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Real-world impact in emerging markets

– an asset owner perspective

Real-world impact in emerging markets

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Executive summary

Real-world impact in emerging markets

– an asset owner perspective

Our new research paper, commissioned by *Ninety One*, expresses asset owners' views on impact investing in emerging markets. Separately, Pensions for Purpose collaborated with *World Benchmarking Alliance (WBA)*

Pensions for Purpose's real-world impact in emerging markets (EMs) paper sheds light on asset owners' perspectives on impact investing in emerging nations. We interviewed 18 asset owners based in the UK, one in North America and two UK independent advisers to understand their views on:

- **Asset class decisions:**
examining long-term attitudes to risk and return, and the factors influencing decision making.
- **Sustainability decisions:**
encompassing approaches to sustainability, exclusion policies and net zero.

- **Impact and fiduciary responsibilities:**
exploring the fine balance between fiduciary responsibilities, climate change and net-zero targets.

Data collection

We posed 14 questions to interviewees, covering asset owners' preferences in asset class when allocating to EMs, their sustainability approach with a focus on net-zero targets, and how pension funds combine their financial performance with meeting their climate and net-zero goals.

Leading practices

This research report presents seven best-practice examples, which were mentioned during the interview process. There were significant variations in the views asset owners hold on impact investing in EMs, but the following examples aim to raise awareness of the challenges and benefits of investing in these regions. Specific considerations were highlighted, including the promotion of global environmental, social and governance (ESG) changes, the underlying risks of EM investments, and strategies for mitigating these risks.

Real-world impact in emerging markets research team & partner

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Introduction



Why did we conduct this research?

Less than 1% of UK assets under management (AUM) are directed towards impact investing¹. This percentage is even lower when it comes to allocations to emerging economies. According to a recent *Pensions for Purpose* paper, only 2% of impact funds are invested in these regions, representing merely 0.1% of AUM². Meanwhile, the United Nations (UN) estimates there is an annual funding gap of \$4tn for developing nations to achieve the sustainable development goals (SDGs), with half of this shortfall related exclusively to the energy transition³. The pace at which developing countries can advance the green transition largely depends on the investments they receive.

Considering this context – where allocation to impact investing, although currently low, gradually increases over the years¹, but the funding gap to promote a fair transition in emerging markets (EMs) remains significant – this paper seeks to understand the barriers, which are preventing UK pension funds from allocating to impact in developing economies, given the clear case for additionality in these investments. To achieve this, we explored how investors approach EMs from a financial performance perspective and in terms of the impact they can generate.

From a financial performance perspective, we found that while the increase in the share of emerging

economies within the world's gross domestic product (GDP) during the 2000s generated great excitement in the international market, the troubled 2010s led investors to question the long-term potential of these economies. The recent underperformance of EMs was a recurring concern among our interviewees and in the literature underpinning our research. It is important to note that, starting in the 2010s, the pace of GDP growth in emerging economies slowed, although it remained above that of developed economies in aggregate. EM equities underperformed DM equities, and EM local currency government debt faced challenges. However, EM corporate bonds performed well. These trends are further explored in the literature review section of this report. As a consequence, asset owners who began investing in EMs during the golden age of the early 2000s, increasingly started to rebalance their exposure to these economies⁴.

Incorporating sustainability and impact considerations alongside risk and return concerns presents a challenge for EMs. Previous research suggests that an 'ESG ceiling' acts as a barrier for these economies and ESG factors sometimes result in these markets being excluded from investment opportunities⁴. While resources are needed to promote the green transition, ESG factors often lead to these markets being screened out of investments.

For this reason, some investors adopt an active approach, focusing on additionality – investments aiming to advance ESG results in those nations and optimising SDGs' achievement. This strategy is essential, as the Paris Agreement and the SDGs can only be fully met if developed and developing economies reach their goals⁵.

The *Emerging Markets Just Transition Investment Initiative*, led by 12 UK pension funds committed to supporting the net-zero transition in emerging economies, has launched guiding principles which underpin their initiative. These principles highlight the importance of advocating for a fair transition in EMs, a concept that was often raised by our interviewees. By 'fair transition', interviewees refer to the inadequacies in climate transition strategies, which fail to consider the varying paces of change and levels of support needed across different economies when comparing emerging to developed markets (DMs)⁶. A fair transition should connect well with the concept of additionality and consider each nation's socio-economic development agendas, while integrating transition and mitigation efforts for countries already affected by extreme weather events.

Combining impact investment and emerging market allocations presents a double challenge.

Firstly, investors must discern between real and perceived risks associated with investing in unfamiliar geographic regions, which often have weaker ESG disclosures due to limited resources. Secondly, overcoming the perceived trade-off between impact investing and financial returns, a topic extensively explored in previous research by *Pensions for Purpose*. Investing for impact in EMs requires understanding of the unique dynamics of these regions.

Through this research, we aim to stimulate debate on the topic, increase understanding of impact allocation to emerging economies and gain insights into asset owners' perspectives on achieving real-world impact in these regions.

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World Benchmarking Alliance's views and experience – how can asset owners invest sustainably in EMs?

World Benchmarking Alliance is a not-for-profit founded to hold companies to account on their contribution to the UN's SDGs. As a global organisation committed to mitigating sustainability-related impacts affecting the world's most vulnerable communities, we are pleased to contribute to this report by *Pensions for Purpose* on helping asset owners invest and drive positive change in emerging nations.

EMs account for over half of global GDP¹ and most of the world's natural resources. They are also home to 85% of the world's population and nearly 90% of people under 30². As a result, as we transition to a net-zero and a more sustainable global economy, emerging nations will require significant amounts of investment – on top of the capital already needed to meet the SDGs and for economic development more generally.

Asset owners are key to unlocking this capital. Crucially, their scale allows them to influence the investment decisions of asset managers. By setting expectations, for example via investment mandates, asset owners can signal how asset managers can invest sustainably in EMs and drive positive change alongside providing a financial return.

In addition to helping capital flow towards EMs, asset owners can also help prevent it from leaving. For example, there is growing evidence the sustainability policies and practices being introduced by asset managers – while well-intended – may be driving divestment from EMs. To address this, *World Benchmarking Alliance* is

working with a group of asset owners to ask asset managers to ensure their sustainability practices do not inadvertently lead to this outcome. Working collectively, we are also developing best practice examples to help asset managers meet this ask. These emphasise the importance of regional context when assessing the sustainability profiles of EM assets, in line with the 'differentiated responsibilities' approach set out in the Paris Agreement. If you are an asset owner interested in getting involved with this project, please email Gwil Mason: g.mason@worldbenchmarkingalliance.org.

Thanks to *Pensions for Purpose* for the opportunity to assist with this report, and we look forward to working together in the future. EMs are key to solving the sustainability puzzle and the transition cannot be 'just' unless it works in the interests of these regions. This report will help asset owners better understand the positive impact investing sustainably in developing markets can bring, and how they can invest to drive positive change in emerging nations.

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1 The asset class decision



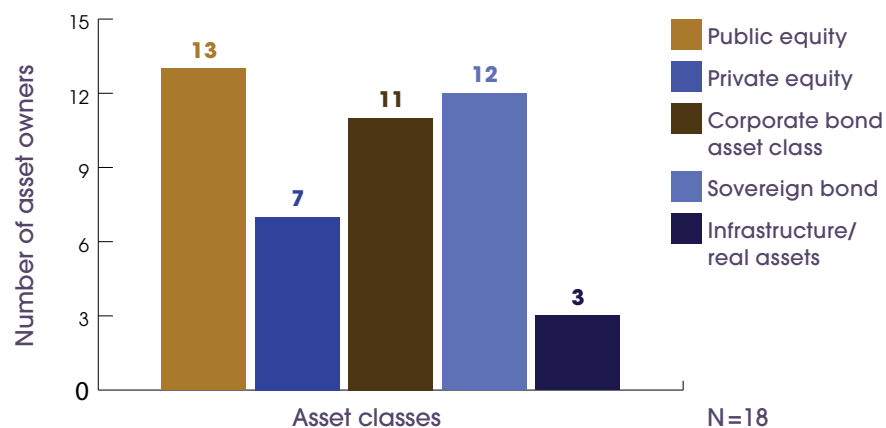
1 The asset class decision

We initiated our interviews by asking asset owners how they allocate to EMs. To understand which investment they prefer and what influences their decisions, we focused on their attitudes to:

- Asset class.
- Active or passive investment strategies.
- Risk and return.
- Influential decision factors.

Our findings reveal asset owners are inclined to choose listed equities, with the consensus that an active investment approach is important to mitigate risk. Figure 1 shows which asset classes our interviewees allocate funds to in EMs. Although a similar number of asset owners had invested in EM equities and bonds, during the interviews, they explained the size of their holding in public equity was more substantial than the capital they were directing towards private equity or bonds. Private

Fig 1 | The EM asset classes in which pension funds invest



equity allocations tend to be concentrated in India and China. In the case of bonds, it was uncommon for asset owners to hold discrete allocations in EMs; rather, they existed due to global mandates or multi-asset credit investments.

Concerns about human rights and geopolitics affect asset owners' attitudes to EM investments. Pension funds implementing an active approach tend to be more optimistic about the future performance of EMs, although they recognise the importance of not seeing developing countries as one single bucket.

Interviewees were more inclined to invest in equity and debt, with an emphasis on listed equities. Of the 13 asset owners investing in listed equities, five diversified their exposure by allocating to listed and private equity, with smaller allocations to the latter.

Previous research¹ has highlighted how the investment case for EMs relies on scrutiny at the individual company level, as EM companies are improving the quality of their financial disclosures and are priced lower compared to those in DMs. In the bond market, it is common for allocations to include corporate and sovereign debt. Among the 12 interviewed funds that allocated to EM debt, five did so through broader global mandates or multi-asset credit strategies, without a specific separate allocation to EM. Only 16% of the funds that allocated to sovereign bonds followed a more targeted approach, with separate allocations for EM debt.

Investments in EM real assets, such as real estate, land and natural resources, are unusual among UK pension funds. However, those that consider them adopt a more opportunistic approach, allowing their asset managers to pursue viable investments if they arise. Only 17% of our interviewees invest in infrastructure in EMs. Where they do, major hubs such as China and India are the main destinations for investment.

“It's mostly equities and some fixed income due to higher expected long-term returns and tapping into EMs growth. We allocate more assets to equities for younger members and mix equities and bonds for older members, reflecting their different risk profiles. Younger members hold more equities due to their higher risk tolerance. For older members, especially those near retirement, we prioritise lower-risk investments like UK government bonds, balancing them with other assets to achieve overall returns.”

ASSET OWNER

“Our exposure to EMs is currently very low. Previously, we had an allocation of about 2.5% to EM equity but we divested from that last year (2023). This decision was primarily financial, guided by advice from our independent financial adviser. Their analysis highlighted EM performance over the last decade has lagged behind DM equity. Additionally, sustainability considerations played a role in our decision.”

ASSET OWNER



1.1 Active vs passive allocations

As mentioned previously, pensions funds shared the view that an active approach - a hands-on strategy where investors rely on research and investors' own judgement - is more effective for risk mitigation, return generation and sustainability when allocating to emerging economies. Some asset owners do not have a specific allocation to EMs in their investment strategies, preferring to let investment managers with global mandates build the portfolio.

One asset owner argued: "A passive approach involves buying everything, which is riskier in EMs. By conducting thorough research on companies and regions, and adopting a macro view with an ESG-based approach, some risks can be mitigated." This attitude was echoed by another asset owner explaining their decision to divest from a passive allocation in equities and transition to an active equity

manager. In their experience, it is challenging to maintain responsible investments in EMs through a passive approach, which replicates the performance of a specific benchmark index and incurs lower fees due to the lack of extensive research.

One interviewee emphasised the importance of field-based expertise for alpha-generation: "Engaging with companies can be more difficult without local representatives who have an in-depth understanding of the companies," they said. They further highlighted the differences in the quality and quantity of information available in developing markets compared to DMs; this asymmetry can be reduced through an active approach.

From a sustainability perspective, one asset owner mentioned how an active approach supports their fund by ensuring their investments are aligned

"I generally prefer active management across all asset classes. We're seeking managers who can differentiate investments, particularly in private markets, where risks can be significant. In EM equities, it's crucial for managers to identify high-return opportunities without having sleepless nights."

ASSET OWNER

with their sustainability objectives, guaranteeing the intentionality of their impact investments (ie ensuring the impact is not coincidental but genuinely connected to the investee business) and additionality (ie making sure their investments actively contribute to positive change).

However, while some interviewees prefer an active approach, they adopt a passive strategy due to cost constraints. “With a limited fee budget, asset owners need to decide where their fees go the furthest,” felt one asset owner. Other funds holding passive allocations said they have initiated internal discussions on whether this approach remains optimal.

Insight: Asset owners revealed a preference for equity and debt allocations, with listed equities receiving most investments; this was echoed by investment advisers. Investments in EMs are approached cautiously, with some funds divesting due to the recent underperformance. Many asset owners prefer active management to mitigate risk, given local knowledge is paramount in EMs; a view shared by investment advisers. Despite this, cost constraints do lead some funds to adopt passive strategies and it is important to recognise the fine balance between maximising returns, managing risk and ensuring sustainability objectives are upheld.

