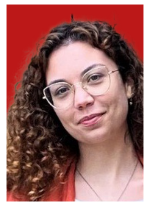
Affecting real-world impact

A practical framework for universal asset owners

By Bruna Bauer



Pension funds have huge potential to increase the assets invested for impact, but some considerations need to be addressed. Firstly, it's essential to identify the most effective investment strategies for achieving real-world impact, with a clear understanding of how to measure this impact. Lastly, engaging with pension fund members on the importance and benefits of impact investing is crucial.

Richard Giles, Senior Director & Community Lead at *Pensions for Purpose*, invited *Church of England Pensions Board, Cushon*, the *Impact Investing Institute*, the *University of Cambridge* and *WHEB Asset Management* to discuss which investment strategies are more effective to promote real-world impact, how to measure the impact of investments and how to engage members on the impact investing journey.

Energy transition vs energy addition

Dr Ellen Quigley, Principal Research Associate at *University of Cambridge*, explained we are experiencing an addition rather than an energy transition. Fossil fuel use remains substantial, while renewables are supplementing the energy landscape, instead of supporting its transition to greener sources:

"We haven't seen the transition we've been hoping for; we've seen an addition. Fossil fuels have actually remained high, increasing in capacity over the last few years and they haven't been replaced by renewables. So, when we approach this question, we

are still focused on making sure that especially new infrastructure that locks in long term demand for fossil fuels is not built," Dr Ellen Quigley.

Debt financing and bank loans

Fossil fuel expansion is predominantly fuelled by bank loans and debt financing, with 90% of its capital coming from the two. Ellen emphasised the need for this to be central to impact investing discussions, given exclusion policies often focus on public equity, reducing their effectiveness. The effectiveness of exclusion remains low because most fresh capital flows into the growing oil and gas sector through financial services, either from bank loans or facilitated by banks through underwriting initial public offerings and bond issues.

Due to this, the *University of Cambridge*'s focus has been on banks, particularly a select few global ones that finance increases in the fossil fuel industry. Efforts have recently intensified, with 67 higher education institutions joining a request for proposals aimed at moving services away from banks which finance fossil fuel expansion and moving to institutions that do not. The strategy combines divestment and engagement, leveraging academic evidence that using both tactics, rather than either one in isolation, is more effective. Ellen explained the University is gradually transitioning services away from such banks, starting with cash and moving to building societies initially, with plans to encourage larger banks to participate in sustainable financing practices.

Company impact vs investment impact

Ellen highlighted the importance of distinguishing between a company's impact and its investment impact. While all investee companies have an inherent burden, the central aspect is understanding whether your capital, as an investor, is contributing to additionality. Hence, the need to focus more on debt than on equity when it comes to exclusions or tilts. Silent divestments, tilts or ESG exclusions that apply only to public equity are one of the least impactful actions investors can take, argued Ellen. However, applying these exclusions or tilts to debt investments tends to be associated with higher impact and greater additionality.

Voluntary disclosure

Ellen also outlined her voluntary-disclosure concerns. Although she agrees with the need to prepare legislation to increase the availability of comparable data, she says it is unlikely demanding voluntary disclosure will lead to significant change. She supported her point with a meta-analysis from 2020, which showed a negative correlation between environmental disclosure and environmental performance.

"This assumption 'what gets measured gets managed' doesn't appear to hold in practice. If you want to get something out of a company, better to ask for the action and then they can disclose to prove whether they have taken that action. We would request companies to not build new fossil fuel infrastructure; because you can see from space whether someone is building a new power plant, for example," Dr Ellen Quigley.

Ellen questions the attempts to get figures for an entire portfolio when a couple of companies represent the majority of emissions. *Climate Action 100+*, was established to focus on the few companies that account for most financed emissions among listed companies. Instead of trying to get data for every holding company, she says it would be better to focus on the companies responsible for the greatest percentage of global emissions.

Stephen Barrie, Deputy Chief Responsible Investment Officer at *Church of England Pensions Board*, argued data is a component of good stewardship. He outlined how standardising disclosures across industries is essential for good accountability, so investors can assess company performance accurately. Additionally, disclosures serve as the foundation for accountability mechanisms, such as class-action lawsuits in cases of misrepresentation. Stephen believes voluntary disclosures lead to regulatory adoption, citing how the mining industry's adoption of global standards on tailings management following voluntary disclosures was prompted by investor pressure.

