Strategies to achieve real world decarbonisation with the Investor Leadership Network
Baringa's Climate Change & Sustainability Trailblazers Podcast

Emily Farrimond [00:00:01] Welcome to our Climate and Sustainability Trailblazers podcast with me, Emily Farrimond. Today, I'm delighted to be joined by a number of the Investor Leadership Network or ILN members. For anyone not aware of the ILN. They're a group of 14 open and collaborative asset managers and owners interested in addressing both sustainability challenges whilst considering the importance of long term growth. So without further ado, let me introduce you and I am delighted to be joined by Richard Manley, Chief Sustainability Officer and Head of Sustainable Investing from CPP, Nathalie Wallace, Global Head of Sustainable Investment from Natixis Investment Managers and Charly Bastard, Advisor on Climate Issues and Sustainable Investments from CDPQ. Under the ILN banner, you've just published your most recent white paper titled 'Investing for the low carbon transition: turning portfolio targets into action'. What I personally found really interesting about this white paper is the way you've all generously shared practical experiences around decarbonisation in the form of case studies. These case studies are focussed on how your businesses are understanding the climate risks in your portfolios and supporting decarbonisation. Welcome to each of you and thank you for joining us. I wanted to start by learning a bit more about you. Could I ask you to introduce yourselves and tell us a little bit about your personal and professional interests in climate and sustainability. And Richard, could I ask you to kick us off?

Richard Manley [00:01:33] Thank you, Emily. Yeah, so as you said, I'm Chief Sustainability Officer at CPP Investments. My journey to sustainability started as an oil and gas equity analyst, so I was effectively recommending buying and selling the shares of oil and gas companies to institutional investors. Until I was asked by a gentleman called Kofi Annan whether good companies did better? And this prompted a piece of research that basically worked out that the oil and gas industry, as we knew it in the eighties and nineties, had moved beyond the provision of engineering solutions and cheap capital to really working as a partner to help develop nation states and their scarce hydrocarbon resources. Those that were engaging proactively in effectively countering bribery and corruption, those who are proactively engaging in health and safety, reducing environmental impact, reducing flaring and helping develop the nation was simply winning more of the world's hydrocarbon resource opportunities. Seems strange to say that today that your journey into sustainability began with the oil and gas sector, but what we concluded was even a sector that is viewed as challenging as we move into the climate debate today, were starting to differentiate itself by taking a more enlightened approach to business and seeking to reduce, to the extent they could, the externalities associated with our operations. So subsequent to that, I spent the best part of a decade working in an investment bank, advising institutional investors on how to integrate sustainability into the investment process. After a while doing that, I thought it was time to stop talking about it and give it a go, and I've spent the last four years at CPP Investments hopefully being able to practice some of the advice I used to give to others previously.

Emily Farrimond [00:03:23] Thanks Richard for those really interesting insights. And what an exciting question to have been asked as to whether good companies do better. Interestingly at Baringa we've recently been exploring the 'Economics of Kindness' and whether being kind drives superior business performance. So thank you for sharing that. And Nathalie, over to you.

Nathalie Wallace [00:03:43] Thank you for having me and I appreciate very much Richard's approach. I'm actually also a retired portfolio manager. I started my career investing in emerging markets. I actually knew Beijing before the international boats and before it was polluted. And so I was firsthand exposed to the impact and the extra financial, as they like to call it, impact of allocating capital and fast economic development. My passion was really around economic development and to see how we could fast forward and increase again income for population as well as industrial development for long term growth. So what really struck me was the impact again of capital allocation on income inequality as well as environmental damage. And thus it came to bear that we really needed to understand again, the negative and positive impact of finance in general. Last year, fast forward to Natixis, we invested into two or three companies to help us, one assess the impact of finance on environment through biodiversity - we invested into the data lab to help us develop the tools. And second, we invested into SunFunder, which is a company that really is active in Africa and soon in Asia, developing and deploying capital through blended finance with development banks to really accelerate and scale the deployment of renewable energy in emerging markets. So that's really critical for me, it’s the how. How we can deploy and scale capital through different asset classes, through infrastructure, through private equity, private debt, fixed income equity, as well as real estate, to make sure we again scale solutions towards more resilient assets and low carbon economies.

Emily Farrimond [00:06:12] Thank you again for sharing a little bit about your personal and professional interest in sustainability. And last but no means least, Charly, can I ask you to introduce yourself please?