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“We invest a lot of time in due diligence with managers to ensure their culture aligns with our beliefs, especially in private markets where there is blind risk. We need to trust that these managers will invest in line with our strategy and our definition of sustainability, as interpretations can vary widely. We aim to ensure our investments are genuinely sustainable - it's the intentionality we are trying to capture.”

ASSET OWNER

PENSIONS FOR PURPOSE'S PERSPECTIVE

When considering asset classes, a major influence on asset owners is to ensure returns reflect the risk and to guarantee the intentionality of their impact investments. It is crucial financial returns are linked to sustainability and risk management. While active management allows for better navigation of diverse and volatile environments, which are often seen in EMs, it is important to adopt a value-for-money approach rather than seeking to minimise costs. Although passive strategies are attractive based on cost effectiveness, active management can provide superior returns when coupled with strategic research, particularly in EMs. From a sustainability perspective, an active approach can further ensure investments generate returns and provide meaningful impact.



“In a purist way, I would prefer active management because that gives you the best tools to navigate some of the risks. In reality, most clients will not pay for the additional cost of active management, so you do end up with passive.”

ASSET OWNER

1.2 Long-term view on risk and return

While the consensus among the interviewed asset owners was EMs should deliver higher returns, opinions on the future performance of these economies and their associated risks varied, some interviewees being more optimistic than others.

According to one asset owner, recent constraints of volatility and currency risk have prevented these economies from 'taking off' and delivering significant returns. However, when comparing the MSCI World and EM indices, we observe they had similar standard deviations in volatility over the past three years (17.63 and 17.22, respectively). Over a 10-year period, the EM index's standard deviation was slightly higher (17.15 versus 15.02 in DMs). Both indexes present a strong historical monthly correlation of 0.82 (1982 to 2019) and a 0.90 correlation between 2015 and 2019.

Other concerns centred on the macroeconomic scenario of major players in the global economy. One asset owner said although the investment case for EMs has been based on their growth potential, some top-down considerations – such as inflation in the US and the global impact of deflation in China – pose challenges.

On the flip side, another asset owner argued the energy transition is central for the global economy in the coming decades, providing a good reason not to overlook these economies. The opportunities are significant because, as mentioned in the introduction of this report, the UN¹ estimates half the investment gap for EMs to promote the SDGs is related entirely to the energy transition, which includes investments in power grids, energy efficiency and storage. Although global investments

“If you consider energy transition as potentially the most significant factor in the global economy over the next 20 to 30 years, which is a bet we are making as a fund in terms of our capital allocation, then you cannot overlook EMs. It is essential that this transition occurs in these economies. They are where the risks are highest, but also where the opportunities are likely the greatest.”

ASSET OWNER

in renewables have tripled since 2015, this is still concentrated in developed nations. As of 2022, emerging countries had only received a third of the resources needed to boost clean energy.

One asset owner explained UK investors are unfamiliar with how EMs operate and the fundamental legal, cultural and political aspects of different countries pose a challenge, as they increase their fear. Another felt the diversity in EM countries is an important consideration when evaluating political risks. To address this, one respondent, in addition to focusing their analysis on evidence-based reports from development financial institutions, is also investing in trusted local partnerships to better access each country's idiosyncrasies.

“While investing in EMs requires more due diligence, successful investments have boosted our committee's confidence. These impact investments have delivered the desired financial returns, inspiring us to embrace the opportunities in EMs. Though it demands extra effort, the additional impact we achieve is significant and something our members and our committee are proud of.”

ASSET OWNER

“EMs is such a broad term it's quite difficult to paint a picture of the whole scene. That's the reason we want to actively take part. The differences between countries and political risks vary dramatically. We have a strong long-term view. Given we're 30-40+ year investors, we don't want to be out of EMs, but it's about being in the right ones, particularly from an impact and ESG perspective. We're moving to a bespoke index, so we can start playing around with that more and have flexibility to respond to geopolitical issues. We're positive for the long-term, if we've got the right mechanisms to be in the right markets.”

ASSET OWNER

Another asset owner agreed with this perspective, mentioning they are moving to a bespoke index to allow for case-by-case analysis and greater flexibility in responding to geopolitical tensions and regional issues.

Views on the future of EMs varied. Some asset owners expressed EM volatility, geopolitical tensions shaping the global economy, the pandemic and the invasion of Ukraine as having been significant disruptors to emergent economies. The optimists, on

Insight: The outlook on risk and return in EMs is mixed with varying levels of optimism. While asset owners believe EMs should yield higher returns due to their growth potential, concerns about volatility, currency risk and geopolitical instability were also mentioned. Recent constraints and macroeconomic challenges generated reservations. However, the energy transition is viewed as a significant EM investment opportunity. Successful experiences of impact investing have boosted confidence, highlighting the need for careful due diligence and a long-term perspective, with custom indices and selective investments being strategies used to mitigate risks and capitalise on opportunities. Despite concerns about volatility and global tensions, long-term demographic and social changes in EMs suggest transformative potential and added returns due to inherent risks.

the other hand, believe demographic and social changes – mainly global population growth ratios specifically from some emerging countries – will lead to transformations in the coming decades.

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“We believe there should be added returns due to the political and legal risks in EMs, and the unfamiliarity compared to DMs. Historically, these markets have been perceived as more volatile, though this may now be untrue. However, developing nations are expected to grow their economies and GDP faster than DMs offering potentially beneficial returns.”

ASSET OWNER

PENSIONS FOR PURPOSE'S PERSPECTIVE

Investing in EMs presents a promising yet complex opportunity. Asset owners recognise the potential for higher returns, driven by growth prospects and the energy transition, but emphasise the need to carefully navigate risks such as volatility, currency fluctuations and geopolitical instability. Despite these hurdles, the shift towards renewable energy and sustainable development in EMs offers long-term investment opportunities. Ultimately, although levels of optimism vary, there is still a feeling, while EMs entail higher risks, they align with the goals of achieving environmental and social investment while providing high returns. Asset owners highlighted, despite the higher levels of effort and risk, impact investments in EMs have delivered high returns and significant positive impact. Overall, careful monitoring, case-by-case analysis and flexibility have been useful in responding to geopolitical risks, generating impact investments with high-returns and positive environmental and social change.





1.3 Influential decision factors

Owners had various perspectives on the factors influencing their decision-making process when evaluating investment opportunities in EMs. We divided these into two major areas. Firstly, they differentiate their concerns into top-down and bottom-up aspects – the former focuses on country-level and macroeconomic factors, while the latter is at the company-level. Secondly, the asset class they are considering plays a significant role. Despite these nuances, risks remain a major factor for pension funds when assessing investments in EMs.

From a country-level angle, asset owners assess the potential for economic growth in the region and the sustainability of that growth. Evaluating the country's demographics, governance landscape, political risks, judicial characteristics and corruption levels is essential. Political, economic, human and regulatory risks are important factors when allocating to the larger EMs. Besides the characteristics of the jurisdiction itself, asset owners emphasised the relevance of global economic analysis to account for geopolitical risks and their potential impact on specific jurisdictions.


From a bottom-up perspective, interviewees highlighted long-term drivers of return that can

“In my view, EMs are where global growth will come from, offering significant opportunities. However, there will be challenges, particularly geopolitical risks. What seems stable now may not be in a year. Currently, India is very attractive to us due to its rapidly growing economy and population, along with better regulation and democratic levels. Our active managers are expected to help avoid major pitfalls, though it's not always possible. Despite the risks, the investment opportunities in these regions are worth it.”

ASSET OWNER

“Newer and different things, which lack a proven track record, are harder for us to get the consultant on board with. As a result, we have to do extra work, involving a lot more back-and-forth communication. From speaking to others, I know we're not alone in this challenge. However, we do need to work harder to achieve this. These are growing economies and, if we don't invest in them, we miss out on returns. It's crucial to take the time to assess these opportunities because ignoring these markets means missing out.”

ASSET OWNER



outperform the benchmark. These factors include valuation metrics and profitability, as well as reputational risks that can negatively impact a company's share price. Recognising this analysis is more challenging in EMs compared to DMs. Asset owners also stressed the importance of having managers with local expertise, conducting on-the-ground research and maintaining communication with investees. In EMs, financial markets are often younger with shorter track records, so active engagement is essential.

Asset owners' concerns vary significantly depending on the asset class they are considering. For direct private investments, they emphasised how currency and default risks, along with scarcity of investable options, can be problematic, especially given changes in the global economic dynamic. China's growing dominance and rising geopolitical tensions were mentioned by one asset owner who noted they are developing a comprehensive sovereign risk framework to address governance and human rights issues. When focusing on equities, asset owners identified risk and return as fundamental drivers, with special attention given to reputational risks. They also raised the need to diversify and select the appropriate location and sector of the investment carefully.

One trend we identified is asset owners that adopt an active approach to their EM investments tend to have more positive perceptions of their allocations and feel more confident their risks are being mitigated. Additionally, ESG factors should be considered a risk mitigation strategy in EM allocations, rather than from an impact intentionality perspective. Looking specifically at ESG, although asset owners mentioned governance and sustainability as crucial in assessing investment opportunities in EMs, the prevention of human rights violations were more commonly raised during interviews. Geopolitical risks were also concerning.

“We look for the long-term drivers of return because we're active investors. We do want to be at the benchmark so we look at the traditional factors like value, quality and momentum, but we also look at the climate and human rights risk – which can ultimately damage a company's share price, any sort of reputational risk. So we utilise managers that have local expertise, boots on the ground so that they can challenge what is being communicated to them.”

ASSET OWNER

“This has been the challenge with EMs. From an investment perspective, you might expect a higher return to reflect the increased risk. However, that hasn't materialised, which is one of the real challenges with investing in EMs. This is the challenge we eventually faced with our EM portfolio.”

ASSET OWNER

Insight: At a country-level, asset owners evaluate economic growth potential while considering demographics, governance and political risk. They also exert caution over human, regulatory, political and economic risks. The company-level approach focused on long-term return drivers like valuation metrics, profitability and reputational risks, a view echoed by independent advisers. It was noted that EMs also require managers with local knowledge and active engagement. Concerns varied by asset class; direct private investments faced currency risks, default risks and a scarcity of investable options. Global dynamics, such as China's growing significance and geopolitical risks, require scrutiny. One asset owner is developing a sovereign risk framework to address governance and human rights issues, reflecting the comprehensive considerations required for EM investments.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Investing in EMs involves meticulous evaluation to align financial return with sustainable impacts. Asset managers prioritise comprehensive risk assessment, focusing on geopolitical stability, regulatory frameworks and human rights protection in target jurisdictions. This approach ensures investments generate high returns, uphold ethical standards and contribute positively to local communities. Active management coupled with local expertise is crucial to navigate the unique complexities of EMs, such as regulatory uncertainties. By integrating ESG factors into investment strategies, pension funds can mitigate risks associated with reputation and enhance long-term sustainability. The goal is to achieve financial security for members and responsible stewardship of capital in emerging economies, fostering inclusive growth amid global economic dynamics.



Investment advisers' view

Focusing on asset classes, investment advisers see a general interest in equity, with a focus on public markets. Although there is interest in fixed income and private markets, these are less common. When comparing active and passive approaches, they strongly agree that an active approach is more suitable, mainly due to geopolitical risks and the limitations imposed by specific indexes when choosing passive exposure. They argued the appetite for EM debt is low because it is usually possible to get some income without incurring the

associated risks. One adviser highlighted investors are increasingly becoming wary of countries whose practices do not align with ESG standards, leading to a general pullback from EMs. However, some still invest with a more focused and cautious approach to geopolitical risks, maintaining the flexibility to withdraw if needed. They echoed asset owners' views on the importance of company selection and having on-the-ground resources to understand and evaluate investments in EMs effectively.



② The sustainability decision



2 The sustainability decision

Following on from how asset owners consider risk, returns and asset classes when they allocate to EMs, we focused the second part of our questionnaire on understanding their approach to sustainability and achieving net-zero targets in these economies, compared to their strategies in DMs.

Our findings indicate most asset owners do not distinguish between their ESG approach to EMs and DMs. However, they tend to scrutinise EM companies more closely, engaging in additional due diligence and raising more questions. Most interviewees apply exclusion policies, primarily focusing on environmental issues such as fossil fuels.

While environmental exclusions are generally

consistent across geographies, with some exceptions, asset owners tend to additionally screen EM investments for governance issues, in some cases excluding companies with poor governance practices. This raises challenges for asset owners accessing impact opportunities in EMs, predominantly related to data availability and disclosure.

Thematic investments and sustainable opportunities in EMs mirror those in DMs, with interviews highlighting climate, biodiversity, social impact and technology. Despite consistency across themes, the nature and scale of the opportunities differ due to demographic and social trends unique to EMs.

Carbon emissions emerged as a significant concern

in EM allocations. While it is acknowledged CO₂ emissions are generally higher in EM countries, some pension funds are interrogating EM transition pathways rather than solely comparing emissions levels between developing and developed nations. 'Brown to green' investment strategies have emerged as viable alternatives for pension funds seeking to invest in EMs without compromising their net-zero targets.

