

# THE RESPONSIBLE INVESTOR ESG YEAR BOOK 2022

Sponsored by UBS

## Global trends to watch in 2022:

▶ Diversity, equality & inclusion

▶ Natural capital

▶ Race to net zero

▶ Performance measurement

▶ Technology & AI

**Plus:**  
**Regulation, regulation and more regulation!**



# Back new energy sources or transform traditional?











Navigating the investment landscape brings tough choices.



For today's investment questions, you're not alone.  
**Sustainable outcomes, *without compromise.***

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#### About Responsible Investor

Reporting on responsible investment, ESG (environmental, social and governance) and sustainable finance issues for 9000+ institutional investment subscribers globally, Responsible Investor also produces multiple specialist conferences and workshops. Our special reports investigate knowledge gaps in ESG and responsible investment and highlight sustainability challenges where the role of investors and the financial markets could be critical in bringing about transformative change.

Find out more at  
[www.esg-data.com](http://www.esg-data.com) and  
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# Foreword

Yet again, the past twelve months have seen seismic shifts in the world of sustainable finance.

At the start of 2021, all eyes were on Net Zero and the bold new commitments being made by corporates and investors alike. They were praised for understanding the issue and the role they needed to play. But within six months, Net Zero by 2050 wasn't enough, the world called for interim targets. And by the latter half of the year, science-based targets had become pre-requisite, meaning a 50% reduction in nine years.

Similarly, the shifting landscape of sustainable funds, driven by client demand, along with the strictures of the Disclosure Regulation which came into force in March. In just one quarter, the sustainable fund universe grew from 3,730 at the end of June to 7,486 at the end of September (Source: Morningstar).

Then consider the plethora of emergent data, metrics and definitions, and the opportunities they offer for new structures, new investments and new technology, while not forgetting of course, the tsunami of regulation – 550 rules and regulations published in the SI space in 2020 alone.

And at the heart of all of this sits the financial community, with an unparalleled opportunity to not just contribute towards, but also drive the transition to a more sustainable world. How? We see four, critical, areas where finance can lead:

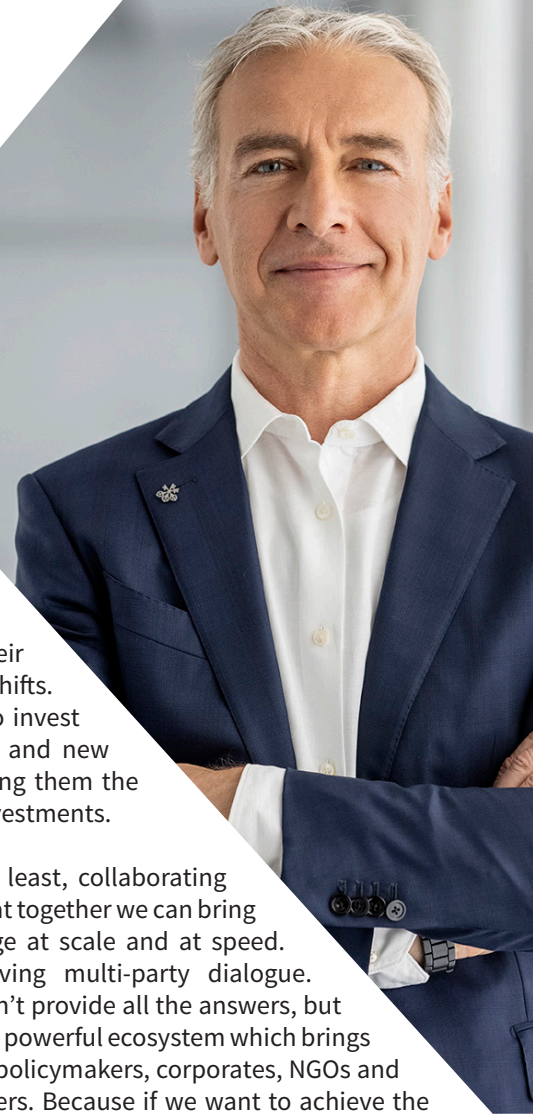
1. Helping clients, by raising awareness and providing the tools and techniques they need to manage the sustainability risks in their portfolios, thereby helping them to make better informed decisions about their investments.
2. Mobilizing capital, in all its forms. The transition to a lower carbon economy will take some \$3.5trn of investment per year for the next decade, so public and private markets need to be spurred into to action if we're to stand any chance of delivering on an undertaking of this magnitude.
3. Engaging with the firms in which we invest. Investors have a powerful voice, provided they have a seat at the table. In that way we can partner with them to identify the

opportunities to monetize and encourage their business model shifts. We need them to invest in new products and new processes, showing them the value of those investments.