Charly Bastard [00:06:23] Of course. Thank you. So, I’m Charly Bastard. I'm an advisor in ESG and energy transition at CDPQ. I've been with CDPQ for the past four years, and prior to joining CDPQ, I was a sustainability consultant at Deloitte. I'd say that my sustainability journey started when I was a student. Just like Nathalie, I wanted to basically do economic development, to lead to economic growth in the developing world and try to increase the access to care and better healthcare to different populations in those countries. And it's in studying economics that I developed a better understanding of the issues related to economic growth that does not take into consideration social and environmental aspects. And that's when I progressively nudged my career and my path towards sustainability and now, climate at CDPQ, where we work on basically having a very good understanding of the impact of climate risks on our portfolio companies, but also our overall portfolio and how we as a pension plan can support the transition to a low carbon economy to try and respect and align with the Paris Agreement, so that we can maintain a healthy ecosystem that can better support the people living in it.

Emily Farrimond [00:07:59] Wonderful. So thank you all for sharing that and great introductions from each of you there. Let me turn to the white paper and I have some questions specifically about your collective work at the ILN. Let me start with you, Richard and CPP. I'm really keen to understand your perspectives on who might be interested in reading the white paper and what are some of the key takeaways for those readers.

Richard Manley [00:08:23] I would hope that anybody who is engaged with how large institutional investors are shaping their investment strategy to support financing of emissions reduction in the real economy, how they're engaging with their portfolios and their portfolio companies to mitigate risks and identify opportunities, to deliver long term sustainable returns for their beneficiaries or their clients, will be interested to read these case studies. Having seen the report myself, I'd say, you know, the important takeaways here are the diversity of representation of the ILN membership. This is not just a specific type of investor from a specific jurisdiction. There are asset owners. There are asset managers from North America, from Europe, from Africa. So there is, I think, a good lens here on different kinds of institutions and their approaches. Notably, there's no single approach. There's nobody really advocating for a silver bullet, but all are committed to delivering long term risk adjusted returns for their beneficiaries and clients. All are committed to supporting financing emissions reductions in the real economy, all are committed to managing climate risks and capturing opportunities in their portfolios, and all are pursuing innovative approaches to doing this. They do identify some shared challenges, like the availability of data, uncertainty in a regulatory outlook, and I think it is fair to say that while addressing these would likely accelerate some of the progress, they're not stalling ambition or innovation. And I think the last point I would make to anybody thinking of picking this up is that whether this be forecasting future emissions and pathways, approaches that they're developing to setting short term and medium term targets, whether it's appraising the feasibility of portfolio companies transition plans, climate engagement with portfolio companies, transition financing or developing solutions for their institutional clients to manage climate risks, it's probably going to take some combination of all of these if the financial services sector is going to support the real economy and the ambition we all have for the middle of the century.

Emily Farrimond [00:10:45] Thank you. And it sounds like then there's plenty to read and absorb and possibly all of the approaches presented in the white paper to leverage the those looking for advice and guidance. Let me turn to Nathalie at Natixis. I mentioned earlier the paper is rich with case studies from ILN members, and I'm interested to know what you learnt from your peers and whether there were any surprises.

Nathalie Wallace [00:11:09] Yes, thank you for that question. There were a few surprises, I think. To give a bit of context, last year with the ILN, we produced the Net Zero Toolkit. What I would say was no surprise there, what we realised is the challenges we face. So we decided this year to actually continue to dig in and to provide even more case studies, even more examples, even more tool kit to understand the how, because we think it's really where we need to make more progress. And this progress is evident from, as Richard mentioned, the array of solutions and case studies and understanding we've seen. I think what we learn is, one, there is a strong commitment, right, that finance and financial services are necessary to accompany the real world towards transition, either through decarbonising solutions, either through engagement as Richard mentioned, or finding climate solutions and financing the transition wherever it is happening. What we've learned and the surprises is, again, the array. There's not one way of doing it. There are several ways. It is a combination of all of the above, as Richard mentioned, that is necessary. The combination is extremely important. It's not an either or. It's not you decarbonise or, it is you find a way to decarbonising but also engaging with your portfolio companies because again, it's the portfolio companies that are going to lower their carbon footprint. It's very hard without the portfolio companies doing that to decarbonise the portfolio, without impacting the risk adjusted return profile of your portfolio. So this is essential. What we've learned as well is it's not through one asset class, it’s across asset classes. And this is important because not all asset classes can be used to reach these commitments or reach the goals of each of our clients and the asset owners. And this is extremely, again, important so that we can construct overall portfolios that can reach two objectives, which is one the real economy decarbonisation, and two the long term performance that each of our client and our clients’ clients are expecting from financial service providers.