Geographically, there is a balanced perspective among asset owners; some see more potential in local markets while others favour opportunities in EMs. Additionally, a few 'geographically agnostic' pension funds prioritise investment opportunities based on potential rather than regional preferences.



2.1 Approach to sustainability: EMs vs DMs

Responses to whether asset owners' ESG approaches to EMs and DMs differ varied widely, reflecting the diverse strategies used to address challenges such as lower disclosure levels and limited local economic information. To capture this diversity, we categorised responses into two groups:

- Asset owners clearly differentiating their ESG approach to DMs and EMs.
- Asset owners not differentiating their approach despite specific considerations.

Few interviewees provided definitive 'yes' or 'no' answers. Most indicated they 'slightly' differentiate or request more specific information for EMs. However, before delving into these nuances, it is important to highlight the straightforward responses.

One asset owner, who firmly change their ESG approach, emphasised they recognise EMs as less developed, particularly in governance and the speed of their transition to low carbon. They argued applying identical criteria to EMs and DMs could unfairly exclude potential investments. On the other hand, an independent adviser resolutely opposed taking a different approach, defending uniform standards across regions due to the significant impact of ESG factors on investment performance. They stressed the need for consistent data access across diverse geographies.

“You must apply the same standards and bottom-up research, whether it's BT or an Indian manufacturer. ESG aspects can influence the outcome of the performance you're going to get from the company. But you need to treat them all in exactly the same way. You may have different entities, may do it differently, but you need a process.”

INVESTMENT ADVISER



ASSET OWNERS WITH DIFFERENT ESG APPROACHES TO DEVELOPED AND EMERGING MARKETS

We identified two distinct approaches among the asset owners who tailor their ESG strategies to DMs and EMs. The most prevalent is a more flexible stance on net-zero targets when comparing EMs to DMs. In this way, asset owners invest in promoting a 'fair transition' and recognise the need to support high-emitting companies in gradual decarbonisation.

The second involves a more rigorous due diligence process in EMs, by maintaining an ongoing dialogue with local communities to understand and mitigate the impacts of their investments

1 | More adaptable approaches to net-zero targets

Four asset owners mentioned the need for more flexible net-zero targets and carbon-emission reduction plans across EMs and DMs.

One asset owner explained how using separate strategies for DMs and EMs leads to different ESG expectations. Although these pension funds have set a net-zero target for 2050 with a 50% reduction by 2030 for DMs, they consider the specific ESG commitments and pathways of EM countries within their index. Another asset owner echoed this sentiment, noting their recent decision to divest from fossil fuel investments. They acknowledged the pace of emissions reduction will depend on the market,

“If your focus was purely to reduce your carbon footprint, you would avoid investing in EMs. However, there’s an irony here: by investing in these companies and aiding their transition, you can actually make a significant positive impact. While this might temporarily increase your carbon footprint, the long-term benefits of facilitating sustainable practices in these markets outweigh the short-term negative impacts.”

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with more flexibility granted to their EM portfolio.

Another pension fund highlighted their climate transition and carbon reduction objectives are slightly adjusted for EMs. They pointed to the limited quality and quantity of data available to these nations and emphasised the need to invest and engage with high emitters to support their transition.

Finally, a further asset owner recognised EM companies cannot be held to the same standards as DM companies. Their climate change alignment policy allows more time for EM companies to meet certain thresholds, but they still evaluate the efforts of these companies to promote the transition rather than focusing solely on greenhouse gas emissions.

“Much of the energy production in EMs is currently high in greenhouse gas (GHG) intensity, necessitating investment for the energy transition. While our EM portfolios initially showed high GHG intensity, they were lower compared to the benchmark. Our asset managers identified lower-intensity companies within this high-intensity context, taking a nuanced approach. However, we later decided to divest from these EMs due to their high GHG intensity and lack of evident transition efforts among the underlying companies – instead, we shifted investments to our sustainable global portfolio. This portfolio still maintains higher GHG intensity than our other portfolios, but it focuses on companies manufacturing products that support energy transition efforts, aligning better with our sustainability goals.”

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2 | Additional due diligence in emerging markets

One pension fund recognised the need for “more work” in EMs, explaining their approach varies according to the country, but takes general considerations into account. Beyond the traditional due diligence process, they conduct free and prior informed consent (FPIC) to ensure local communities approve projects or investments. They also analyse the security of each country, including corruption rates, and use evidence-based information to assess environmental physical risks. This fund holds an optimistic view of long-term EM performance. They emphasised this active approach reassures their committees and boosts confidence in allocations.

ASSET OWNERS NOT DIFFERENTIATING THEIR APPROACH DESPITE SPECIFIC CONSIDERATIONS

Even asset owners who maintain a consistent ESG process in EMs and DMs mentioned slightly adjusting it to account for regional variations. This includes bespoke considerations for specific jurisdictions, more active engagement with EM investees and more scrutiny of supply chains

1 | Bespoke considerations for particular jurisdictions

One asset owner explained they do not adopt different ESG and impact strategies across geographies and markets. However, they acknowledge the need for greater examination of certain areas within EMs, particularly governance and UN Global Compact controversies. While they maintain consistent base levels, exclusion policies and impact themes across both regions, there is a slightly higher requirement for additional review and research in EMs.

Another pension fund mentioned, although their approach does not distinguish between EMs and DMs, they do ask more country-specific questions to understand the macroeconomic context of jurisdictions unfamiliar to DM investors. The primary objective is to assess the governance and regulatory landscape to evaluate political stability. They also recognised DM investors are unfamiliar with EM-based companies, necessitating increased checks on these companies.

A third asset owner advocated considering specific aspects of individual areas rather than having a uniform 'EM approach'. For example, while governance is generally perceived to be lower in EMs than DMs, countries such as Chile possess DM-level governance structures. Consequently, they do not alter their ESG approach to suit different geographies, but instead incorporate bespoke factors based on the unique characteristics of the country. For their China mandate, they conducted

“Our approach is broadly consistent but DMs typically require less scrutiny. In EMs, the strategy is more bespoke, varying by country. Governance is a strong focus and social factors, such as modern slavery and human rights, are crucial. We aim for a fair transition, recognising that each country's path is unique. Our tailored ESG approach involves a bottom-up examination of growth, energy security and affordability, considering how these factors influence each country's progress towards net zero.”

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a detailed analysis of human rights issues, including business practices related to modern slavery in supply chains. This thorough assessment varies from country to country. As stated earlier in our report, ESG issues serve as a strategy for risk mitigation in these cases.

2 | More engagement with emerging market investees

Two asset owners explained they apply the same responsible investment (RI) policies to EMs and DMs and they do expect to receive the same reporting level from EM and DM managers. However, they highlighted engagement is stronger with EMs. Still, they recognise the diversity within EMs and prioritise different themes for engagement according to the specificities of the province they are looking at.

“Our RI policy is global, although some aspects are asset-specific rather than region-specific. We recognise that risks differ between these markets and, even within EMs, countries are at various stages of the energy transition. Therefore, each country requires a tailored approach, which our expert managers handle. Our overarching policies are applicable worldwide, but engagement strategies differ between EMs and DMs. Issues like human slavery are more prevalent in EMs but are interconnected with practices in DMs that are procuring those products or services. Hence, while our principles remain universal, practical applications are customised per region without separate policies.”

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3 | Special attention to the supply chain

One asset owner explained the same policy goes across the entire business and is replicated in all asset classes. However, they see the risks in EMs as greater especially from a social perspective. Consequently, they are more careful in ensuring their managers are aware of the supply chains of the companies they are investing in and that human rights risks are mitigated.



Insight: Some asset owners clearly differentiate their strategies while others maintain consistency despite unique EM challenges. When looking at asset owners that change their approach to DMs and EMs there were two positions: a more flexible stance on net-zero targets, and more rigorous due diligence in EMs to better understand the impacts of investments. An asset owner also stated EM companies cannot be held to the same levels of carbon reduction as DM companies. Asset owners who choose to maintain consistency in their ESG approach mention making small adjustments to account for regional differences, such as additional review and asking more country-specific questions. Additionally, EMs pose more social risks, prompting careful management of supply chains and human rights issues by asset managers.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Asset owners navigate across DMs and EMs with nuanced ESG strategies. Both approaches recognise the challenges of EMs, especially in carbon transition and social risks, but to varying levels. A tailored approach emphasises incremental improvements in ESG standards and advocates for transparency in supply chains and human rights protections. Factoring in unique EM challenges allows for flexible strategies, facilitating meaningful progress within feasible timeframes. Ultimately, a balanced approach supports sustainable development goals, mitigates investment risks and fulfils fiduciary duties by promoting long-term value creation across diverse EMs. It recognises the importance of adapting strategies locally, while maintaining global ESG standards. By doing so, asset owners enhance their portfolios and contribute to broader societal and environmental goals.



2.2 Exclusion policies: EMs vs DMs

Most of our interviewees either apply, or are in the process of implementing, exclusion policies (77%). However, the extent and focus of these policies vary significantly, with a major emphasis on environmental issues. This is likely because their investments are primarily concentrated in DMs. As we show later, in cases where different policies were applied between EMs and DMs, it was usually to address 'social and governance' concerns, particularly in EMs. This involved screening out companies with human rights violations and poor governance – uncommon issues in DM companies, according to one asset owner.

Only 23% of interviewees do not apply exclusion policies, the most common reason being that they advocate for engagement over divestment and do not support exclusion. In some cases, however, individual managers may implement their own screens at the mandate level, depending on the nature of their specific requirements.

Although there are human rights and social concerns about allocating to EMs, most of the overarching exclusions in asset owners' policies revolve around environmental topics, with a focus on fossil fuels. The exclusion of UN Global Compact Violators was directly referenced in three interviews.

“Our exclusions are similar across our funds. Initially, we implemented the UN Global Compact screen for our EM mandate and later expanded it to other funds due to concerns about certain companies. We also have fossil fuel climate exclusions and aim to phase out thermal coal by 2030. Additionally, our EM fund includes a screen to exclude companies with poor governance.”

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Fig 2 | Do you apply exclusion policies?

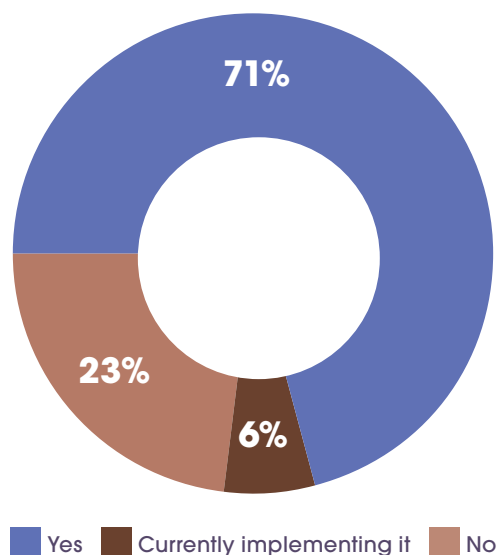
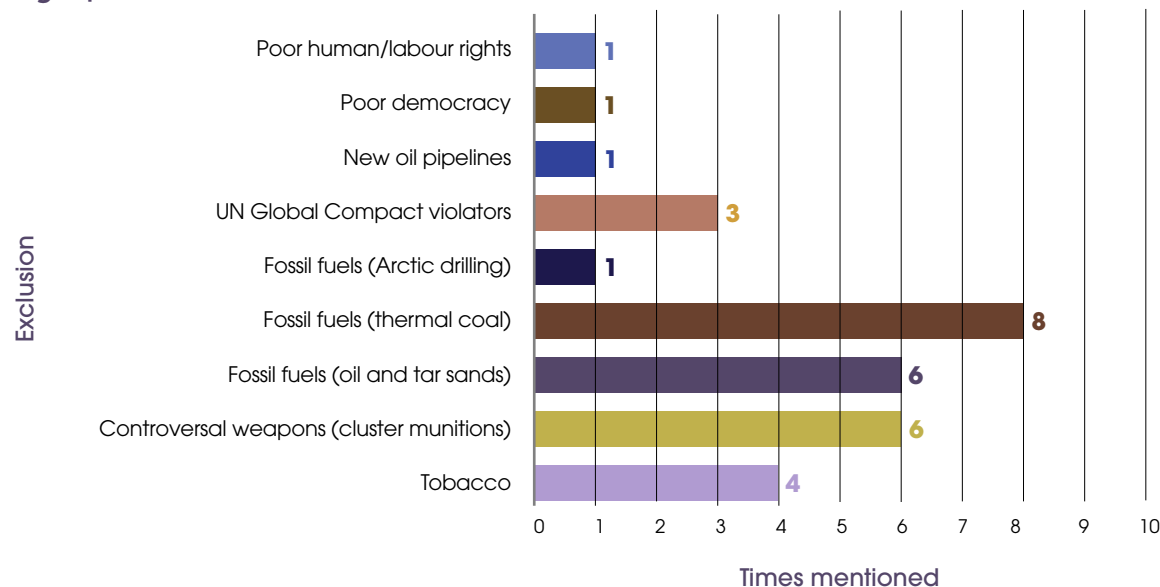


Fig 3 | Exclusions





The Global Compact¹ is a UN corporate sustainability initiative which invites companies to align their operations with 10 principles from the Universal Declaration of Human Rights, the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the UN Convention Against Corruption, consequently embracing four major topics: human rights, labour, environment and anti-corruption.

