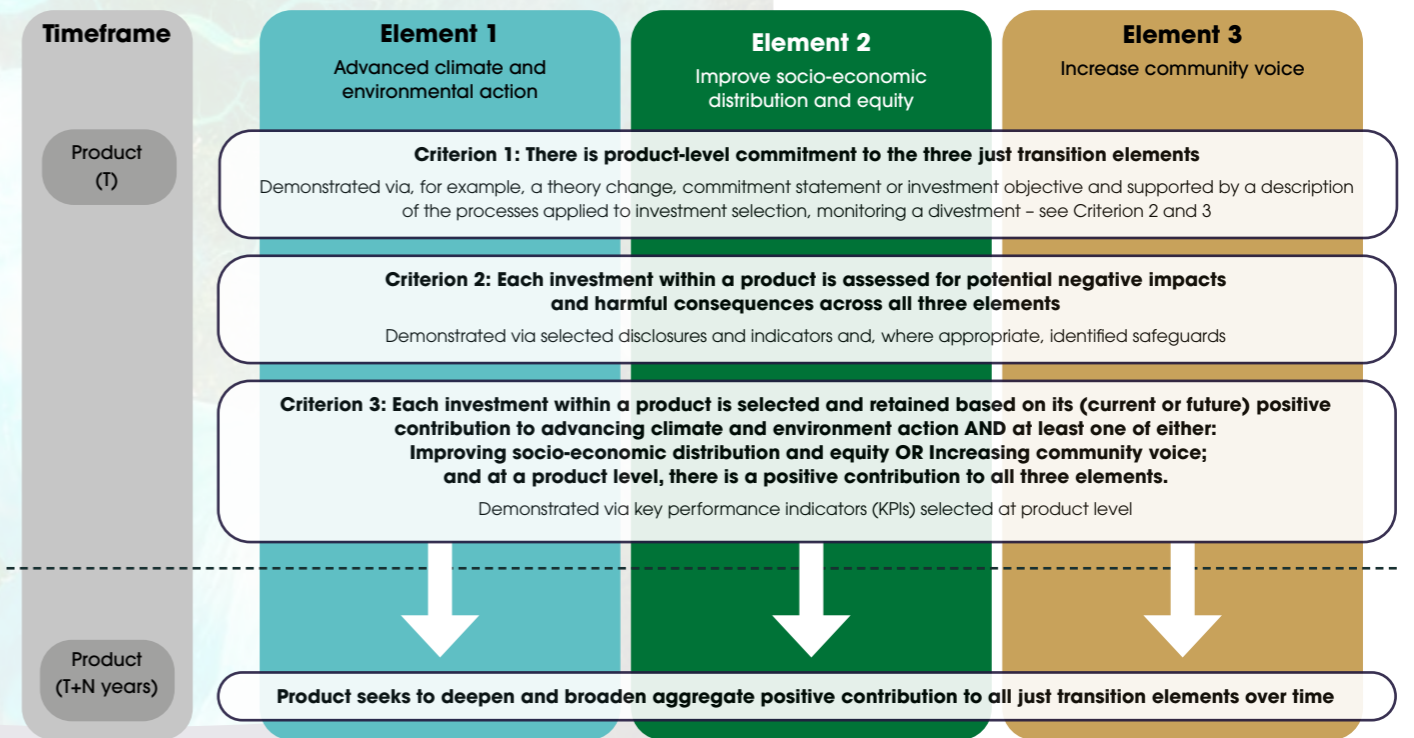




How to finance

just transition

Figure 1 | The Impact Investing Institute's just transition challenge



Source: Impact Investing Institute

By Cameron Turner

The transition will be an expensive one to make, especially when social outcomes are included. So, for asset managers and owners to contribute, with a just transition lens, will be of paramount importance.



This blog reflects the view of multiple stakeholders involved in the Paris Alignment Forum all-stakeholder event on 18 January. David Krivanek of the *Impact Investing Institute* and Katharina Lindmeier from *Nest* were invited to present. David talked about

the *Impact Investing Institute's* soon-to-be published just transition challenge which provides a framework for asset owners and managers to integrate just transition into their investments, portfolios and products. Katharina presented *Nest's* approach to integrating the just transition into the investment process for their pension fund.

What is a just transition?

The definition of a just transition is contested but it can be defined as a fair and inclusive transition to net zero. The net-zero transition will be one of the biggest economic shifts we witness in our lifetimes, so we should attempt to mitigate the negative consequences of that move while providing capital to the solutions which will get us to net zero before 1.5 °C of global warming.