Emily Farrimond [00:13:56] Thank you. And then Charly at CDPQ. I'm interested to explore with you how you see this is an evolution of the previous ILN work, and then also it would be great to touch on what in your mind needs to come next.

Charly Bastard [00:14:11] Thank you Emily. Well, at a high level, the ILN's purpose in climate is to contribute to the transition to a low carbon economy. So in practice, we try to identify and anticipate the needs of the financial industry to facilitate the transition to a low carbon economy. That's why the ILN first started with guides on TCFD implementation at a time where TCFD reporting was nascent. Then a few other white papers on climate change mitigation in portfolios and climate change physical risks tool kit. Now the new white paper 'Investing for the low carbon transition: turning portfolio targets into action' is a natural next step. As the financial industry is increasing in overall climate maturity, we need to move beyond portfolio decarbonisation targets to find ways to actually decarbonise the real economy through investments. And that's what we're hoping to support with this report. Now, in terms of next steps, the next white paper 'Transition and the inheriting role of frameworks and taxonomies' touches on another very important aspect of the low carbon transition. Since we need reliable taxonomies to help identify what is a transitioning asset and what isn't. And we're hoping this will provide further guidance at a time where we see a lot of evolution in the realm of sustainability related taxonomies.

Emily Farrimond [00:15:45] Thanks, Charly. One of the components of the paper that stood out to me, as I've already mentioned, were the case studies. Richard, the paper profiled CPP's Abatement capacity framework. For our listeners who haven't read the paper yet, could you briefly describe that framework and explain why you felt it deserved to be profiled?

Richard Manley [00:16:04] Absolutely. So the genesis of this work really predated COP26, and it was a moment where we could see hundreds, and then ultimately thousands, of companies providing forward looking guidance to the market that by the middle of the century, they would comprehensively decarbonise not only their own operations, but their entire value chain. And that's a bold statement. The comprehensive decarbonisation of your business in less than three decades, I framed as the human equivalent of running a sub-two hour marathon. But the strange thing is, if you commit to run a sub-two hour marathon, people ask you "What's your personal best?", "How fast can you run one today?". But if a CEO says "I'm going to comprehensively decarbonise my entire business and value chain by the middle of the century", people say, "is it a science based target?". And perhaps the more pertinent question would be to a CEO that says I'm going to comprehensively decarbonise my business by the middle of the century. "How much can you remove now?". And just following that logic, what we started to conclude was that if you were the Director of a public company that was being asked to approve a transition plan to comprehensively decarbonise the business by the middle of the century, what would you want to know? And our initial thinking was that you would probably want to know how much of that 100% of greenhouse gas reduction was technically and economically feasible today. You know, what could you view as a slam dunk or repurposing some oil and gas terminology, what would you view as your proven abatement capacity, that could be done, that could be approved by the board, no regrets. The question is not if it can be done, but by when will we do it. The next bucket would be what's technically possible, but not quite economic. Not quite economic because the costs are too high, the carbon price isn't high enough, or maybe the regulatory environment is not conducive. But were one of those three to change, that is a lever you have to abate the emissions in the business because it's actually technically possible. And we call that bucket ‘probable abatement capacity’ because it's likely that between now and 2050, the technology costs would improve, the carbon price would evolve, or the regulatory landscape would change, to make that highly probable by the middle of the century. And the third bucket was that it’s uneconomic. It's either technically impossible or just so expensive to do, that even with a transformation, the cost of the technology, it might still not be possible to do by the middle of the century. So we outlined a way for all companies in any sector to go through an exercise of determining that proven, probable and uneconomic abatement capacity to be able to communicate to the market when they give that 2050 guidance of “I'm getting to net zero, don't worry”, to be able to say “because 45% is proven, 50% is probable, meaning there's only a residual 5% that I'm struggling to work out how I'll deal with it”. Or in contrast, another company saying “I'm 15% proven, 10% probable. I really don't yet know how I'll deal with the last 75%, but I'm going to be transparent in disclosing that to you, so you can calibrate and more appropriately price the risk of me failing to deliver on that ambition”. So we have piloted this with a few of our portfolio companies. We are up to 12 companies now. We've actually done this exercise on ourself. So our own greenhouse gas reduction targets from our own operations are informed by quantifying our projected abatement capacity. And we found it to be really helpful for our portfolio companies. When you ask a portfolio company, we'd like you to quantify how you get to zero by the middle of the century, it's a pretty alarming proposition. But as soon as you start to break it down into let's get the baseline in place, let's work out what we can do through efficiency, let's work out what will happen through greening of the grid, let's work out the investments we can do economic today, let's work out the investments that are likely to be economic over time, and then let's ultimately have a strategic debate about the more challenging things, it manages to break down, I think, what is the corporate equivalent of eating an elephant, into a somewhat more manageable challenge. And I think one of the things we're always at pains to say to people is we don't expect having done this, you're going to commit to net zero by 2030, but we do expect you to have real conviction in setting short and medium term targets. And we do expect you to be able to engage in a really strategic debate about the more problematic molecules you have in your business to work out the strategic levers you have to play with over time.