4. And last but not least, collaborating with others so that together we can bring about real change at scale and at speed. That means driving multi-party dialogue. Finance alone can't provide all the answers, but we can convene a powerful ecosystem which brings together clients, policymakers, corporates, NGOs and key societal players. Because if we want to achieve the estimated \$60 trillion+ needed to deliver the SDGs we need to encourage as many different voices as possible to join our conversations.

So as we begin a new year, we are delighted and proud to partner with Responsible Investor to explore just some of the key themes which we believe will be front and centre in shaping the sustainable finance landscape in 2022.

**Michael Baldinger,**  
Chief Sustainability Officer,  
UBS Group Ag



# ▶ Getting to net zero by 2050 is going to take more than just a few tweaks - it will make the financial system unrecognisable

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*Sophie Robinson-Tillett,  
Editor, Responsible Investor (2020-2021)*

The transformation the world has undergone in the past two years would have been unimaginable to most of us in 2019.

The spread of Covid-19 has altered how many of us work, travel, socialise and much more, with many of these changes set to become permanent. In a survey by the European Central Bank, nearly half of respondents said they expected higher long-term levels of remote working as a result of the pandemic. This will have an effect on where people choose to live, and the future of our megacities: the UK's London Assembly Housing Committee recently found that more than a third of Londoners that were planning to move house were now hoping to leave the capital completely. And research shows that, in the economic uncertainty of the lockdowns, people in high-income countries stopped having as many children.

It's still unclear what these changes will mean for society, but one thing is for sure: the structural transformation needed to reach net zero by 2050 will be no less dramatic, and the implications for investors and companies are bigger and longer lasting.

The International Energy Agency has warned that if governments want to meet their net zero pledges, there must be no more investment in new fossil fuel supply. Policymakers in most major economies are now reconsidering coal and oil subsidies, in order to discourage such expansion. The IEA also predicts that, in a Paris-aligned world, carbon prices will need to go from their current global average of \$3 a tonne to between \$200 and \$250 per tonne. These are just some of the once-unimaginable changes investors and companies must prepare for, upending valuation models and pricing dynamics that have been in place for years.

And it isn't just the future of energy that's up for debate. There is a growing recognition that some of the most fundamental tenets of institutional investment will have to be rethought if the economy is going to shift fast enough to keep us below that 1.5 degrees of warming.

It is difficult, for example, to see how investors will be able to fulfil their increasingly ubiquitous net zero commitments if they continue to hug market cap-weighted benchmarks so closely. Such benchmarks are designed to reflect the current economy, and by definition net zero portfolios come from investing in a future economy instead. Asset owners are already waking up to this, with many insurers and pension funds ditching benchmarks they've used for years in favour of more sophisticated alternatives. Likewise, companies and asset managers seeking to implement long-term climate strategies will need to be freed from the shackles of the quarterly (or even annual) reporting cycle. And calls for executive remuneration to be linked to a companies' progress on climate goals are growing louder every day, in another example of how the markets and policymakers are rethinking financial incentive structures in the face of the climate crisis.

For now at least, the changes will be more measured and less abrupt than those created by Covid-19; but they are still game-changing. Regulators in the EU are pushing on with the introduction of rules that will essentially force private sector players to demonstrate how they're supporting the region's climate goals – or explain why they aren't. That comes alongside countless other policy interventions focused on changing how decisions are made along the entire investment chain in Europe.

But perhaps the most significant rule changes are yet to come, because the US has only just entered the race. US President Joe Biden made it clear when he came to office earlier this year that he will prioritise the fight against climate change – a promise swiftly followed by an Executive Order on Climate-Related Financial Risk. 2022 will see regulation begin to creep in in response to that order, meaning it will soon be almost impossible to operate in the financial markets without meeting at least some of these major new climate requirements.