Pension funds taking different approaches to EMs and DMs saw climate exclusions as broadly the same across regions, with few exceptions. However, they apply an additional governance screen to EMs, excluding companies where they identify poor governance.

In addition to the greater importance of screening social and governance factors in EMs compared to

DMs, some asset owners allow a degree of flexibility for EM companies that demonstrate commitments to, for example, phase out coal, contingent upon having a proper plan and evidence-based targets to promote the transition. However, some argued they would divest from companies if engagement fails to promote meaningful change and where companies did not show initiative in starting their transition journey. Asset owners stressed how essential it is to hold high-emitting companies to account and engage with them, excluding them only on the lack of climate progress. Engagement and stewardship can lead to improvements, which could have a transformative impact globally, they argued.

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¹ United Nations Global Compact, The ten principles, viewed July 2024, <<https://unglobalcompact.org/what-is-gc/mission/principles>>.

“Wherever you are in the world, our governance exclusions apply. We have a specific list of exclusions related to Foreign Corrupt Practices (FCP) allegations or significant governance issues. This list includes some DM companies but is largely composed of EM companies. Thus, our exclusion policy has two main sets: a broad, general one and a more targeted, EM focused one.”

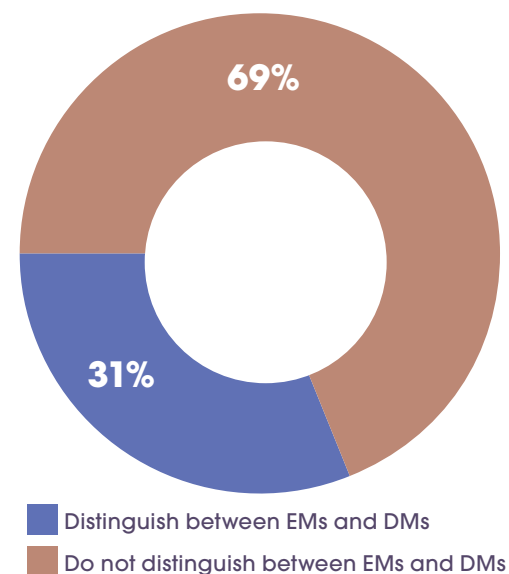
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“China's largest dairy company was on our climate impact pledge divestment list, but they then reinstated a deforestation policy and set their own carbon neutral policy by 2050. As a result, we've now brought them back. A similar situation occurred with a major Indian steel company. I'm not saying that being put on the 'naughty list' will necessarily stop harmful practices, but we believe it's important to hold companies accountable where possible. The data is often less clear, making it harder to get certain points. Many people use this as an excuse not to bother but it should be the opposite. We should spend even more time on stewardship with those lacking data and that's what our team aims to do. We don't have separate policies for different regions but there will be varying levels of engagement depending on whether the market is emerging or developed.”

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Insight: Most organisations have, or are implementing, exclusion policies, with an overall focus on environmental issues. While 23% do not apply these policies, they justified this stance by advocating for engagement over divestment, having their own screens at a mandate level. Three interviewees specifically mentioned safeguards to comply with the UN Global Compact. Those pension funds adopting different approaches to EMs and DMs tend to apply the same or a similar climate lens across both regions but add a governance screen for EMs, mainly to exclude entities with poor governance. Consequently, there is a greater emphasis on social and governance factors in EMs compared to DMs, allowing flexibility for EM companies phasing out coal. However, some funds will divest from companies not showing any initiative to transition. It is essential to ensure high-emission EM companies are liable and engage with them on stewardship.

Fig 4 | Do you apply different exclusion policies across EMs and DMs?



PENSIONS FOR PURPOSE'S PERSPECTIVE

Engagement with high emission EM companies can have global impact, balancing environmental needs with long-term socioeconomic development. By advocating for engagement over divestment, investors can steer direct impact, promoting positive changes and emphasising the importance of stewardship. Engagement, rather than exclusion, encourages direct impact and improvement in company practices, addressing governance and social issues.



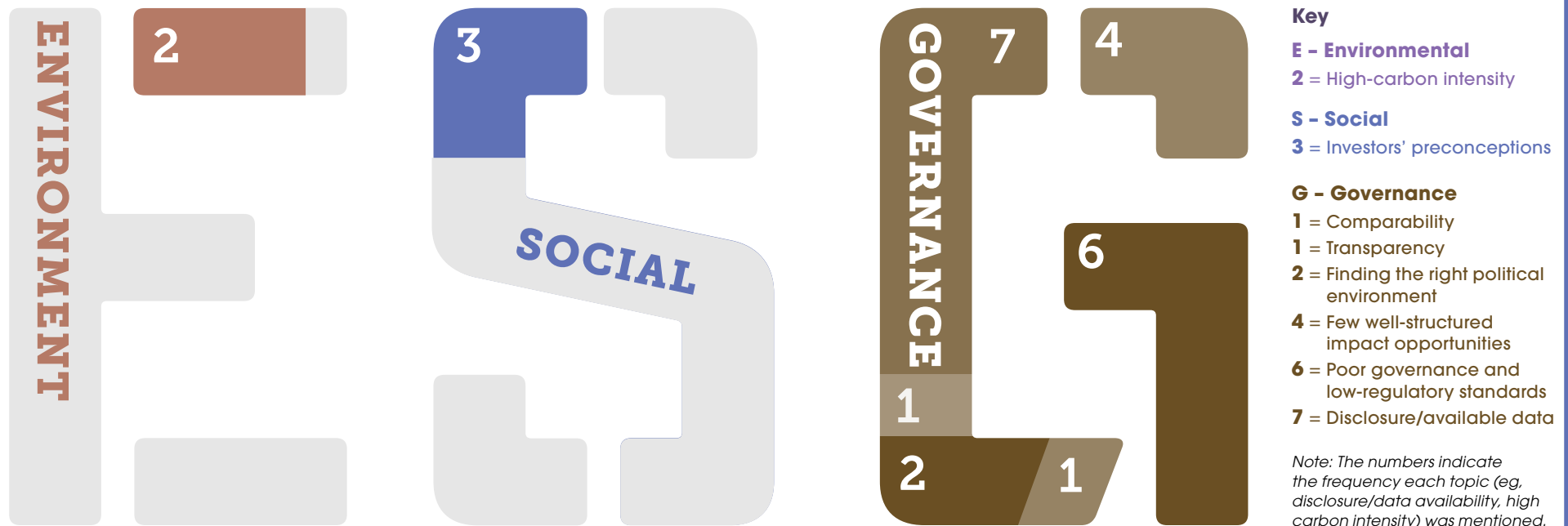
2.3 Barriers to accessing impact opportunities

We grouped the barriers to accessing impact opportunities in EMs, mentioned by our interviewees, across 'E', 'S' and 'G'. We understand some of these topics overlap but we grouped them to allow for analysis of data.

Figure 5 shows most of the challenges preventing or diminishing impact allocation to EMs centre around disclosure/data availability, poor governance and regulatory standards, lack of well-structured

impact opportunities, finding the right political environment, and transparency and comparability, all governance topics. This was followed by investors' perceptions of the high-carbon intensity seen in many EM investments. Their views on how these barriers affect their investment decisions differed and how their strategies respond to these challenges. It is important to highlight 28% of our interviewees are prioritising impact investing in DMs, hoping to expand it to EMs at the right moment.

Fig 5 | Barriers to impact opportunities divided into E, S and G considerations



Not looking at impact in EMs

Those yet to allocate or those with low allocations in EMs explained they are at the early stages of their impact journey. They have chosen to focus on DMs first, expecting to extend their efforts to EMs at a later stage, recognising the potential for real-world impact in those economies. In one case, the matter of cost and associated risks was raised as a constraint.

ENVIRONMENTAL

High-carbon intensity

Although high-carbon emissions were mentioned twice as an impediment to impact allocation in EMs, both asset owners emphasised their focus on understanding and tracking incremental improvements towards net-zero targets, rather than only considering where EMs currently stand on their journey.

SOCIAL

Investors' preconceptions

UK investors' broad perception of EMs poses a challenge for allocating funds to these economies. One asset owner said DM investors often view EM countries as a single bucket, leading to inconsistencies, particularly regarding risks, and disregarding that these countries face different challenges.

Additionally, there's a debate about the lack of comparable data within DMs, which becomes more pronounced for EMs. This issue is exacerbated by UK investors having a limited understanding of regional governance, regulatory and legal contexts, increasing perceived risks in EMs.

Another point raised was the risk of neglecting the needs of local communities and accurately assessing the impact of investments upon them. One asset

“We expect to pay more for an EM mandate because the manager will need to do extra work and engage more with these companies, understanding their risks and suitability – this cost is passed on to us. The EM topic is nuanced as we recognise the potential impact of allocating funds here. However, explaining complex narratives to stakeholders is challenging, as seen with the fossil fuel debate. While we acknowledge the potential positive impact, we decided against the allocation due to associated risks. This decision isn't permanent and will be revisited but, for now, the risks outweigh the benefits.”


ASSET OWNER

“We aim to push for improvements, knowing we won't achieve 100% coverage next year or the following. The committee has tasked me with asking our managers, 'How is this improving?' and demonstrating progress in all areas. We're committed to incremental improvements at the company, country and sector levels. This process is subjective and not as clear-cut as it may seem. People often simplify things to make decisions but the reality is more complex.”

ASSET OWNER

“We are increasingly focusing on impact, though we haven't prioritised it in EMs yet. We expect to follow our DM strategy, especially in private markets, with a small EM allocation where we can achieve significant impact. Currently, in EM fixed income and equities, impact is not a primary consideration in our investment decisions.”

ASSET OWNER



owner establishes initial agreements to set expectations for disclosure and data. By defining the expected impact of their investments, they find it easier to align the information necessary to evaluate this impact.

GOVERNANCE

Comparability, transparency and disclosure/data availability

We combined these three topics because they were often mentioned together by asset owners. It is important to note asset owners recognise the challenge of comparing data across different countries or companies as an existing issue in DMs. However, this challenge is exacerbated in EMs due to differences in governance models.

Strategies to deal with minimal data from companies in EMs include 'pushing for improvements', mainly through engagement with these firms, establishing an agreement on the climate metrics analysis to check for improvements, and setting expectation levels for topics they want companies to disclose on. Still, the importance of having managers in the field was seen as essential to ensure UK pension funds have an inside perspective, including the legal and political context.

Ultimately, asset owners with clear impact objectives mentioned it was easier for them to navigate these issues, as they would measure the level of disclosure they need based on this specific objective.

In some cases, asset owners cited poor governance and regulations as reasons for lower levels of disclosure. They suggest asset managers engage with companies to improve their disclosure practices and suggested EM companies should adopt DM regulation and governance standards. This

“There's a lack of understanding of what EM actually is and investors often lump it all together. It is not possible to lump together Central Africa and Southeast Asia, in the same way that is easy to do with Europe and North America. There's also undue nervousness about perceived risks in EM that aren't always supported by evidence. Furthermore, investing in certain countries challenges our view of robust governance. It's tempting to avoid investing in these countries altogether but this approach doesn't address the underlying issues.”

ASSET OWNER

challenge, however, transcends geographies and applies to DMs when considering measurement and disclosure across various greenhouse gas emission scopes, especially Scope 3 which focuses on the emissions indirectly generated by a company up and down its supply chain.

Few well-structured opportunities

One asset owner stated the financial market universe in EMs is inherently smaller than DMs, with fewer listed companies, making private markets essential for those looking to invest in these economies. They also highlighted positive impact in EMs can be achieved by investing in DM companies focused on solving EM issues. Another pension fund mentioned the challenges posed by the narrow 'investable universe' for impact in EMs, given opportunities are often small-scale. Combining ESG factors holistically is difficult because environmental solutions in EMs can sometimes create social problems and vice versa.

Finding the right political environment

Asset owners frequently mentioned political risk when asked about considerations when allocating to EMs. They also identified it as a restriction to allocation, affecting governance levels, transparency, disclosure standards of companies and broader aspects such as corruption rates.

Poor standards

Engagement is necessary in improving governance and regulatory standards in EMs. Asset owners emphasised the importance of evidence-based assessments by multilateral development banks and second-party opinions in guiding their decisions. Another asset owner spelled out the necessity of aligning the governance standards of developed and developing economies, emphasising the imperative to meet global climate targets rather than solely DM's.

“Particularly for Scope 3, you're unable to compare things fairly as everything is done so differently. Data helps you to make more specific decisions better but, ultimately, we know the direction we need to go. So it's not an excuse not to do nothing. What we have learned is if there is not an initial agreement about the data you need to get, it's hard to access this information later. So we have increased demands around what we require in terms of impact reporting and we learn from previous investments.”