Emily Farrimond [00:21:13] So sounds like a really collaborative process with your portfolio companies. And I'd just be keen to understand a little bit more about how that process is working with them and also how receptive they've been?

Richard Manley [00:21:24] So Emily, probably no surprise that we were able to start this, or we chose to start this, in parts of the portfolio where we had 100% control of the business. The very first pilot we did, it’s public, we published this as a separate report. It was with the Trafford Centre at Manchester and we'd recently taken control of the assets, and as a result of that change in control, we were able to engage in a very constructive dialogue with the management team and the board, who were themselves very keen to position the asset as the greenest shopping venue in Europe. So they had a desire to actually understand what levers they had to play with. The process was a very expedited timeline. It basically took ten weeks to conclude and shortly after the end of that ten week process, they committed to net zero by 2030. So it was collaborative, I'd say, in the other 11 pilots that we did, plus ours on top, there were varying levels of complexity in the challenges we had to deal with. That’s the great thing about starting with the shopping centre, it's one asset, in one place, it does one thing. As we as we got into bigger businesses with more sources of emissions in more jurisdictions, in different industrial processes, we certainly started to realise that this is a big lift. But one thing I'm at pains to tell people is, it's worth the investment. I think we hear a lot of companies today saying that as they've engaged consultants to think about developing a transition plan, what they've really sought to do is corroborate the degree of ambition for the medium term and identify a few safe levers to deliver upon that medium term ambition. What I would say in contrast is, the government has already indicated it is its intent to comprehensively decarbonise the economy. So even though we don't necessarily know the regulation that they will use to get us there, we have, you know, very clear guidance that it is the intent of the regulator over time to pursue comprehensive decarbonisation of the economy. If you do the work to understand the levers available to you, it's much easier to respond to those interventions as they present themselves. If you haven't done the work, you know, when the facts change, when the regulations change, when the technology costs become cheaper, when the carbon price becomes higher, it will be a cycle of effectively perpetual fire drills. And look, I appreciate it's not easy to do the work as we've outlined it, but certainly the experience we've had today is that it really empowered the board and it really empowered the executive to move forward with conviction in the targets they were setting, and actually have not all the answers for how they were going to get to net zero over the medium term, but real conviction over the key debates they would need to engage in over time, in shaping how they get there.

Emily Farrimond [00:24:42] Fantastic. Thanks for sharing that Richard. The white paper also highlights CDPQ’s $10 billion transition envelope. That's quite a commitment to financing real world decarbonisation. Turning to you, Charly, what do you feel the biggest success has been so far, and can you describe the biggest challenge for you as you implement the envelope?

