uncertainties involved but we've also been very vocal on saying that if governments don't deliver, then we can't deliver either. When we came out with our latest 2050 target, I did get questions on how we justify that target when Finland has 2035 as its target for net zero. My response is to look at the portfolio. As a central bank, we need to have certain sovereign bonds in our portfolio so we're not only dependent on what Finland does. We're confident that we can deliver on equities, real estate and corporate bonds but we don't have the muscle to twist the arm of sovereign countries if they don't deliver."

NIKLAS TELL: WOULD YOU AGREE THAT IT'S ON THE SOVEREIGN BOND SIDE WHERE YOU ARE THE MOST DEPENDENT ON OTHERS DOING THEIR SHARE?

MATT CHRISTENSEN: "It's a huge issue. We've had a lot of discussions, both internally and with other asset managers, on how we can engage with sovereigns. How do you talk to the treasurer of a country and how does that connect back to the climate policy of a country? Sometimes they don't like each other and sometimes they're not connected at all. It's early days when it comes to doing engagement with countries and I think it's still an open question for the industry."

SARAH BRATTON HUGHES: "We're thinking a lot about this and the way we've historically observed the quickest progress occurring in emerging markets on the corporate side has been via the exchanges and in particular the exchanges that you get a premium for listing on for having superior sustainability practices.

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– Anna Hyrske, Bank of Finland

We're able to influence corporates this way and are exploring if this is a potential angle for sovereigns."

CAROLINE LIINANKI: MIKA, WHAT ARE YOU SEEING AS SOME OF THE CHALLENGES WHEN SETTING UP A CLIMATE POLICY?

MIKA LESKINEN: "One challenge as an asset manager is that the demand from clients keep changing and they are much more detailed today. It's amazing the kind of RFPs we're getting these days with requests for very detailed exclusions and I sometimes wonder who the consultant has been that has sold those ideas to the client. We need to be able to respond to different types of requirements and I think we're flexible in being able to develop new products for new demands. We have a very general and tight climate policy but then we're, of course, able to offer very specific products, be that fossil free or Paris aligned etc. One challenge that has always been there is the data but I think the biggest challenge today is being able to demonstrate that you're doing what you say you're doing. Take ESG integration. How do we demonstrate and report on that? It's just part of the normal, fundamental analysis for us these days. Another question relates to impact and I think it's misguiding to say that we have an impact if we invest in listed companies. The company may have an impact but I don't think we have an impact if we buy the shares on the stock exchange."

ANNA HYRSKE: "It's one of my pet peeves when someone says they're financing the green transition and they buy shares on the stock exchange. I'm questioning where the financing is coming from."

GABRIELLE KINDER: "As a listed equity investor in green technology providers, we wouldn't necessarily market ourselves as an impact fund but I still believe we have some sort of impact. For some of our holdings, we're a fairly small owner and arguably wouldn't have much of an impact. But in others, we're a significant owner and there we can have influential discussions with management. But I agree, there are a lot of green labels and there needs to be very tight definitions behind them. Otherwise, it becomes confusing."

ANNA VARPULA: "Mika, you mentioned that you're requested to provide a lot of details in RFPs and I understand that. We too receive a lot of information and we're constantly developing our ESG reading skills. We need to go deeper to really understand what each strategy mean in terms of ESG. We don't have targets for Article 8 or 9 funds because the articles in itself don't provide us with enough insight."

ANNA HYRSKE: "I agree. The idea that an Article 9 is better than Article 8 is flawed and you simply need to understand the underlying strategy. Somewhere along the way, it seems as if a fund was labelled ESG, you didn't need to do your homework and I don't understand where that came from.

MATT CHRISTENSEN
Global head sustainable & impact investing at Allianz Global Investors. Before taking on the role in 2020, he was global head of impact and responsible investment at AXA Investment Management. Prior to that, he was the founding executive director of the think-tank Eurosif where he worked for nine years.

GABRIELLE KINDER
Investment specialist and environmental analyst at BNP Paribas Asset Management. She joined the company in 2021 from Bloomberg's market research team dedicated to decarbonisation. She began her career as a consultant in Jacobs Engineering Group, specialising as an environmental scientist.