Seb Beloe, Head of Research at *WHEB Asset Management*, also offered an alternative perspective for listed markets, acknowledging, while major companies contribute to climate problems, there are opportunities in industries providing climate-change solutions. *WHEB*'s approach to equities centres on intentionality, specifically how companies address climate-change issues and measuring their impact. Seb believes this approach aligns with initiatives such as the *GIIN* and the sustainability disclosure requirements of the *Financial Conduct Authority*. Seb encourages problems and solutions to be considered during impact investment discussions. He also highlighted the role of listed equity in driving financial system change.

Effectiveness of tilts and exclusions in public equity

According to Ellen, shareholder proposals have low implementation and success rates, even when they win. However, voting against the re-election of directors generates a stronger response from companies, even with as little as 15% opposition. This approach is more effective because high-status individuals are embarrassed by dissent and directors facing challenge.

Transition plans

Ellen is sceptical of companies devising their own energy transition plans because, in her experience, they are rarely credible. Utility companies are major emitters and often lobby against climate legislation, while hiding new gas-fired power plants in their plans for delivering on net-zero goals. Despite being top emitters, they don't receive the same scrutiny as fossil fuel companies. Most utility companies set targets based on the intensity of their emissions or other metrics allowing them to build new fossil fuel infrastructure while seemingly adhering to their targets. She demanded high-impact measures that cannot be manipulated to boost climate progress should be put in place.

Impactful ways to invest

Marc Barnett, Head of Investment at *Cushon*, emphasised the importance of actively and selectively deploying debt and capital, rather than denying debt. He explained that their default fixed income fund employs effective impact bond managers while passively managing equities because the impact of capital asset selection decisions is minimal on the equity side. He agrees with Ellen that, in equities, engagement makes a huge difference. However, being active and selective in the fixed-income market enables investors to influence the new capital companies raise, given the multiple issuances of debt with various touchpoints for engagement. Mark believes constructive collaboration with companies over capital allocation decisions is more feasible in the debt space compared to the listed-equity space.

As *Cushon* is a defined contribution (DC) master trust, he pointed out the importance of private assets, which potentially offer greater impact than debt or listed equities. Private assets require a high degree of care in allocating to projects and companies, which often involves new capital raised for smaller firms, having a direct influence on the growth of these companies and allowing a significant ownership stake, either through funds or direct ownership. This holding fosters an impact-oriented mindset within the companies.

According to Marc, when comparing the impact potential across asset classes, listed equities have limited impact from an asset allocation perspective, while listed bonds can be more impactful with active management. However, private assets offer the most impactful opportunities.

Assessing impact

When considering impact, it is key for pension schemes and trustees to define the specific changes they want to see in the world. This may be tailored to the pension scheme's context, such as serving a local area, as a result improving communities. By anchoring impact goals to the broader sustainable development goals (SDGs), everything else falls into place, guiding strategic decisions and actions towards meaningful impact.

Bella Landymore said: "Disclosure is meaningless if it doesn't have context – if it is just a data point (the number of meetings you've had, just a random number equating to carbon, carbon volume), it means nothing without a goal and a target for that disclosure. So what is

"As a universal owner, you have to think about what decreases the value of your whole portfolio and then try to do something about those issues. So the profits that you get from the factory farm that is using antibiotics, for instance, are actually illusory profits because they are being subtracted from the other companies that you hold across your whole portfolio."

DR ELLEN QUIGLEY

All-member event blog

the change that you want to see in the world? That could be a reduction in carbon emissions, limiting biodiversity loss, increasing employment opportunities… So it can be contextual to the pension scheme or it could be taken from a larger SDG and from that everything else flows," **Bella Landymore**, Policy and Strategy Director at the *Impact Investing Institute*.

When it comes to stewardship, large pension schemes often have their own in-house managers or stewardship schemes. The challenge lies in setting objectives and holding investment managers and consultants to account. Communication is clearly important in articulating goals and ensuring targets and understanding are in unison. If targets are not met, there must be accountability measures in place.

Navigating the variety of impact measurement and reporting frameworks can be overwhelming. However, diversity offers robust options. From standardised frameworks like the *Taskforce on Climate-related Financial Disclosures* to bespoke ones, having clear targets and a structure for measurement is essential for evaluating impact effectively.

Seb explained how WHEB analyse company-reported data on renewable energy capacity, healthcare access and other key indicators. They then calculate their equity stake's share in these outcomes, using nine key performance indicators (KPIs) to track progress towards their objectives. However, understanding that the impact generated is not owned by investors or the companies they invest in is essential. For instance, solar panels benefit the homeowner, but the entire value chain, including investors, is associated with it. They emphasise the importance of clear language to reflect this point.