ASSET OWNER

“Transparency and reporting deficiencies in EMs pose challenges, particularly when applying climate alignment policies. Initial disclosures may not meet required thresholds, yet engagements often reveal that companies are effectively aligned. These issues, alongside political risks, are primary concerns in these markets.”

ASSET OWNER

“Solving sustainability issues in EMs does not necessarily involve investing in EM assets directly. There are DM companies addressing water scarcity, a significant EM challenge. Investing in technology from any region can help solve EM problems. This requires an active approach and data availability for decision-making. Partnering with experts who have local expertise is crucial since no single asset manager can cover all regions effectively. Additionally, EM countries are underrepresented relative to their capital, with fewer investable companies. Private markets offer a better avenue for funding smaller startups in EMs that can't access public markets. This issue is more pronounced in EMs but also exists in DMs like the UK.”

ASSET OWNER

“EM companies face less accountability from government and regulatory bodies compared to those in DMs, making it a challenging but essential effort. For example, if India reaches China’s emission levels, it would negate carbon savings expected from Europe and North America over the next 20 years. This highlights the urgency of the issue.”

ASSET OWNER

Insight: Obstacles to accessing impact opportunities in EMs are mainly related to governance and data availability. For these reasons some investors prioritised allocating to impact in DMs, hoping to eventually extend their efforts to EMs. High-carbon emissions in EMs are a challenge, some investors make incremental changes. Asset owners highlighted the need for better data comparability, local governance and regulatory standards in EMs. Strategies to address these concerns include setting clear impact objectives, engagement and advocating for improved disclosure and transparency. Verifying sustainability claims and identifying reliable opportunities in EMs are also a major challenge.

Investment advisers’ view

Verifying sustainability claims and finding reliable opportunities are challenging. Advisers stressed the need for thorough due diligence despite these difficulties, suggesting investments in solar panels and other sustainable technologies require more effort in EMs compared to DMs. They described the ongoing establishment of acceptable practices and criteria-setting among investment managers. There is a growing recognition of the potential in EM investments despite perceived risks, with increasing efforts to mitigate these risks through selective investments and alternative routes. Advisers agree while investing in EM can be lucrative, it also presents an opportunity to support economic development and improve living standards, highlighting the importance of strategic investment approaches in developing markets.

PENSIONS FOR PURPOSE’S PERSPECTIVE

Investing in EMs presents significant challenges, ranging from governance issues to higher carbon intensity and negative investor perceptions, which often redirect focus to DMs. The complexities of EMs - such as inconsistent data, political instability and high perceived risk - demand rigorous due diligence, strategic communication and effective education. Incremental improvements and active engagement with EM companies enhance transparency and disclosure.

EM investments have the potential to drive economic development and social change, such as improving living standards. By adopting strategic approaches and fostering transparency, investors can unlock impact potential, contributing to long-term sustainable growth in these markets.



2.4 Sustainable themes

Asset owners view sustainable opportunities in EMs similarly to those in DMs. In our interviews, climate themes, particularly renewable energy, were prominent. Biodiversity issues, especially water and nature conservation, were frequently mentioned. Demographic changes, a growing population and other social aspects affecting EMs were highlighted. Additionally, technology, enhanced by demographic and social shifts, was considered significant.

Although there is consistency across sustainable

themes in emerging and developed nations, asset owners highlighted the dynamics and scale of opportunities differ due to demographic changes and social trends, leading to higher potential in EMs.

According to UN estimates, the world population will reach 9.7 billion by 2050, with most growth in Africa. In 2015, China and India accounted for 37% of the global population. Nigeria is expected to surpass the US by 2050. Among the current top 10 countries by population, the US is the only developed nation alongside emerging economies¹.

“As countries develop and the middle class grows, there is a noticeable trend towards increased demand for financial services. People begin to actively engage in managing their finances, including taking out insurance policies and planning for pensions. Investment managers can capitalise on this trend.”

ASSET OWNER

Fig 6 | Sustainable themes mentioned during the interviews





This new global landscape, marked by increasing populations in EMs and declining birth rates in developed nations, coupled with the emergence of net-zero targets and the transition to a green economy, sparks new imperatives across investments in EMs. Addressing social and environmental transformations while fostering sustainable economic growth in these regions is essential to enable them to achieve the status of developed nations without increasing their carbon emissions.

Promoting the green economy alongside socio-economic development is crucial to ensure EMs diverge from the historical English experience of rising inequality in the 19th century – followed by a decline in the early 20th century – due to the monopolisation of economic development. England is a classic example to typify the Kuznets curve – a hypothesis coined by Simon Kuznets in the 1950s arguing that economic development initially increases inequality, which later decreases as income distribution becomes wider – that may not apply universally to all economic development trajectories², but is already being seen in some countries in Latin America, such as Brazil and Colombia.

“A significant social consideration is modern slavery, particularly in EMs where many products are manufactured. We support the ‘Find it, Fix it, Prevent it’ initiative to combat modern slavery in supply chains. It is important to mention that exposure to EMs often comes indirectly through DM companies, like Apple, that operate in countries like China.”

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“We focus on investments in climate, nature and biodiversity, particularly in the energy transition. This includes all key players in the transition – renewable energy companies, solar power firms, EV manufacturers and battery producers. We invest in companies providing essential resources like metals and batteries. Even sectors like mining and energy we view as opportunities for active strong engagement and stewardship.”

ASSET OWNER

To avoid rising inequality, when implementing net-zero targets and the green transition in EMs, it is imperative social factors are considered. Asset owners are embracing different strategies to support this.

An asset owner mentioned how combining investments with socioeconomic initiatives in EMs is important to ensure long-term success and capitalise the potential of growing economies and demographics. They noted environmental issues are closely linked with social issues like gender inequality and education. Another asset owner drew attention to the need for investment in jobs associated with the transition to a green economy, particularly as fossil fuels still employ over 30 million people globally, with China, Russia and the United States having the highest numbers³.

Insight: Sustainable opportunities in EMs were viewed similarly to DMs, with climate, biodiversity, social aspects and technology themes at the fore. However, the scale of opportunities differs due to demographics and social changes in EMs. The global transition to net-zero targets and a green economy in EMs dictates the need for strategies that integrate social considerations to foster sustainable development and mitigate inequality. Combining investments with socioeconomic initiatives was another important point to ensure long-term success and maximise the potential of growing economies. Environmental issues were presented as closely linked to social issues such as gender inequality and education.

“We’ve funded vaccinations and supported gender diversity in EMs. ESG issues in these regions go beyond carbon emissions; they include transforming polluting energy sources into cleaner ones, leveraging water and solar power, and addressing broader societal needs. Empowering women, who make up 50% of the population, can also drive carbon change. The challenges in EMs are similar to those in DMs but on a larger scale.”

ASSET OWNER

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Investment advisers’ view

Independent advisers saw opportunities arising from demographic changes and development in EMs. They emphasised the need to enhance ethical practices, especially in environmental and labour standards. Technological advancements and higher educational levels in EMs have enabled these economies to diversify beyond manufacturing. New social trends, such as a growing and better-educated middle class, create market opportunities and increase demand for electricity. However, integrating net-zero targets into socioeconomic development is essential to ensure new consumption patterns do not exacerbate the environment further.

PENSIONS FOR PURPOSE’S PERSPECTIVE

Sustainable themes in EMs present an opportunity for pension funds aiming to align financial returns with positive environmental and social impact. Investments in renewable energy, sustainable agriculture and green infrastructure offer investors the chance to curb increases in carbon emissions which are otherwise inevitable as emerging economies develop. By directing capital towards companies and projects that prioritise environmental stewardship and ESG principles, pension funds can bring meaningful change while potentially receiving high returns from these growth opportunities. Furthermore, supporting sustainable initiatives in these regions can help address critical challenges such as high or increasing emissions, social inequality and job insecurity. Investing in sustainable themes mitigates risk associated with environmental and social issues and capitalises on the demand for responsible investment solutions, positioning pension funds at the forefront of a transformative shift towards a more sustainable and inclusive global economy.



2.5 Asset owners' approach to achieving net zero

Most pension funds we interviewed have set 2050 as their net-zero target. Although their approaches to achieving this goal vary widely, they all face similar challenges. Asset owners frequently mentioned the difficulty of accessing data in private markets to help achieve net-zero targets, a challenge even more pronounced in EM equities. As a result, several funds have either set targets exclusively for listed assets or are still in the early stages of implementing net-zero goals for private markets.

Defining a unified pathway for different countries and managing pooled and segregated funds also present significant challenges. For segregated funds, asset owners can directly instruct managers to set targets. Setting goals for EM debt, often managed in pooled funds, remains particularly challenging because of multiple clients with different objectives. One pension fund emphasised calculating direct and indirect emissions for net-zero targets can be detrimental to diversification.

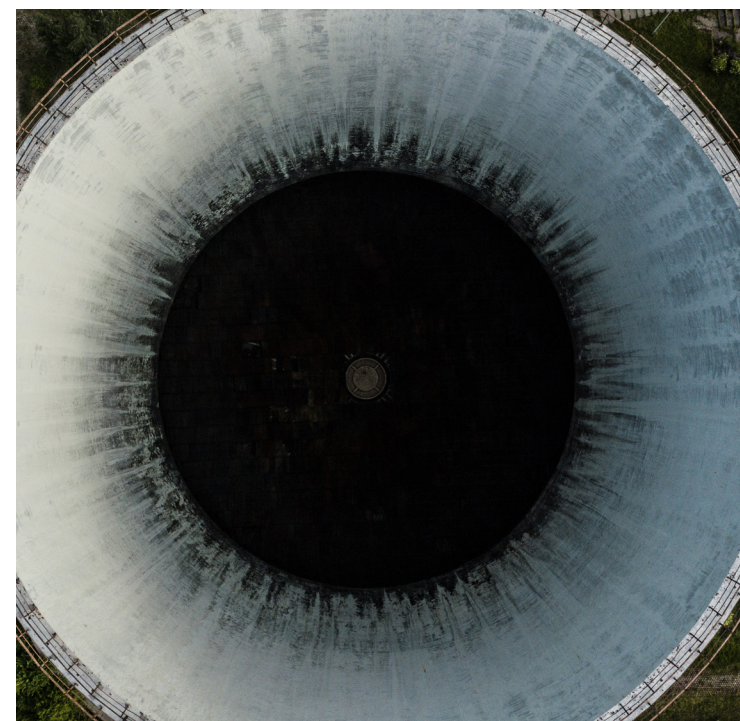
Although asset owners face similar challenges, their responses are different. We divided the approach taken by asset owners into: those setting up a portfolio-wide strategy, not differentiating across geographies or asset classes; those focusing their targets on public markets; and those focusing on DMs.

Portfolio-wide strategy

The industry is in the early stages of setting net-zero targets, but some asset owners have decided to set an overall target for their entire portfolio without distinguishing between asset classes and regions. This approach challenges them to improve over time. Although they acknowledge the difficulties

“Defining net zero is complex. Currently, for mastertrust assets, we have Scope 1 and Scope 2 decarbonisation targets, aiming for a 65% reduction from 2019 levels by 2030. However, this poses challenges because diversifying assets can conflict with rapidly achieving temperature alignment goals. Few companies align with the under 2 degrees target, making it difficult to balance portfolio diversity with climate goals. We currently use Scope 1, Scope 2 and temperature alignment metrics for the mastertrust. In the future, as data improves, we aim to incorporate targets for temperature alignment. Despite data limitations, setting targets is crucial for directing efforts, even if adjustments are needed along the way. We recognise the need for flexibility in evolving targets, allowing for adjustments based on new data.”

ASSET OWNER



“EMs need significant capital to decarbonise. As investors, we should ensure committees don't overlook these markets, as they are crucial for global decarbonisation. It's about decarbonising the planet, not just our portfolio.”

ASSET OWNER

in assessing data in private markets, they have been pushing their sources for increased disclosure.

Focus on public markets

Some pension funds have set the overall milestone of achieving net zero by 2050, expecting all portfolios to work towards that goal. They are addressing the challenge of limited data availability in private markets, which leads them to focus initially on public markets due to those constraints. They do not differentiate their targets between EMs and DMs, but they do adjust their approach based on different asset classes. Firstly, some asset owners adopt different approaches for various asset classes but emphasise that this is not DMs versus EMs, the net-zero commitment is across all public market equities. Other pension funds initially focused their net-zero plan on public markets, both equities and debt, and are expanding to private markets and real estate, with engagement efforts involving direct decarbonisation discussions and collaboration with credit managers on key emitters. Lastly, others established net-zero targets at a full-fund level but are currently excluding private markets investments as a result of data, measurement and reporting challenges.

One DC pension fund focuses their net-zero targets on their default funds while planning to extend them to individual asset classes, such as equities and corporate bonds, and eventually to individual managers. They observed that passive strategies can be more easily incorporated into these objectives compared to active strategies, which face the challenges of frequent portfolio changes. A second pension fund is transitioning to a custom benchmark solution aligned with their net-zero target. Initially, not all their investments have specific net-zero goals: infrastructure is an example where they expect emissions to reduce in time. Their default portfolio includes biodiversity-aligned equities and

green bonds to support broader net-zero transition pathways. Their strategy allows flexibility within individual asset classes to avoid overly restrictive constraints.