SARAH BRATTON HUGHES
Head of sustainable investing at American Century Investments. Prior to joining the asset manager in 2022, she spent more than 10 years at Schroders, most recently as global head of sustainability solutions. Before that, she held roles at JPMorgan Asset Management and JPMorgan Chase.

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> *– Matt Christensen, Allianz Global Investors*

ESG doesn't mean it's automatically good – you still need to do your due diligence on the underlying strategy. I was looking at the weighted average carbon intensity numbers and the implied temperature rise for two separate funds – one European equity fund and a US equity fund. One showed lower average carbon intensity numbers, so you think that looks better but the implied temperature rise was close to 3 degrees. The other fund showed the exact opposite. You can't look at just one number."

SARAH BRATTON HUGHES: "I think we, the financial services industry, brought this on ourselves. ESG is the only place you see managers trying to be all things to all people. You wouldn't do this for any other strategy – a growth manager wouldn't go pitch for a value mandate. There are no shortcuts and you can't distil how sustainable a strategy is to one number. I get annoyed when I hear the discussion that the ESG ratings are not correlated and you don't know what goes into them. You can't think about ESG ratings as credit ratings. You need to see them as sell-side price targets because that's what they are. You wouldn't take sell-side research on face value and invest only based on that view on a company."

MIKA LESKINEN: "I think SFDR is a good example of this problem. I was sceptical before it was introduced and I'm even more sceptical today. The whole regulation is about disclosure but it's being used as a classification. I don't understand how you can use this as a classification when there are no strict definitions. We're seeing a lot of funds being downgrades from Article 9 to 8 following the new clarifications that an Article 9 funds needs to contain 100 per cent sustainable holdings. But everyone is free to define what a sustainable holding is."

NIKLAS TELL: SO WOULD YOU SAY THAT THE REGULATION IN ITSELF A GOOD THING?

MIKA LESKINEN: "Well, when I started this some 17 years ago, there weren't to many voices around and I was hoping for regulation. Now, I'm not so sure. It's a complete mess right now."

GABRIELLE KINDER: "I think we can all agree that aligning with the EU taxonomy reporting requirements have been a challenge. Asset managers were required to report the minimum aggregate exposure for portfolios in August at a time when corporate EU taxonomy reporting was not fully developed. Fund managers were encouraged to make claims about funds at a time when the data was incomplete. It became a case of game theory where asset managers tried to be conservative but also competitive."

MATT CHRISTENSEN: "My impression is that the regulator has gotten too far ahead of the skies. I think they had the idea that they can have an impact in this field, just like they're working on having an impact on data privacy. I think if we can get through this painful period and if the industry can force a reality check with real world examples, I still have hopes that this could be good. It has gone too far into a purity contest. It wasn't supposed to go there and it's not good for investing. I had hopes that this would clarify ESG but it doesn't right now."

SARAH BRATTON HUGHES: "I think one issue that very few are talking about on the asset management side is that if regulation stays on this path, it will reduce scale in the asset management industry. Today, you're able to market your institutional composites but with different countries and regions going in different directions, you will have to split your composites. This is going to make the asset management industry less scalable and more highly customised than it is today."

NIKLAS TELL: WOULD YOU SAY THAT REGULATION IS EVEN FORCING THE INDUSTRY TO DO THE WRONG THING HERE?

MATT CHRISTENSEN: "I think the good thing is that everyone is now talking about this and it means that everyone in asset management, regardless of job title, needs to think about it. It also means that if you're a professional focused on ESG, everyone will be asking you for guidance. We need to figure out how climate fits into the compliance and into the risk function etc. It will be a bumpy road ahead and the jury is out when it comes to the end result but in my best days, I think that the regulatory drive is for something that will be good in the end."

SARAH BRATTON HUGHES: "I almost can't believe I will say this but I actually think that the path to get us out of this is more regulation. We need clear definitions. It's the only way out. I guess it goes back to being rules based or principle based, so maybe it's a cultural thing but if you give me the rules, I will follow the rules. Currently, we don't even know what a sustainable investment is according to the regulator and we still need to report on what percentage of our portfolios is sustainable."