There has been much fanfare around the net zero pledges being made by investors over the past 18 months, but the reality of achieving them will be much more gruelling. It will not only require changes to the way the investment world does business on a daily basis; it will also challenge some of the big assumptions that have underpinned capitalism for decades. As the worst of the global pandemic begins to subside, we must prepare ourselves for another unimaginable transformation.



It's still unclear what these changes will mean for society, but one thing is for sure: the structural transformation needed to reach net zero by 2050 will be no less dramatic, and the implications for investors and companies are bigger and longer lasting



# ▶ 2022 in numbers

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The statistics and numbers that should focus minds in 2022 and beyond

▶ 0

Net emissions target set by the world's largest emitters for 2050 (EU and USA), 2060 (China) and 2070 (India)

▶ 12,000

The planet is already at least 1.1 degrees warmer than the pre-industrial era – hotter than it has been for at least 12,000 years

▶ 0

None of the [Aichi Biodiversity 20](#) targets for 2020 were reached, with only six having seen partial progress

▶ 50:50

Glass half full or half empty? More than 50% of countries, states and cities worldwide have committed to net zero by mid-century

▶ 2½

Current governmental climate pledges for 2030 would take us to 2.4 degrees of heating by 2100 – more than double the current levels already baked in. However, actual policies translate to 2.7 degrees, 2½ times higher than current levels





68%

Animal populations have declined by 68% since 1970

10 million

Every year we lose 10m hectares of forest - roughly the size of Scotland and Wales. Around 4bn hectares of forest remain globally

+50%

The Principles for Responsible Investment now has 4,578 signatories (as of 7 Dec 2021) - up more than 50% from 3,038 at the end of 2020

+5%

\$229.9bn of green bonds were issued in the first half of 2021, with the Climate Bonds Initiative forecasting \$500bn by the end of the year. This was almost double the 2020 record of \$290bn and just 5% of the global debt capital markets (\$10trn) in 2020

\$2.5 trillion

\$5-7trn is required annually to meet the SDGs by 2030 - but there is a persistent financing gap of at least \$2.5trn each year

# ▶ Global trends to watch in 2022

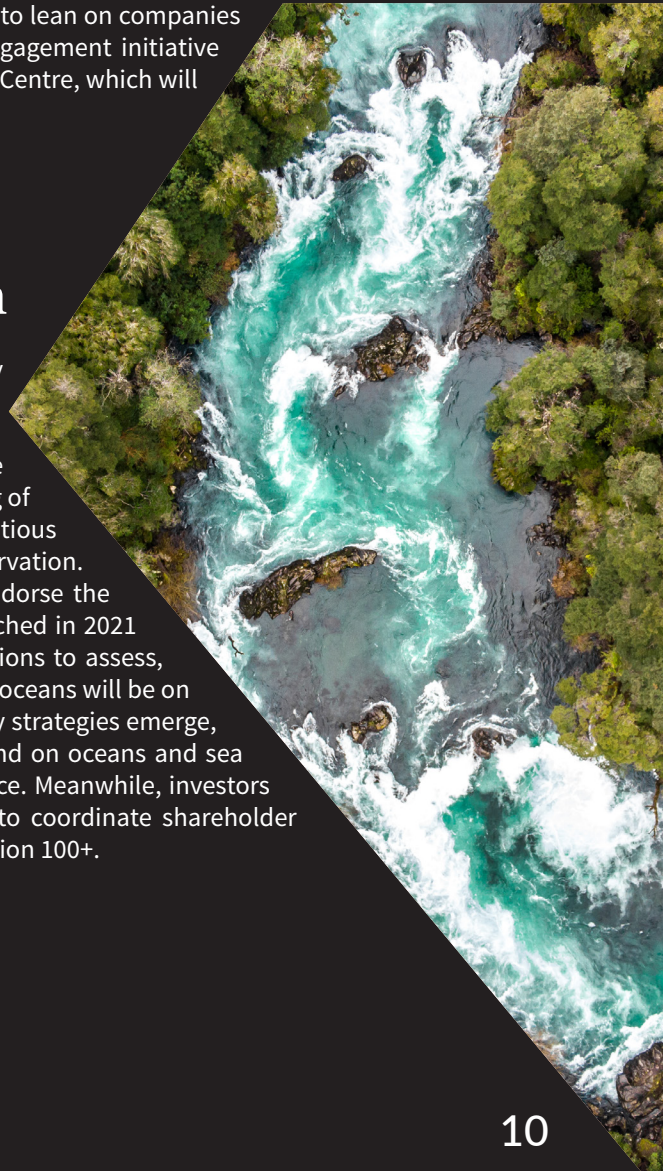
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## 1 Climate change remains centre stage