Focus on DMs

Some asset owners respond to the challenge of insufficient data in EM private markets by setting specific net-zero targets focused on DMs, while engaging with EM companies to improve data availability and quality, enabling them to set targets in the future.

Insight: 2050 was the most typical net-zero target set by pension funds we interviewed. Several pension funds faced similar challenges such as accessing data in the private markets, which is more pronounced in EM equities. As a result, some pension funds have set up net-zero targets exclusively for the public market or have just started implementing them for private markets. Even though these challenges are similar, strategies in response varied. Some asset owners decided to set a portfolio-wide strategy, across all asset classes and regions, challenging themselves to improve with time; other pension funds are distinguishing across asset classes; and a third group changes their approach across different geographies, allowing for targets to be set in the future.

“We have a 2050, net-zero target to aim for, but we’ve set interim goals for 2025 and 2030. We’ve included the whole portfolio without setting specific asset class or regional targets to challenge ourselves and learn. Some have chosen listed equities with net zero targets, which are easier to measure, but we didn’t want to ignore other assets. We’ve faced pushback from private markets due to data gaps, but many of their strategies already align with our goals. We’ve even challenged private market managers to provide more data.”

ASSET OWNER

PENSIONS FOR PURPOSE’S PERSPECTIVE

Setting portfolio-wide targets pressures companies to improve and promotes greater data transparency fostering long-term change. Tailoring net-zero strategies to different asset classes addresses data constraints and allows for flexibility. Engaging with EM companies to enhance data quality and availability is crucial for developing net-zero targets. This approach not only drives corporate accountability and allows for EM growth, but also ensures pension funds can sustainably manage their investments for contributing to global climate goals.



2.6 Carbon emissions and EM allocations

Asset owners agreed carbon emissions are higher in EMs compared to DMs. However, their opinions varied on whether this would affect their allocations. Several pension funds recognised carbon emissions are only one of the lenses which should be applied when assessing sustainable investment opportunities. Moreover, a minority of asset owners stated EM carbon emissions are an insignificant problem for their overall net-zero targets because their allocations to these regions are small. Still, they cautioned that, because allocating to EMs may increase the portfolio's carbon footprint, at least in the short term, it is important to be careful and transparent in communication with members, highlighting the long-term benefits and their engagement with EM companies to change this scenario.

Looking at how asset owners are reviewing EM carbon emissions, we identified four trends.

TRENDS: HOW ASSET OWNERS REVIEW CARBON EMISSIONS

1 | Looking beyond carbon metrics

Recognising carbon emissions are more intense in EMs, some asset owners prefer a holistic assessment, that goes beyond carbon metrics. They acknowledge the global economy must transition and cannot ignore EMs or simply exclude high emitters willing to evolve. These asset owners evaluate companies' transition plans in greater detail, considering efforts to decrease emissions in future, along with social factors and return strategies. Exclusions occur only if they do not see substantial reduction efforts. One asset owner highlighted they avoid 'greenwashing' by not merely cutting high-emission companies. Instead they base divestment decisions on investment and sustainability risks, prioritising trust in energy transitional plans over merely improving carbon metrics.

“A realistic approach is key. We consider what an economy needs for transition, even if it means short-term carbon spikes. We focus on hard-to-abate sectors and overall progress toward net zero rather than just single GHG metrics, which don't tell the full story.”

ASSET OWNER

2 | Tailoring EM transition pathways

Some pension funds prioritise understanding the EM transition pathway rather than comparing EM and DM emissions. Positive experiences with EM managers, where engagement has resulted in EM companies setting transition targets, were mentioned, although they recognise this is a long-term process. One asset owner alluded to historical industrialisation in DMs that produced high-emissions – it is unfair to demand EM countries with developing economies cut their CO₂ comparably. They should benefit from new technology and expertise developed in DMs to advance emissions reductions – politics has a part to play.

“DMs have already contributed heavily to emissions. It's unfair to demand EMs to cut their emissions to zero immediately. That's why countries like India and China have later targets beyond 2050. They can learn from our mistakes and adopt new technologies faster. For instance, housing in the UK is inefficient but EMs can build better homes using current technology. It's unfair to expect EMs to have the same targets as us but they can benefit from our experience.”

ASSET OWNER

3 | Challenges and concerns specific to asset class

Private debt and listed fixed income are asset classes that raise concerns. Pension funds mentioned them as major sources of their emissions due to the challenges in assessing ESG in these categories. A topic extensively debated at a *Pensions for Purpose* event, and cited by an asset owner in this research, is debt in financing fossil fuel expansion, which diminishes efforts taken on the equity side.

“We have concerns about the fixed income side as the ESG link is not strong there. On the equity side, we may have a portfolio with a significant ESG focus, helping us avoid some of the more polluting companies. This approach isn’t just about reducing CO₂ emissions; it’s also about managing risks that could affect the investment. However, a significant part of the fixed income market involves borrowing by oil, gas and other companies possibly excluded from our equity portfolio for various reasons. Despite this, they can still end up in our fixed income portfolio, which poses a challenge for maintaining consistent ESG standards across all investments.”

ASSET OWNER

4 | Carbon emissions support the case for an active approach in EMs

As well as the need for strong engagement and the establishment of tailored transition pathways, pension funds argue that the higher emissions and specific circumstances of each country (including different nationally determined contributions) make a stronger case for an active rather than passive engagement approach with EMs.

“The reason for an active approach is evident in EMs. For example, investing in cement manufacturers, major emitters, can be strategic. Our managers focus on companies leading in decarbonisation and partnering with market leaders in developed countries. This way, we expect these companies to improve more quickly. Although simpler investment opportunities exist, they carry higher climate risks. Our managers consider these factors when selecting investments.”

ASSET OWNER

5 | Incremental impact and brown to green strategy

Pension funds and asset owners may choose to allocate to companies committed to reducing carbon emissions, by investing in ‘brown to green’ strategies within EMs without hindering their net-zero targets. This approach is accompanied by close engagement, reporting and monitoring processes to minimise the governance risks.

“EMs tend to be higher carbon intensity generally as a portfolio. We had accepted this was going to be the case. We have set targets that are long enough to engage with those companies and try to get them down.”

ASSET OWNER

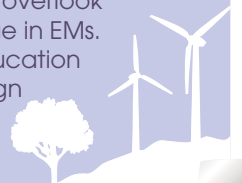
“Carbon emissions are a concern, but we want to invest in companies driving emissions down and be part of the change. Although some companies may currently be higher emitters, we believe in their potential for improvement. We monitor EMs closely.”

ASSET OWNER

Insight: Asset owners agreed CO₂ emissions are generally higher in EMs than DMs. Some asset owners favoured a holistic assessment, acknowledging they cannot ignore EMs or exclude progressive high emitters. Some pension funds focus on the transition pathways of EMs rather than comparing EM and DM emissions. Positive experiences where engagement led to the transitional targets were shared. Debt and fixed income investments are major emissions sources due to the challenges of accessing ESG-compliant options. Pension funds argue high emissions in EMs necessitate an active approach. For those wanting to allocate to EMs without compromising net-zero targets, investing in 'brown to green' strategies was seen as a viable alternative.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Investing in EMs presents unique challenges. Pension funds face a choice: prioritising real-world impact through transition investments, which may initially increase emissions but support long-term sustainable development, or focusing on reducing portfolio emissions to meet climate targets. Transition investments in EMs can drive significant environmental improvements and foster economic growth, but they come with higher initial carbon footprints. Conversely, concentrating on reducing portfolio emissions may limit exposure to higher emission sectors but could overlook opportunities for impactful change in EMs. Thoughtful consideration and education of these strategies is crucial to align both fiduciary duties and global climate objectives.





2.7 Local vs global impact

When we evaluated the perspectives we received on climate impact, opinions differed on whether local, UK-wide or global investments offer the best 'bang for your buck'. There was a balance between asset owners who see more potential within the UK and Europe compared to those who see more potential in EMs. A few pension funds argued they are 'geographically agnostic' as they prefer to keep their options open to a global mandate, seeking the best opportunities regardless of the region. Focusing on renewable energy, some asset owners see opportunities are more abundant in EMs, while others see a balance between opportunities in the UK and abroad.

Those funds prioritising local impact allocation justified it on two grounds. First, they see the need to allocate to place-based investments, considering their members are spread across the UK. However, due to the large number of infrastructure and landscape opportunities across the UK and Europe, they tend to hold a broader European allocation with a focus on the UK. Second, asset owners find more opportunities in UK private markets and real assets, mainly investing in wind and solar farms. Connected to the points previously discussed, when allocating to EMs, asset owners are more frequently allocating to listed assets rather than private markets.

“The opportunities are in the real asset space and the private market space. Real assets, both debt and equity, allow us to invest directly in assets such as wind farms and solar farms in the UK. We also have exposure to geothermal projects, particularly in parts of Europe. From a private market perspective, we are investing in US, UK and European companies providing the essential components for the decarbonisation value chain, which is profitable and necessary, offering decent margins and making them good investment opportunities.”

ASSET OWNER

One asset owner's overarching concern remains the risk-adjusted return on investment, given investments in EMs are promising for carbon reduction but must not compromise the fiduciary duty. Careful consideration is needed when looking at climate impact investments.

“We need to make a risk-adjusted return – what's competitive, best for pensioners. While investing in green assets in EMs is fabulous, we're not going to prioritise investments where it is cheaper to reduce tonnes of carbon at the expense of return or taking additional risk. We need to pay attention to 8 million people (which means our) first priority is risk-adjusted return.”

ASSET OWNER

Global climate impact

When discussing areas with the highest impact potential, EMs were a focus. One asset owner described this as a widely-held perspective, with opportunities in wind and solar power in EMs being promising. Specifically, China, India and Brazil were pointed to due to their sheer scale of emissions and development occurring within these regions. China was also noted for its significant coal plants and power stations, offering substantial engagement opportunities from an impact perspective to reduce carbon emissions. Geothermal projects were also presented as a point for impact, particularly within parts of Europe.

“China and Indonesia continue to build coal power plants, making them high-impact targets for engagement. Focusing on these EM economies could be a key pressure point. In contrast, the UK is in a relatively strong position compared to China. Given the sheer scale and development expected in China, India and Brazil, efforts in these countries could yield significant benefits in terms of climate risk reduction.”

ASSET OWNER

Global themes

Asset owners identified several global themes with substantial impact potential including healthcare, education, climate, nature loss and water. The relevance of these themes varies by country, reflecting how diverse local needs and opportunities require local knowledge.

“I’m talking with other people in these emerging economies. If we’re not investing there, we’re missing out on returns. So you really do have to take the time to assess that because, if you don’t look at these markets, you’re missing out.”

ASSET OWNER

Even though EMs were commonly referred to as the ‘biggest bang for your buck’ on impact criteria, there are many challenges from the investment side due to risk when considering projects in the private market, which may lead managers to shy away from these regions. However, one asset owner emphasised the need to consider growing economies to avoid missing out on future returns. They accentuated the importance of taking time to assess these markets.

Geographically agnostic perspectives

One asset owner emphasised their ‘geographically agnostic’ investment approach, referring to their use of global mandates and discretion to grant their investment managers the ability to explore opportunities worldwide.

This sentiment was also echoed by an asset owner who stated that their active equity impact managers invest globally, focusing on substantial themes and tailoring their investments to make significant impact in each region. Instead of prioritising specific geographies, they utilise global mandates following good impact opportunities wherever they arise.

“We’d like to think that we’re geographically agnostic. We have exclusively global mandates and, therefore, we’re happy to give our investment managers the discretion to go to any geography; they have found good opportunities in the UK and good opportunities outside of the UK.”

ASSET OWNER

“We tend to use global funds when we are thinking about impact, we have active equity impact managers that invest globally. There are some big global themes such as healthcare, education, climate, nature loss and water but it is different for different countries, the relative importance and what is going to make the biggest impact is what matters.”

ASSET OWNER

Local UK climate impact remains a high priority

Asset owners emphasised the many opportunities in the UK, particularly in renewable energy. The electrification of the UK opens plenty of local opportunities in energy efficiency and improving the energy performance of properties with difficult energy performance certificate (EPC) ratings.

Opportunities in the property sector, such as retrofitting existing buildings to meet higher energy standards and collaborating with tenants on decarbonisation initiatives, were also presented as having high impact locally. These measures reduce carbon footprints and lower energy costs, providing immediate financial benefits to residents and businesses. When considering local investments in affordable housing, one asset owner explained how these investments need to be balanced with the return's fiduciary duty, as there may be better opportunities elsewhere in the UK, than in their local area.

Investments in real assets, such as wind farms and solar farms, were mentioned as particularly promising by one asset owner. These local investments, whether through debt or equity, enable direct involvement in renewable energy projects. Supporting local renewable energy infrastructure could create jobs, stimulate local economies and enhance energy security. Moreover, localised investments in energy transition projects can lead to more resilient and sustainable communities.