MATT CHRISTENSEN: "What we've done as a firm on sustainability is to say that you need two binding elements on the development of your funds. The first is exclusions and that's usually where the US finishes and secondly, you need something that shows more of an outcome-oriented approach and we use KPIs. But I agree, it's difficult."

MIKA LESKINEN: "I think the French regulator recently came out with a suggestion on Article 9 funds – that they should have an increasing percentage of taxonomy-aligned companies. So you would have a lower threshold at first and as more companies report, the threshold would increase. Regarding the risks with regulation, I think one scenario would be less financing for new technologies if clients are sticking with Article 9 funds because as new technology doesn't exist yet, it can't be taxonomy aligned so it would not be allowed in Article 9 funds."

GABRIELLE KINDER: "I agree. This is a challenge because some of our smaller and newer companies don't even have revenues and that's an automatic zero for the EU taxonomy revenue box. It's a struggle."

CAROLINE LIINANKI: WHICH ASSET CLASSES WOULD YOU SAY ARE THE MOST DIFFICULT TO ANALYSE FROM A CLIMATE PERSPECTIVE?

SARAH BRATTON HUGHES: "I would say structured credit and CLOs. Because they're pooled vehicles, it's much more difficult to get to the underlying data. It's an area that we're constantly improving and it's the area where we have some of the most intellectually stimulating discussions but it's difficult."

MATT CHRISTENSEN: "On the listed side, it's multi-assets

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>
> *– Mika Leskinen, S-Pankki*

because of derivatives. We're trying to find a derivatives framework that we can use to discuss ESG because if we can come up with something that's good enough, then we can bring these assets into our discussions on net zero etc. There are a lot of assets sitting in these products, so it's important but difficult."

ANNA VARPULA: "For derivatives, it gets complex very quickly, so I would agree with that."

GABRIELLE KINDER: "From a hedge fund perspective, shorting is a big challenge. For asset managers running long/short funds, there's a question about whether it's sustainable to short a sustainable company."

ANNA HYRSKE: "I would very much appreciate if we would not use the term 'downgrade' when we're talking about SDFR classifications. I would say re-classification because 'downgrade' implies that it's going from something good to something that's not so good and that's not the case."

NIKLAS TELL: AS INVESTORS, HOW DO YOU BALANCE THE AIM OF MAKING YOUR PORTFOLIO LOOK GREAT FROM A CLIMATE POLICY POINT OF VIEW AND ACTUALLY MAKING A DIFFERENCE IN THE REAL WORLD?

ANNA HYRSKE: "I think Mika a couple of years ago said in an interview that as investors, we need to ask if this company is helping to solve the problem or if it's creating problems. I think that's a key question to ask. Even if it's a carbon intensive company, it might be crucial in helping us reach the solutions."

CAROLINE LIINANKI: MAYBE THE PROBLEM IS THAT'S MORE DIFFICULT TO QUANTIFY?

ANNA VARPULA: "Yes, it's not easy and straightforward and that's why we don't only focus on low-carbon investments but also look at, for example, solution providers."

GABRIELLE KINDER: "I also think we need to be actively engaged on operations and not give companies that provide environmental solutions, such as wind or solar power, a hall pass. We need to make sure that they have good processes in place when manufacturing the solar panels or the wind turbines. This is why in our reporting, we look at both the manufacturing process, which we refer to as the footprint of the company, as well as the impact of the product or service, which we refer to as the handprint. Ultimately, we want to have a good ratio between the two and engage with companies to lower their negative footprint and increase the positive handprint."

MATT CHRISTENSEN: "I agree. I think it's crucial to not only rely on individual metrics or ratings but to complement that with storytelling to really get the client to understand what you're trying to do. Because these are complex issues."

SARAH BRATTON HUGHES: "I think one big challenge is balancing the green transition with the just transition. We've talked about all these enablers but we haven't talked about the mining of cobalt and how sustainable that is. There's a social issue here because the green transition will affect communities and that's something we must not forget."

ANNA HYRSKE: "We've focused a lot on the challenges and the problems in this discussion but I think we also need to acknowledge that there are a lot of opportunities as well. We can get positive outcomes out of this. While the ESG debate started very much with reducing risk, I think today it's as much about opportunities."