Climate will no doubt continue to top the list of investor priorities in 2022. COP26 saw policymakers and investors alike convene around the net-zero agenda amid a raft of green finance announcements and major global commitments on key topics including methane, forests and clean technologies. Chair of the Glasgow Financial Alliance for Net-Zero, Mark Carney, said the \$130trn-backed initiative could meet the \$100trn investment needed to reach carbon neutrality – so investors will be looking to governments and businesses to provide green opportunities to invest in. Investors will also be grappling with the nitty-gritty of how to measure and move towards net-zero on multi-asset class portfolios currently predicated on a high carbon world, with industry-specific net-zero alliances exploring what it means for asset owners, asset managers, financial service providers, investment consultants and more. The UN is expected to weigh in on the debate, too, having promised to establish an expert group to analyse the credibility of net-zero commitments from the private sector after Secretary General Antonio Guterres warned of confusion around the “different meanings and different metrics” attached to the numerous decarbonisation targets. Meanwhile, investors will continue to lean on companies to turn net-zero commitments into transition plans, through investor engagement initiative Climate Action 100+ and the newly launched TPI Global Climate Transition Centre, which will assess how companies are aligning with a net-zero pathway.

## 2 Biodiversity gathers momentum

Financial sector interest in understanding the risks posed by biodiversity loss will continue to snowball in 2022, as protecting nature catches up with climate on the global policy agenda. Markets are still far from being able to factor biodiversity into investment analysis – but both governments and the market are demonstrating critical momentum. World leaders at the first leg of UN biodiversity conference COP15 this year committed to negotiate an ambitious framework to transform financial and economic models to support conservation. Many in the finance sector are calling for the framework to explicitly endorse the market-led Taskforce on Nature-related Financial Disclosures, which launched in 2021 tasked with developing a framework for companies and financial institutions to assess, manage and report on their dependencies and impacts on nature. Healthy oceans will be on government and investor agendas, too, as a host of national blue economy strategies emerge, and financial institutions seek to understand how they impact and depend on oceans and sea life, with help from the upcoming update to the UN’s blue finance guidance. Meanwhile, investors are flexing their stewardship muscles, plotting a Nature 100+ initiative to coordinate shareholder engagement with companies on biodiversity in a similar way to Climate Action 100+.



## 3 Diversity and inclusion efforts deepen

A year and a half after George Floyd's murder spurred worldwide protests against systemic racism, diversity is showing no signs of dropping off the investor agenda. A record 40 diversity-related shareholder proposals garnered an average 36.7% support this year, according to Bloomberg Intelligence, and some of the world's largest asset managers beefed up their ED&I proxy voting guidelines. UK investors as part of the 30% Club initiative are already doubling down on companies lagging on race as well as gender diversity at the board and executive-level, and next year could see other national branches follow suit.

2021 also saw a step change for data on racial diversity at the company level – with voluntarily disclosing Fortune 100 firms rising to 86%, from last year's 54%. Mandatory reporting could be round the corner in some jurisdictions, too, with both Nasdaq and the UK financial regulator making game-changing proposals on diversity and disclosure. The finance industry itself won't escape scrutiny, either, with NGOs and legal actions increasingly alleging lack of diversity and discrimination in the sector, and the UK's £1.1trn-backed Asset Owner Diversity Charter making moves to demand detailed ED&I disclosures from fund managers and service providers as part of procurement.