"We (have been looking) at the data underlying companies report (for six years now), in terms of how many megawatt hours of renewable energy capacity have been installed, how many people are receiving healthcare therapies and so on. We then calculate what is the share of that that we own through the equity stake that we have in the underlying business. We have nine different KPIs we use to report against the objectives that we set. This is the data to show that we're investing behind those issues," Seb Beloe.

Pension schemes need to think about sustainability

Ellen called attention to the concept of universal ownership. As a universal owner, your investment perspective shifts drastically. It is not just about personal gain or managing risks; it is about making an impact on systemic issues. Take antimicrobial resistance, factory farms profit by overusing antibiotics, but this practice poses risks to public health and the economy. Universal owners consider the broader impact on their entire portfolio, recognising apparent profits from such practices are detrimental in the long run.

"As a universal owner, you have to think about what decreases the value of your whole portfolio and then try to do something about those issues. So the profits that you get from the factory farm that is using antibiotics, for instance, are actually illusory profits because they are being subtracted from the other companies that you hold across your whole portfolio," Dr Ellen Quigley.

How to engage members

Marc mentioned the relevance of a compelling impact narrative and language to engage members. In DC schemes, connecting members to their pension is crucial for fostering healthy savings habits – it is essential to make retirement savings feel tangible and relevant throughout their entire career, rather than just later in life. To achieve this, he suggested funds should be more creative in how they communicate with savers about their impact investments:

"Our impact investment in a sustainable pepper farm significantly reduces emissions by utilising waste heat from a local treatment plant, resulting in peppers with 80% lower emissions than the UK average. However, traditional impact metrics do not always resonate with members. To make it engaging, we connect them to tangible outcomes, like the number of peppers produced by their pension investment. This helps them see the direct impact on the economy and the planet, providing a narrative that's more relatable and compelling," Marc Bennett.

Questions and answers

Q&A: Should we openly acknowledge the challenges we face when focusing on specific SDGs or impact goals, even if it may detract from the positive messages we're conveying to members? Openness could build trust and promote a dialogue, but how much emphasis should we place on these challenges without overshadowing our achievements?

A: Seb Beloe:
Materiality is crucial in these discussions. For instance, we've received feedback on two fronts: one concerning a company, known for its pharmaceutical packaging, which has a significant carbon footprint due to its use of glass. While we engage with them to reduce emissions, their connection to vital pharmaceutical therapies is a positive aspect. Conversely, an environmental consulting firm, despite a minor spill, was flagged as potentially breaching UN principles. Determining the significance of such incidents is an important consideration.

Q&A: As we consider impact and the SDGs, there's a notable absence in discussions about increasing investments in frontier markets like Africa, which have immense potential to be part of the solution. Despite Africa's abundance of critical natural resources for green technologies, less than 2% of global renewable energy investment has been directed there. This represents a missed opportunity from a universal ownership and potential returns perspective. How can we increase allocations to these regions, while collaborating with asset owners from emerging markets to unlock value and contribute to global decarbonisation efforts?

A: Stephen Barrie:
We've brought together 12 UK-pension schemes to explore emerging market transition investing and have publicly consulted on guiding principles for this topic. While the investment management offerings in this area aren't fully developed, we recognise the importance of investing in transition-aligned opportunities in emerging markets. This initiative aims to address the concerns high-level portfolio decarbonisation commitments may discourage investment in such markets.

Impact Lens

Our research includes published and commissioned reports. Through engagement with a range of stakeholders, we gather insights into the challenges of sustainable and impact investment. Impact Lens seeks to offer solutions and informed decisions on governance and investments.

Read *Pensions for Purpose*'s latest report, 'Navigating diversity, equity and inclusion – an asset owner perspective,' sponsored by *Jupiter Asset Management, or visit our Impact Lens section*.

We are seeking sponsorship for this report: 'Defining good quality stewardship – challenges, engagement and best practices'.

Join Pensions for Purpose

This event was open to all our members. If your organisation is not a member of Pensions for Purpose you can attend an event before deciding to join. See our future events.

More information

Interested in a conversation on this topic? Please e-mail Karen Shackleton or Bruna Bauer.

Click to watch the video event.

● ***Bruna Bauer is Research Manager at Pensions for Purpose***

Our Community Partners

AXA Investment Managers, cardano, Downing, EY Building a better working world, Federated Hermes Limited, J.P.Morgan Asset Management, Jupiter Asset Management, LCP powering possibility, Quinbrook Infrastructure Partners, Stewart Investors, Tikehau Capital, WHEB

Knowledge Partners

A4S, GIIN Global Impact Investing Network

We are grateful for the support of our Partners & Community members. Learn more about the Community and collaborating with us – contact Richard Giles.