Charly Bastard [00:25:04] Yes, definitely. Well, I’ll start by providing a bit more context. We've developed this transition envelope to support the decarbonisation of the real economy by facilitating the financing of companies in carbon intensive industries that are required for the low carbon transition. So this includes the industries of materials, transports, energy and agriculture. Now within these industries, to determine if an investment can be included in the transition envelope, we assess the companies decarbonisation strategies against the Paris Agreement, and we analyse whether or not the companies have strong enough internal processes to actually support and execute their decarbonisation. In terms of success, so far we have been able to include three investments in the transition envelope. And each of those in itself is a success. Another point worth mentioning is the great collaboration this transition envelope drove with our investment teams. We had extensive conversations on what is a good decarbonisation plan, and what is a decarbonisation plan that is aligned with the Paris Agreement and technically what sectors need to be decarbonised in priority to then enable further decarbonisation in the real economy. It was a great opportunity to share information and knowledge on this topic, which then helps our investment teams in identifying investment opportunities that could be a good fit for the transition envelope, and overall, just give them a better understanding of the low carbon transition and what it entails. And when it comes to challenges, I would say that accessing good, reliable data is a challenge as of now. We need more comprehensive data on decarbonisation targets, pathways and companies’ supporting strategy. So far, a good chunk of the work that we have to do is to bridge the gap between the data that we have and the data that we need, to assess companies’ decarbonisation pathways. Once this information and its reporting becomes more standardised and mainstream, it will definitely reduce the efforts needed to analyse the company's current strategy and assess whether or not the company is likely to meet their decarbonisation strategy.

Emily Farrimond [00:27:51] Thanks, Charly. And not the first or indeed, I suspect, the last time the conversation around data and data quality is raised around kind of some of the challenges of decarbonisation. Moving on to Nathalie and Natixis, where you've made your green and sustainable finance have a clear part of your ongoing strategy. Can you give us some more detail on what the hub means and what it signals for your climate priorities going forward?

Nathalie Wallace [00:28:15] Yeah, and thank you, Emily. The role of an asset manager, such as ourselves, is to accompany our clients and to help them identify not only ways to decarbonise, but as I said, find solutions across the board. I think as we talked about strategic asset allocation earlier on, is to understand again how what's the pathway of each of our clients - what's their profile, their risk adjusted profile, their type of clients, are they retail, are they retiree pensioners, what's their objective for long term performance and profile - and based on that and asset classes that they are exposed to, what's the tangible real economy and tangible solutions we can provide. So we developed tools, one to assess today what are the climate risk, both physical and transition risks in each and review that on a weekly sorry yearly basis to really understand what is the pathway that they can implement, so we can advise and support them in designing their objectives. Second, we can help them on their strategic allocation processes, again both to deliver on these two objectives of risk adjusted return and decarbonisation pathways. Third, again as I said, thanks to our affiliates and the array of solutions and active solutions that they provide, we can assess them, where they are, where clients are and provide with these solutions, be it simple municipal bonds that have been screened for the physical risks, especially, I would say, in the U.S., but also in Europe or Asia, through exposure to flooding or fires, but also through potentially delivering carbon related offsets for the hard to abate segment of the portfolio, as Richard mentioned. And to help scale allocation of capital towards reforestation projects, that's all been financially feasible because of these carbon offsets, so very targeted natural capital allocation, but potentially have a place in a portfolio in the short to medium term. Just again, in these hard to abate sectors, as long as again, our clients and the companies in the portfolio engage on a decarbonisation pathway. So the idea is to really come with those solutions across the board. As we say, there's not one solution. There are many ways to reach goals, there are many ways to implement. And given our multi asset exposure or offering, being with Loomis Sayles or Euronova, we can really bring that to the forefront.

Emily Farrimond [00:31:29] Thanks for sharing that, Nathalie. And that sounds like another engaging and collaborative approach.

Nathalie Wallace [00:31:33] It is. It is. We are, you know, I think it's an overused term, but it is very important. And that's why ww are very, not only proud, but very interested in being part of this conversation at the ILN. Again, we understand the challenges, we understand that it’s the hard part, but how can we all collectively work towards solutions that are, again, tangible and practical and can be implemented.

Emily Farrimond [00:31:56] Thank you. And I've really enjoyed exploring with you all the tools necessary to support real world decarbonisation. What I feel we've heard from you all is that a suite of solutions are required across all asset classes to deliver both real world decarbonisation and also long term financial performance. Thank you to Nathalie, Richard and Charly. We're really grateful that you've taken the time out of a busy and important role to share your perspective. And personally, I've really enjoyed our conversation and I am sure our listeners will too. I'm sorry to say we've run out of time for today, but it's been an immense pleasure having you on the podcast. It's been really insightful and I'm sure will resonate. So thanks again for taking the time and thank you to our listeners. Now if you enjoyed the podcast, please do follow like and share and also look out for future instalments of Climate and Sustainability Trailblazers. We've got some more really exciting guests in the pipeline who will bring their unique perspectives on the markets they work in. And if you have any feedback on our podcast, then please do let us know. Thank you.