## 4 Rethinking performance management in the net-zero era

As the world gears up for the race to net zero, 2022 will see the investment industry grapple with what this means for benchmarking and performance management. Some in the sector are calling it a fundamental shift in indexing theory – as low-carbon indexes looking to slash carbon exposure relative to the benchmark give way to net-zero strategies that target absolute decarbonisation, irrespective of the benchmark – with potentially unprecedented tracking errors. As Mona Naqvi from S&P Global Sustainable 1 put it in a recent Responsible Investor webinar, “The benchmark may not be the best yardstick for performance in a new frontier of unprecedented climate risk.” Similarly, the £30bn UK pension pool Brunel weighed in on the debate in 2021 saying that traditional benchmarks and indices block decarbonisation and announcing research into alternative frameworks to assess and manage performance.

However, the debate is far from settled. Others maintain that indexes hugging mainstream benchmarks can offer real change on sustainability and question whether it's really effective from a climate perspective to pursue net-zero strategies that merely divest from high-carbon sectors, rather than focusing on engaging with companies to produce emissions reductions in the real economy. There's also the argument that more and more companies are becoming eligible for inclusion in net-zero strategies as they make their own net-zero commitments and set science-based targets, closing the gap with traditional benchmarks over the long term. The market's far from united on this – and this year will continue to discuss whether benchmarks and tracking errors need to undergo a fundamental shift.

## 5 New frontiers beckon in AI and unstructured data

Investors have long been unsatisfied with the 'black box of ESG data'. Updated just once a year, reliant on what companies choose to self-report, and often with unclear links to materiality, the limitations of traditional sustainability information have meant the sector has long been ripe for innovation. Enter the bots. Now, as the pressure ramps up on the investment industry to root out greenwashing and step up on sustainability, ESG tech providers are harnessing AI to give investors unprecedented sustainability information and insights derived from any number of alternative datasets – from legal documents to social media posts. These providers say their datasets and processes can not only offer investors a real-time view of how a company is performing on ESG issues – they can also provide forward-looking risk signals where traditional ESG data would have failed to raise alarm bells. These new sources of data can also be used to help investors cross-check the claims a company makes about its sustainability. The GreenWatch tool, for example – recently launched by academics – uses AI to check whether companies' publicly reported emissions data square with how green the company claims itself to be. Whatever an investor's ESG priority, AI-powered tools look set to bring new ways to keep informed.

# ▶ Chief Sustainability Officer - Joining the dots

Michael Baldinger Chief Sustainability Officer, UBS Group AG contextualises the move of sustainability into the mainstream, for business, finance and society

*Michael Baldinger  
Chief Sustainability Officer,  
UBS Group AG*



When I first joined UBS to set up the S&I business in Asset Management, I knew something powerful was happening in the marketplace, that sustainability was becoming one of the most important topics for corporates and investors alike.

Today we have witnessed nothing less than a paradigm shift - the move of sustainability into the mainstream, for business, finance and society.

You only have to look at the experience of our own firm. Between January and September 2021, our SI assets grew 63%, with our Asset Management division's climate aware assets breaking through the \$20 billion mark, an almost seven fold increase in less than two years. This trend is similarly reflected in the wider marketplace. Between January and September 2020, there were no less than 270 new sustainable fund launches, with sustainable fund assets globally approaching \$3.9 trillion, according to Morningstar.

In my mind, that shift has been driven by one thing: increased transparency. It affects what individuals buy, how they travel, and now how money is invested. It also underlies the regulators' agenda. Yet it's very clear that sustainability means different things to different people. Just look at the United Nations' 17 Sustainable Development Goals: these set out a wide range of essential areas to improve, from environmental through to social.

The attendant complexity associated with tackling such a broad and myriad range of issues cannot be underestimated, but to me one thing is crystal clear: it is the capital markets which provide the most powerful transmission mechanism in promoting corporate sustainability. The power of investors to mobilize capital can have a tremendous positive impact in tackling the fundamental challenges encapsulated by the SDGs, placing the financial services industry squarely at the centre of the sustainability movement.