It will be an expensive transition to make, especially when social outcomes are included, so the contribution from asset managers and asset owners will be crucial.

There is a broad consensus among asset owners and managers that they are still learning about the just transition.

The Impact Investing Institute's just transition challenge

To bridge the gap between asset owners' and managers' desire to integrate just transition thinking into their investment process and their lack of understanding of how to do so, the *Impact Investing Institute* have stepped in to build a framework for them to use.

This framework is applicable across asset classes, investment strategies and geographies. The *Impact Investing Institute* have also tried to complement and build on existing structures and labels to avoid overloading already stretched resources with the current regulatory requirements. Above is a diagram of the proposed framework, see figure 1.

They acknowledge it is difficult to find potential investments that meet all three elements from the onset, so they are leaving space for engagement and active ownership. But, over time, all three elements should be met across the portfolio and targets should be set. In addition to the framework, the Institute want to launch a just transition 'label' for aligned products.

Case study – Nest

Nest has 10 million members; many of those are young and on lower salaries. Because younger members' pensions are more likely to be impacted by global warming, the decision was made to put a reference to the just transition into their climate change policy and net-zero commitment. However, *Nest* were not sure how that could be integrated into their investment process.

They use four pillars to implement their climate policy:

1. Asset allocation.
2. Manager selection and monitoring.
3. Stewardship.
4. Advocacy.



They have mostly been targeting the just transition through stewardship but say it is difficult to understand how this affects different sectors. Two thirds of their assets under management have some climate key performance indicators (KPIs) but there are not any specific social KPIs. As a founding signatory to the just transition challenge, they welcome the framework and the criteria it will give them, helping to guide and improve their engagement with companies on both social and environmental topics.

Ensuring a global just transition

The responsibility increasingly lies on institutional investors to help ensure a just transition in emerging markets, as governments in the emerging world seek to encourage private sector investment.

Investors need to consider the impact of climate change in the countries that will be most affected. Models which set decarbonisation milestones in portfolios will often end up diverting money away from emerging markets. This is because there is considerable difference between transition pathways for companies in emerging markets compared to those in developed markets.

There is a huge requirement for capital in emerging markets but a lack of risk appetite for investment in these countries. We therefore need to find structures to reduce risk, where this applies, so that it aligns with asset managers' and owners' goals. For example, international development banks need to support institutional investors more by de-risking investment opportunities in emerging markets.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Work with asset managers to look for opportunities.



Holistic view of impact for a just transition

We are starting to witness the negative consequences of the climate transition with job losses in sectors that are impossible to decarbonise. On the other hand, new opportunities are arising as a result of large amounts of capital flowing towards green jobs and re-skilling, and the regeneration of places transitioning to a new economy.

It is important to recognise that a commitment to investing with a just transition lens requires a holistic view of impact. For example, an investment in a vertical farm in the UK may create job losses for farmers in warmer climates that export to the UK. There will always be negative and positive impacts of investments so

learning how to mitigate them through active ownership is critical. The just transition challenge can help with navigating this holistic view.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Incorporate a holistic view of impact, identifying opportunities for engagement to improve just transition outcomes where possible.



Issues pension funds face investing for a just transition

Many funds are still grappling with learning how to invest with a just transition lens, especially given that climate-aligned products are still evolving. This is particularly difficult for smaller schemes.

We need a pooling of information across the industry; this is where standardisation and the just transition challenge's common framework comes in. The resourcing issue is an obvious headwind, with the TCFD reporting requirements and incoming further regulation, so the just transition challenge's commitment is to complement these existing commitments.

Data availability, of course, is a major concern for pension funds as impact data can be limited. There are also questions around which measures are best to use when it comes to social impact.

For DC schemes and the LGPS, the scope for investing in a just transition is wider because they can more easily invest in illiquid real assets. There remain issues to resolve, however. Some LGPS funds have been trying to find impact investments which invest in their local regions. Some have encountered conflicts, for example in Cumbria where the local authority is granting a license for a new coal mine. Others feel that the levelling up agenda could benefit from government clarification. As well as this, it was felt certain sectors need to be prioritised to contribute to a just transition.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Aim to bolt on the just transition challenge's framework to existing impact processes to incorporate a just transition investment lens.



Despite the barriers and hesitation in investing with a just transition lens, regarding holistic impact, 'we shouldn't let the perfect be the enemy of the good'.

● **Cameron Turner is an Intern at Pensions for Purpose and recent Durham University graduate.**