Balancing local and global climate impact investments

The decision to prioritise local versus global climate impact investments require a nuanced understanding of various factors, including risk-adjusted returns, the abundance of renewable

energy opportunities and specific climate goals. While EMs present significant potential for high-impact investments in renewable energy projects like wind and solar power, they also carry higher risks that necessitate careful assessment. Conversely, the UK offers opportunities in electrification, energy efficiency and renewable energy infrastructure, contributing to local economic resilience and broader climate goals. Ultimately, the choice between local and global investment should balance the impact potential with prudent risk management, ensuring the pursuit of carbon reduction and sustainability does not compromise financial returns.

“In terms of the local and place-based discussion, we’ve got 1.5 million members spread out across the UK. We don’t have a specific need to invest locally but we do need to invest in the UK. So our infrastructure is going to be heavily UK-based.”

ASSET OWNER



Insight: There was a balance between asset owners, with some seeing more potential locally and others favouring opportunities in EMs. Additionally, a few 'geographically agnostic' pension funds seek the best opportunity regardless of region. Concerns were raised about the effectiveness of local investments, compared to EMs. One asset owner emphasised risk-adjusted return was the primary consideration. EMs were a key focus area, with China, India and Brazil highlighted due to their significant emissions and development, making them important areas when discussing global climate impact. Themes like healthcare, education, climate, nature loss and water were prominently mentioned. Renewable energy and the property sector were noted as having a high-local impact. Those prioritising impact allocation gave two reasons: the need to hold place-based allocations and the discovery of more opportunities in the local private market and real assets.

PENSIONS FOR PURPOSE'S PERSPECTIVE

Adopting a strategic approach, that balances local, EM and opportunistic investments can optimise opportunities while mitigating risks from regional economic fluctuations. Considerations include comparing the effectiveness of local versus EM investments, with a strong focus on achieving risk-adjusted returns. Locally, there is a growing commitment to impact allocations, driven by the need for place-based investments and increasing opportunities in private markets and real assets. Sectors like renewable energy and property are highlighted for their potential to generate significant community development and infrastructure growth. Globally, climate impact often focuses on significant emitters such as China, India and Brazil. These countries are undergoing large-scale development, where stewardship is important to manage emissions growth while supporting economic advancement.



Investment advisers' view

Overall, independent advisers took a more holistic view. While incremental improvements at the local level are crucial, global issues like India burning crops, Brazil destroying rainforests and China building coal-fired power stations can overshadow these efforts. Addressing this challenge requires education and consideration of the consequences of individual decisions, which collectively build up to significant impacts. Long-standing environmental

concerns show many countries have merely outsourced their environmental problems. Effective change needs collaborative global diplomacy, engaging governments and companies in EMs to shift their policies.

Despite all nations striving for net-zero emissions, their ability to achieve this goal varies significantly, making strategic investment and engagement essential. Disengaging from countries with poor

environmental records, like China, can lead to a loss of influence and the ability to drive change from within. By supporting EMs and lagging countries, investors can accelerate transitions, learn from global best practices and contribute to a unified global effort to reduce carbon emissions. This inclusive approach empowers investors to shape policy and foster a worldwide movement towards sustainability.



③ Impact & fiduciary responsibilities

3 Impact & fiduciary responsibilities

Asset owners had three views on impact and fiduciary duty: a strict focus on performance, a long-term investment view with a willingness to accept fluctuations for future gains, and a holistic approach that integrates fiduciary responsibilities with climate and net-zero targets

THREE MAIN ANGLES ON FIDUCIARY DUTY

1 Fiduciary duty and investment performance at the forefront

This view emphasised financial return and performance are paramount, as securing returns for members is essential. Asset owners aim to integrate sustainability considerations, but their primary focus is on generating robust returns for members. Although sustainability is crucial, it should not come at the expense of financial performance.

One asset owner noted the general acceptance that sacrificing returns to achieve ESG targets is undesirable. They actively seek ESG and impact investments, but only with a strong return profile, focusing on balancing financial performance with sustainability responsibilities. Another asset owner identified themselves as a 'relative value investor', making fiduciary duty of performance their top priority, not to be compromised.

2 Long-term investment considerations

Some asset owners adopted a long-term investment perspective, accepting tracking errors and performance fluctuations to achieve long-term benefits. One pension fund noted they take an 80-year horizon, accepting lower short-term returns by investing in initiatives like the energy transition. This longer-term strategy aligns with their fiduciary duty, especially considering the potential for damage to the global economy from unmitigated climate change. Accepting these fluctuations was seen as an acceptable element of the longer-term benefits and the wider view of the world, allowing future generations to be supported.

Fiduciary duty was frequently linked to climate risk and net-zero targets. Some interviewees view it from financial and non-financial perspectives, recognising members' retirement depends on financial security and the state of the world they retire into. One asset owner explained fiduciary duty involves delivering more than financial outcomes, and it should contribute to the health of the planet for members and future generations. Another fund provided an example of economic tensions, presenting the importance of understanding short-term performance downturns within a holistic global picture.

3 Holistic views of fiduciary duty integrating sustainability

A holistic view of investments, which considers financial and sustainability performance, was adopted by some asset owners. While performance is always important, it is not the only driver. Sustainable equity portfolios, especially those with lower emissions compared to the benchmarks, were noted as having underperformed, particularly in the UK over the last 24 months. One asset owner took the view that, even though performance is their focus, they consider sustainability a necessary investment risk that needs to be taken into account.

Another asset owner highlighted climate change as a significant concern but made it clear they would not sacrifice returns to achieve better ESG outcomes. Instead, they grant broad discretionary mandates to investment managers, working with them to set targets for either limiting greenhouse gas emissions or by allocating to sustainable and impact investments in the private markets. They collaborate with the investment manager to determine what can be achieved without compromising the established investment return targets.

There was some diversity in the interpretation of fiduciary duty, *as can be seen from the views on the previous page*. An overall agreement was that asset owners' primary duty was to members, but some pension funds expanded the traditional understanding of fiduciary duty to include their commitment to sustainability. Asset owners indicated a willingness to accept underperformance in the short-term, to generate long-term impactful outcomes.

Managing risks and fiduciary responsibilities

Our interviewees highlighted the importance of ESG risk considerations. Strong frameworks and governance were emphasised as tools to ensure members are not exposed to significant risks. A combination of effective risk monitoring teams and managers assessing return ratios were presented as crucial for balancing fiduciary responsibilities with ESG principles.

One asset owner mentioned fossil fuel companies have outperformed over the last 18 months, due to the energy crisis triggered by the Russian invasion, regarded as a short-term issue. In contrast, renewables have underperformed but they are seen as a long-term investment. Asset managers must make assessments based on these risks; their engagement strategies are crucial in addressing these challenges.

Stewardship and engagement

Investing in strategies with less exclusions can be beneficial for engagement purposes. This approach supports real-world decarbonisation and fosters long-term improvements in ESG performance. Through stewardship, investors can influence companies to adopt better practices, making these investments an essential part of broader sustainability efforts.

LONG-TERM VIEW

“Fortunately, we have an open trustee board with values beyond performance. They expect some tracking error and understand we may underperform or outperform in different years. Our priority is investing responsibly for our beneficiaries and the planet, ensuring a sustainable future. Despite varied interpretations, our stance is clear: we accept fluctuations for long-term benefits.”

ASSET OWNER

HOLISTIC VIEW

“We still believe in the primacy of the fiduciary duty but I suppose you could see a conflict there. We believe climate change is a significant risk, so we will then challenge our managers by asking how confident they are that investee companies have taken climate risk as part of their investment risks.”

ASSET OWNER

“Asset owners are in a position where they can take a wider view of the world, not just for us, but for our children and our children’s children. Looking after the world is vitally important for them as much as it is for ourselves.”

INVESTMENT ADVISER

“Our portfolios are underweight in fossil fuel companies and that has impacted our performance versus the benchmarks since the Ukraine invasion. Our committee understands that, and we are happy to wear that because we see it as a long-term fiduciary duty to invest into climate mitigation and combatting climate change”

ASSET OWNER

“If there are less sustainability-friendly options, we won’t disregard them. Instead, we will endeavour to integrate ESG practices into those investments as much as possible. This approach becomes our way of real-world decarbonisation as we progress. Many so-called ‘brown’ or transition investments require not only capital but also stewardship. We see this as an opportunity. So, from our perspective, it’s not black or white.”

ASSET OWNER

Investment advisers’ view

Investment advisers emphasised fiduciary duty entails making responsible and prudent financial decisions for clients, while recognising broader obligations. Beyond supporting pensions, it is imperative to understand the importance of impact investing. Recent years have shown the financial robustness of pension funds and other institutional investors, including LGPS. This strong performance has enabled them to integrate ESG factors into investment strategies. This approach can have positive implications for future generations beyond pensions benefits.

Insight: Asset owners views were divided into three perspectives:

1 Fiduciary duty of performance (the most important factor for many).

2 Long-term investment views, accepting fluctuation of performance to see long-term benefits for future generations.

3 A holistic stance combining the fiduciary responsibilities of performance and climate and net-zero targets. Stewardship, risk management and engagement were presented as important. Investing in less sustainable opportunities is an option to support decarbonisation and foster long-term improvements in ESG performance. Independent advisers highlighted ensuring prudent financial decisions for clients and recognising broader obligations should be responsibilities of pension funds.

PENSIONS FOR PURPOSE’S PERSPECTIVE

Broad and effective stewardship, with a focus on credible transitions, can drive transformative change by improving unsustainable practices. By accepting fluctuations in performance over long-term investments, investors can create benefits for current and future generations. Embracing a long-term perspective proves a more stable investment environment, aligning financial goals with environmental responsibility. This approach supports the transition to a low-carbon economy while fulfilling fiduciary duties.





4 Literature review



Literature review

Emerging economies saw significant growth from the 1960s to 2000s but declined in the 2010s due to reduced demand and fiscal tightening. Despite recent underperformance, some sectors and countries in these markets have excelled, although challenges like liquidity and ESG concerns remain

The contribution of emerging economies to the world's GDP increased from a mere 17% in the 1960s to almost 40% in the late 2000s, sparking significant attention from international investors¹. This exponential growth was largely driven by favourable external conditions, like the commodity supercycle, an expansion in global trade and low-interest rates in developed economies. However, this prosperous environment experienced a downturn in the 2010s, with 80% of EMs seeing reduced growth. This decline was mainly due to decreased external demand, particularly from China, and the conclusion of fiscal stimulus measures promoted to control the effects of the 2008 financial crisis¹.

There have been three major events in the last decade which have significantly impacted emerging economies but are unlikely to be repeated²:

- The initial public offerings (IPOs) of Chinese equities, which were added to the EM index at peak valuations but then fell sharply.

- The IT sector in EMs has consistently outperformed the same sector in DMs over the past two decades. However, recent economic cycles have not benefited the financial, energy and materials sectors. These divisions make up almost half of the EM index.

- The opportunity cost of investing in EMs has been exceptionally high due to strong US performance and a robust US dollar.

A comparison between the performance of the MSCI Emerging Markets Index and the MSCI World Index reveals significant changes from the 2010s onwards. Over the last decade, the MSCI Emerging Markets Index delivered returns of 2.96% pa, significantly lower than the 7.56% pa net return seen at the beginning of the millennium. In contrast, the MSCI World Index, which focuses on DMs, achieved higher returns over the last decade of 8.87% pa, but lower returns of 6.30% pa since 2000³.

EMs are a heterogeneous group and individual performance has varied greatly over the last 10 years. Taking the largest constituents of the index: China, India, Taiwan, South Korea and Brazil, which collectively represent nearly 80%, – over the period, significant discrepancies were observed, as they respectively exhibited gross returns of 2.31%, 13.88%, 13.12%, 3.23% and 0.99% pa.^{4, 5, 6, 7, 8} This accentuates the problem of relying on benchmarks when allocating to emerging economies – EM indices fail to capture the diverse geographies, sectors and economic characteristics across emerging nations.

Analysis shows half the 100 top-performing companies in the last decade, excluding those from the US, were EM-based.⁹ Historically, EM equities outperformed European equities by 64% between 2002 and 2021. Many of the asset owners we interviewed, who invest in EMs raised how global investors often misunderstand local economies and these misconceptions can lead to unwarranted fear of the region.



Looking at specific asset classes, despite recent downturns, EM fixed income investments have outperformed their DM peers over the past two decades. For EM sovereign bonds, strong yields have led to positive long-term returns, although currency fluctuations have affected short-term performance. Investors should factor in currency rates and economic cycles when deciding how to invest in these assets effectively².