Now undoubtedly our clients are experiencing the same complicated, fast-changing environment. That's why we want to, and need to be, their partner. We want to raise awareness, guide, engage and assist them with their decisions, and above all, offer the right solutions for achieving their sustainability goals, mitigating their risks and improving their opportunities. On the other side of the coin, we are operationalizing our own firm's sustainability commitments targets and priorities. Take net zero. We're committed to reaching net zero across our operations by 2050, but making sure we get there means delivering, not just on our own emissions, but those of our clients as well – a hugely complex undertaking.

Strategic sustainability priorities are another case in point. At UBS, inclusive growth is one such priority. The "S" in ESG is rising up the agenda fast. Events such as COVID-19, Black Lives Matter, #MeToo, have shone a spotlight on systemic inequalities in society, which in turn means that businesses must consider the role they play as regulation expands, stakeholder scrutiny intensifies, and the growing advantages of DE&I come to the fore. Tackling societal challenges requires inclusion, economic growth, and sustainability. Each of these factors is inextricably linked, but the outcome represents a compelling business case, for our clients, for us and for wider society:



When I first joined UBS to set up the S&I business in Asset Management, I knew something powerful was happening in the marketplace, that sustainability was becoming one of the most important topics for corporates and investors alike

of our Social Impact team. Through the team’s work, UBS is aiming to create a fairer, more prosperous society and increase our efforts in community activities. For our clients that means delivering innovative philanthropic solutions designed to tackle environmental and social issues, ranging from wetland restoration to the protection of children from abuse; for our own firm, employees are contributing via the many community impact projects which we are supporting around the world.

So, in conclusion, what I see as I look across the investment landscape, is a myriad of sustainability topics and initiatives, every single one of them critically important. I also see the very great momentum behind those initiatives. This is not simple, but by bringing our purpose, our globality and our ability to convene the financial ecosystem, I firmly believe we are well-placed to drive sustainable outcomes for our clients, our firms and our wider stakeholders.

a more equitable and inclusive society drives economic opportunities for all.

So how do we bring all these different aspects and opportunities together, particularly across a global firm such as ours, which spans some 50 countries and employs nearly 73,000 people? That’s my job, as Chief Sustainability Officer. Unsurprisingly, for many firms this is often a new role, so interpretations will vary. But at UBS the CSO acts as a focal point for sustainability. It’s up to my team to join the dots, right across the organization, to drive the implementation of our sustainability strategy, identify and execute against business opportunities and provide a center of sustainability excellence. Crucially, we also track and report on our firm’s progress towards public commitments that we’ve made, key among them being our Net Zero commitment.

At UBS, sustainability means thinking and acting with the long term in mind. For me it is those two words – long term – which are critical. It’s not just the companies we invest in and finance which need to demonstrate that their business models account for long-term risks and opportunities, it’s our firm too. One way we’re doing that is focusing our activities on three areas – planet, people and partnerships. We firmly believe that by mobilizing capital towards those areas, and by prioritizing them in our own activities, we can make the biggest difference. So, tackling climate change is front and center, we’re targeting wealth inequality through a focus on health and education, and we’re working with our wide network of partners to drive change on a global scale.

Nowhere are these priorities more apparent than in the work



# ▶ Where next for climate finance

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## If the developed world wants more ambitious goals, it's going to have to foot the bill

One after another, developing nations took to the stand at COP26 to implore rich countries to cough up more in climate finance.

Barbados suggested a yearly \$500bn for highly impacted countries, while India demanded \$1trn. African negotiators reckoned \$1.3trn per year by 2030 was more like it. But whatever the figure, poorer and climate-vulnerable countries were united in wanting more cash to adapt to and mitigate climate change.

This debate isn't new. Climate finance is provided for in the Paris Agreement, and developed nations agreed back in 2009 to provide \$100bn a year by 2020 until 2025. However, with that target missed and the likes of China and India setting net-zero targets decades later than the 2050 goal espoused by the developed world, the thorny issue has reared its head once more.

Developing countries can't be left out of the climate equation. As well as being more vulnerable to the effects of climate change, developing nations account for nine of the 20 most significant carbon emitters.

That's not to say it's always been that way – taking the historical perspective, the US tops the chart of biggest carbon emitters, having emitted twice as much as China to date.

But the biggest polluters haven't been paying their way. The US in particular has failed to stump up the cash, contributing just \$7.6bn between 2016 and 2018, while the World Resources Institute gauged the country should contribute up to 47% of the yearly \$100bn. Australia, Canada, Italy and Greece have also not met their parts of the pledge. Germany, Japan and France have paid more than their share, though predominantly through loans, which a group of climate-vulnerable nations this year argued were increasing their financial burdens. Adaptation efforts also receive much less funding than mitigation, with just 8% of climate finance to date directed to the crucial objective, despite the Paris Agreement calling for an equal split between the two.

A string of countries have recently stepped up their climate finance commitments. Biden came out saying that America and other polluting nations have “overwhelming obligations” to provide aid to countries feeling the impacts of climate change, and is trying to get Congress to quadruple climate finance to \$11.4bn by 2024. The UK, Germany, Canada, New Zealand and the EU have also increased their commitments.

Regardless, the \$100bn figure set more than a decade ago barely scratches the surface of the financing needed to stop and adapt to climate change. Negotiations began in Glasgow for post-2025 finance targets, and though a specific target hasn't been set yet, the UN estimates that developing countries' needs for adaptation finance alone are already at \$70bn per year, and could hit up to \$300bn by 2030.

Recent analysis revealed that current government net-zero pledges would put us on course for a perilous 2.4 degrees increase by 2100. And from what developing countries are saying, if the developed world wants more ambitious goals, it's going to have to foot the bill.



Developing countries can't be left out of the climate equation. As well as being more vulnerable to the effects of climate change, developing nations account for nine of the 20 most significant carbon emitters

# Sustainability and impact see accelerating interest from private wealth

Sustainable investing is UBS's preferred solution across its giant private wealth business, as private client demand for such investments continues to accelerate

Last September, UBS made sustainable investment its 'preferred solution' for its \$3.2 trillion global private wealth business. The bank actively counsels private clients on the importance of sustainability from an investor perspective, helping them to position portfolios for the potential risks ahead and to tap into compelling sustainability opportunities that increasingly drive or are sources of investment performance.

It's a shift that coincides with private clients' own growing interest in sustainability and desire to allocate capital towards specific themes and key outcome areas they want to address, among them climate, health and education. This interest is being fueled in part by the next generation of private clients, including those who increasingly influence decisions for generational wealth, and those who run their own businesses with sustainability in focus. They know that social and environmental issues matter for corporate and financial performance and are reshaping the world. Indeed, a recent UBS investor survey revealed that 66% of respondents believe that sustainability is an important part of their investment strategy and that it can help enhance risk-adjusted returns.

"Sustainability is increasingly core to the advice and solutions we provide to our clients. They see that topics like climate and inequality can affect financial performance, and more and more they want to explore how their investments can have positive impact (and mitigate negative impact) on society and the environment" confirms Andrew Lee, Managing Director, Global Head of Sustainable and Impact Investing, UBS Global Wealth Management. "Sustainable investments can deliver financial returns for clients while also contributing toward their broader objectives. Our expectation is that sustainable portfolios should deliver comparable performance to traditional portfolios through market cycles, with the potential for outperformance."

## Portfolio approach to sustainability

Historically, many private clients typically approached sustainability mostly by removing certain exposures using a values-alignment lens. Even if investors start with exclusions, their focus appears to be shifting as they consider which dynamics will drive investment returns and how they can orient more investment capital toward their long-term individual objectives, hand in hand with their philanthropy. An important first step is to identify and define investors' priority sustainability focus areas and philosophy. "Sustainability means something different to each individual," says Lee.



Andrew Lee,  
Global Head of Sustainable Investing  
& Impact Investing, UBS Global Wealth Management

Investor expectations about sustainability have indeed evolved. Today, many investors show interest in going well beyond using ESG factors in investment process, increasingly focusing on sustainability as a key driver of investment thesis and strategy, and some going further still to use their capital to generate intentional positive impact. With regulatory initiatives - particularly in Europe – helping to set minimum expectations around sustainability, it's a natural evolution that a growing number of clients are going beyond this baseline and moving toward portfolios constructed with sustainability focus at the core and in each of the underlying exposures, enabling them to allocate potentially all of their capital in a sustainable, diversified and returns-oriented manner.