The gap between investor perception and reality is widening, which is also due to discrepancies in the quantity and quality of the disclosure and data available from developed and emerging economies. Our findings align with previous research, showing many asset owners and managers prioritise on-the-ground research and primary information over benchmark performance. While this approach accrues higher costs through establishing dedicated EM teams, it helps investors overcome the disadvantage of little available ESG data and insider information. Managers often view these investments as beneficial, given they help rebalance information asymmetries and provide a competitive advantage.¹⁰

For pension funds, allocating to emerging economies can be a challenge due to the need for extended track records and specific liquidity requirements. Defined contribution (DC) schemes typically have lower exposure to EMs compared with their defined benefit (DB) scheme counterparts because EMs are less liquid markets which presents challenges to DC schemes because of their liquidity constraints. Additionally, reputational risks, concerns over ESG and net-zero targets further limit larger allocations to emerging economies. Although pension funds are interested in learning more about EMs, the high start-up costs relative to low allocations can make it difficult to justify and sustain this investment case.¹⁰

ESG scoring systems can be detrimental to EMs. Relying merely on ESG screening could lead to divesting from, or not investing in, countries with great potential but strong ESG needs, which are crucial to the Paris Agreement. Instead of excluding emerging nations completely, some investors adopt an additionality approach, focused on improving ESG performance. A *Financial Times* article

reported the social issues arising from many women losing their jobs and income after a multinational corporation cancelled contracts with Cambodian suppliers due to accusations of underage labour.¹¹ The article suggests improving conditions is a more effective strategy than severing partnerships, especially when promoting real-world impact.

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5 Best practice

Examples of best practice

After analysing the experiences of 18 pension funds and two independent advisers, we identified best practice for impact investing in emerging markets

THE MAIN RECOMMENDATIONS

1 | Industry initiatives

Participating in corporate ventures like the *Net-Zero Asset Owner Alliance* and the *Net-Zero Investment Framework*, were mentioned by our interviewees:

- Net-Zero Asset Owner Alliance: a UN-convened initiative led by institutional investors committed to transition their portfolios by 2050.
- Net-Zero Investment Framework: part of an initiative to support investors with Paris-alignment goals, the framework has been adopted by over 180 investors around the globe to develop net-zero strategies and transition plans.

“We are a signatory of the Net-Zero Alliance, committing to achieve net zero by 2050 with specific milestones. By 2025, we aim to reduce carbon intensity in our corporate bonds portfolio, equities and real estate. By 2030, we aim to halve emissions intensity across our broader portfolio where we have influence and control, relative to a 2019 baseline.”

ASSET OWNER

2 | Evidence-based approach

Using evidence-based methods and trusted local partners for due diligence reassures committee members about real risks in EM investments, instead of being misled by perceived risks.

“In the past, it was important to have an educated committee on perceived vs real risks in EMs. A quick Google search often highlights negatives, so we use sources like the *World Bank* to provide factual information. Our evidence-based approach reassures our committee. As they can't visit sites abroad like they can in the UK, we rely on trusted local partners for due diligence. Although investing in EMs demands extra effort, the additional impact we achieve is profound, a source of pride for our members and committee.”

ASSET OWNER

3 | Consent

Pre-free and prior and informed consent is centred around gaining consent from Indigenous Peoples for anything undertaken on their respective land, including investments concerning their land.¹ This consent can foster community trust, maintain ethical practices and enhance project sustainability by incorporating local knowledge.

“We probably have to do a bit more (due diligence), and it always varies depending on the asset class and strategies you're looking at, which can differ from country to country. In emerging markets, pre-free and prior informed consent is something we do additionally. This serves as an additional check, along with assessing the security of the country and its corruption rating according to recognised organisations.”

ASSET OWNER

4 | A jurisdiction-specific approach

While DMs generally have comparable governance structures, maintaining a consistent ESG approach is crucial. It is equally essential to allow for bespoke analysis, considering the specific challenges and risks unique to each EM market and sector.

“While governance is generally better in DMs compared to EMs, some countries like Chile have governance structures similar to developed economies. We focus on bespoke considerations for each jurisdiction, with our approach to ESG remaining consistent. For example, in a China mandate, we discussed ESG integration with the manager, emphasising human rights and modern slavery in supply chains. Although the overall approach is the same, DMs require less scrutiny whereas, in EMs, governance, social factors and environmental concerns are more deeply examined. Each EM’s transition trajectory is unique, requiring a tailored ESG approach considering growth, energy security, affordability and the move towards net zero.”

ASSET OWNER

5 | Navigating imperfect data

Data is important for decision making in EMs. Its absence should spur more engagement to advocate for better reporting, not lead to inaction. Throughout the interviews, we heard positive experiences from asset managers, who embraced this approach.

“We accept we can’t obtain perfect data, but we understand the direction in which we want to move. Perfect data helps make more precise decisions but, ultimately, it shouldn’t be an excuse for inaction. Experience shows if data requirements aren’t met from the outset, obtaining it later, even from excellent impact managers, is challenging. As we learn from previous investments, our impact reporting demands have increased. We include specific data requirements in our documents to ensure compliance. This is challenging for consultants, especially those new to the industry, with limited benchmarks for comparison, increasing the perceived risk. While EMs aren’t to blame for these difficulties, our fiduciary duty compels us to ensure our assets deliver positive returns.”

ASSET OWNER



6 | Impact and fiduciary duty

It is important for pension funds to adopt a long-term holistic view, which not only secures financial returns for pensioners, but also ensures sustainable practices that benefit future generations and the planet.

“(Pension funds) have much better room for manoeuvre now to ensure that, while they are achieving the required returns, they keep their actuaries happy. They are also in a position where they can take a wider view of the world, not just for us, but for our children and our children’s children, going forwards, because paying pensions is one thing but, ultimately, we’re also going to need them (for global conservation). To support our pensions into the future, looking after the world for future generations is as vitally important as it is for ourselves.”

INVESTMENT ADVISER

7 | ‘Brown to green’ strategies

Brown-to-green’ strategies actively work toward long-term decarbonisation in high-emission areas, such as EMs. They emphasise the importance of not only maintaining a green portfolio but also supporting the transition to a greener economy.”

“There is more carbon in EMs, yes, but it depends how you define your net-zero objectives. If you want to decarbonise the portfolio, then EM carbon emissions are going to be a problem. If you want to invest in intelligent carbon that is decarbonising, then your carbon budget is not necessarily a problem. One of our largest emitters in the portfolio is in India but it is a brown to green strategy. It is about reducing its emissions progressively.”

ASSET OWNER

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⑥ Ninety One's view on the research



Ninety One's view on the research

Emerging markets intertwine with our everyday lives in the UK. Over one-third of the UK's imports, like the chips in our phones (Taiwan, Korea), clothing (India, Turkey), coffee (Brazil, Colombia) or fruit (South Africa, Costa Rica), come from EMs. Over the last two decades, EMs have driven the bulk of global growth; they account for 85% of the global population and 58% of the world's global domestic product (GDP). However, an abiding perception of risk has held back allocation decisions for many investors.

For several years, EMs have learned from mistakes and worked to mitigate external vulnerabilities. They have improved institutional frameworks. At the corporate level, a push for higher operating performance and governance standards has helped propel several EM companies to be global leaders in their industries. The opportunity set in emerging countries is vast. We have also seen successful EMs

emerge: Japan in 1987, Singapore in 1994, Portugal in 1997 and Korea in 2009.

At *Ninety One*, we believe our EM origins help provide a different perspective. We aim to be the partner of choice for asset owners investing in EMs. Our investment teams have developed a range of core and innovative EM solutions covering equities, fixed income, global and regional allocations, and solutions in public and private markets. We strongly advocate for a fair and just energy transition for EMs. In 2024, supported by prominent UK investors, we launched Emerging Market Transition Debt, which aims to generate commercial returns while financing climate solutions and transition plans that can decarbonise the real economy.

The value of investments, and any income generated from them, can fall as well as rise.

Pensions for Purpose disclaimer

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Conclusion

What have we learned from the research?

When we began the interview phase of this research, we often received replies from asset owners refusing our interview invitation, either because they were not allocating to EMs or they were divesting from these economies. Consequently, the early finding we drew from our study, was that UK asset owners are not yet broadly considering developing economies for their allocations, even less so for impact allocations. However, the qualitative aspect of our research challenged this view. The UK asset owners interviewed recognised the investment opportunities in these economies, driven by social and demographic changes, as well as potential for meaningful real-world impact. What is preventing more allocation to EMs?

Challenges

The first challenge we identified is that applying a DM investment approach to EMs is ineffective. As one asset owner noted, it is not possible to lump different emerging economies together as can be done more easily with European and North American nations. Additionally, UK asset owners are not as familiar with EMs' political dynamics as they are with those of DMs.

Relying solely on EM benchmark performance for investment decisions provides a limited view of these economies. EM benchmarks are dominated by five countries, primarily in Asia, and EM regions have shown diverse performance over the last decade. While geopolitical concerns are prevalent among pension funds, treating all EMs as a single entity prevents the recognition EM regions face varying levels and types of risk, presenting unique challenges and opportunities.

Asset owners prefer to use an active management style in EMs due to the need for local knowledge to

mitigate risk, although cost constraints led some to adopt passive strategies. It was interesting to note pension funds currently applying an active approach to EMs have a more optimistic view about the future performance of their investments, and do not exhibit insecurity towards uncertainty and volatility. Strong engagement with investees is seen as mitigating risks raised by the lack of long track records, for instance. These pension funds also demonstrate a more tailored approach when responding to the specific challenges of EMs – for example, around data availability – which includes setting up clear disclosure expectations and implementing free prior consent to establish a positive relationship with local communities. Having said this, active investors highlighted they had to go through a journey, learning from mistakes to get to this point.

EM investment insights

After overcoming the 'DM investment lens' challenge, a special look needs to be directed towards impact investing in EMs. As we explored throughout the research, UK asset owners are incorporating an ESG approach into EMs investments mainly as a strategy to mitigate risks, focusing on governance and human rights issues – but less with the lens of intentionality. In DMs, on the contrary, there is a greater emphasis on environmental aspects, since it is believed that governance issues are not as significant as they are in EMs – yet the financial crisis showed that governance issues can still be prevalent in DMs. EMs can learn from the experiences of DMs, and the reverse is also true. For instance, EM countries are addressing issues like corruption to improve investors' perceptions.

While net-zero and ESG considerations in investments have been recurring topics in recent years, there is still further to go. During *Pensions for Purpose's*

all-member events and discussions, asset owners often report challenges when understanding and implementing ESG/Impact frameworks. Some funds choose to adopt elements of the frameworks in the early stages, while others adapt them to their specific needs and strategies. Allocating to EMs adds an extra layer to this challenge, but it is also a journey of discovery that evolves as pension funds move on from their first steps. For the world to combat climate change, it is crucial not to overlook these economies and to ensure a fair transition. Achieving the Paris Agreement goals will be impossible if only developed economies meet their targets.

Although experiences of global warming vary in speed and intensity, its aftermath is already impacting us all. Ensuring a fair transition for EMs is not just about environmental equity but also about securing generational fairness for young UK members. By supporting EMs in their shift towards sustainable practices, we not only mitigate global climate risks but also lay the foundation for a more equitable future where young generations can thrive in a world that values sustainability and inclusivity.


The fact remains: to achieve real-world impact in climate action and address social challenges globally, pension fund investors cannot ignore or avoid EMs simply because they demand greater due diligence. As some of our examples show, opportunities in EMs can offer strong returns and significantly contribute to addressing global challenges. We need to take the time to understand these opportunities, develop ways to mitigate and control the specific risks they present, and ultimately discuss whether they should increasingly play a role in an impactful pension fund investment strategy.



Appendix

Participants who gave permission to be named

Asset owners	Investment advisers
Aon MasterTrust	Anthony Fletcher
Cambridgeshire & Northamptonshire LGPS	Philip Hebson
Caisse de dépôt et placement du Québec (CDPQ)	
East Riding Pension Fund	
Environment Agency Pension Fund	
Hampshire Pension Fund	
Kent Pension Fund	
Legal & General	
Legal & General Master Trust	
LGPS Central	
Nest Pensions	
Northern LGPS	
North Yorkshire Pension Fund	
Oxfordshire County Council Pension Fund	
Railpen	
The Phoenix Group	
Tyne and Wear Pension Fund	



Asset owner questionnaire

The asset class decision

- 1 | In which EM asset classes do you currently invest: equities, fixed income, private markets?
- 2 | Do you prefer active or passive allocations when investing in EMs?
- 3 | What is your long-term view of risk and returns in EMs vs DMs?
- 4 | What factors influence your investment decision-making when evaluating opportunities in EMs?

The sustainability decision

- 5 | Does your approach to sustainability or ESG differ when you invest in EMs compared to DMs?
- 6 | Do you apply exclusion policies? If so, do you apply the same exclusion policies to DMs and EMs?
- 7 | In your opinion, what are the primary barriers in accessing sustainable/impact opportunities in EMs?
- 8 | Which main sustainable themes do you view as investment opportunities? Are there any specific topics in EMs you are focused on?
- 9 | Could you explain your organisation's approach to achieving your net-zero targets, particularly whether it is set at a portfolio-wide level or if different targets are applied to specific classes or allocations?
- 10 | How have your EM allocations been reviewed since setting your net-zero target? Have there been any resultant changes and, if so, what are they?
- 11 | Are carbon emissions a concern or hurdle to EM allocations from a sustainability perspective? Can you give examples of other asset classes which have similar problems?
- 12 | How do you think about climate impact locally (ie within your local UK area) vs globally? Where do you see the most 'bang for your buck' in terms of impact and why?

Funding and performance

- 13 | How is your organisation managing the fiduciary responsibilities of performance vs climate and net-zero targets?



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