Lee explains that UBS meets this demand with portfolios constructed around its Chief Investment Office's differentiated sustainable strategic asset allocation that is diversified across asset classes and designed to perform through market cycles. These and other portfolio solutions can also be tailored to reflect investors' sustainability preferences, whether thematic or operationally focused. "The solution an investor chooses is a reflection of how active he or she wants to be in the decision process and what approaches or focus areas he or she prioritizes," he says.

## Innovation

Investors are increasingly looking for innovative and differentiated sustainability-focused strategies as integration mainstays. For example, Lee notes interest in development bank bonds as a replacement for, or alternative to, high grade fixed income. "This exposure provides comparable performance together with a clear focus on sustainable development," he says. Other examples of innovative exposures available in UBS client portfolios include emerging market sustainable finance strategies designed to increase development finance flows to emerging market and to enhance financing projects in less liquid markets, as well as oncology focused impact private market solutions. "If done properly, structures like these can incentivize positive change or behavior" he says.



**Sustainability**  
is increasingly core to  
the advice and solutions  
we provide to our clients.

## Growing focus on impact

Lee further observes that next generation clients in particular show affinity for innovative ways to drive positive impact with their capital, citing examples like active engagement strategies in public markets, disruptive venture and growth investments through private markets, as well as through direct investments that allow them to have hands-on involvement. "In the coming years, this group could reshape the impact investing landscape with their capital, active contribution, and drive to make a difference," he says.

Delivering intentional impact through investments is no small commitment for asset managers, requiring integration of impact into the heart of investment process and strategy as well as effort to measure and manage of that impact throughout the life of an investment.

Impact is an ongoing area of focus for UBS Global Wealth Management. The universe of impact-focused solutions continues to grow rapidly, although complicated somewhat for end investors by differing approaches to measuring impact across the industry. Lee is encouraged by what he sees as growing convergence in the frameworks and principles used by impact-focused asset managers and investors. "One example is the Operating Principles for Impact Management (where UBS is a founding signatory and advisory board member), a framework launched in April 2019 to ensure that impact considerations are purposefully integrated throughout an investment lifecycle. The initiative now has 149 signatories covering approximately USD 430bn in assets.

## Growing client interest

As with every investor type, sustainable investment amongst private clients is a carefully considered decision. But the firm's private clients are on the sustainability train, says Lee. "More and more of our clients recognize the importance of sustainability for investments, and are making thoughtful decisions about how to bring sustainable investments into their portfolios to reflect their individual goals. Starting with a diversified portfolio can help deliver through-cycle investment performance while providing exposure to a range of sustainable investment types across asset classes. We expect the composition and focus of sustainable investing portfolios to evolve over time as client objectives change and the universe of credible sustainable investment solutions continues to expand."



# ▶ Net Zero - What is it all about?

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## An overview of what UBS means by 'net zero' and the opportunities it presents

Right now it feels like there's only one topic out there, and that's net zero.

But do we mean when we talk about net zero and why is it so high on investors' agendas?

'The concept of net zero is simple: when the amount of CO<sub>2</sub> we're extracting from the atmosphere is no greater than the amount of CO<sub>2</sub> that we add to the earth's atmosphere then we're at net zero'. The reality of getting there is considerably less simple and the clock's ticking fast.

Most net zero pledges carry a target date of 2050, based on the commitments made as part of the 2015 Paris Agreement to limit the rise in global temperatures to well below 2 degrees Celsius, and preferably 1.5 degrees or less. Meeting those targets means reaching carbon neutrality, or net zero, by the middle of this century. But when you consider the world emitted over 30 billion tons of CO<sub>2</sub> in 2020 alone, reaching net zero will take little short of a global economic reset.

But as with all transformations, while the shift to net zero will inevitably result in a dramatic decline in some areas, it will also open up a wealth of new opportunities in others.

Taking just one sector – energy – it's been estimated that meeting the world's net zero ambitions will demand a doubling of annual investment in renewables, up from the current spend of USD 310 billion to at least USD 660 billion per annum.

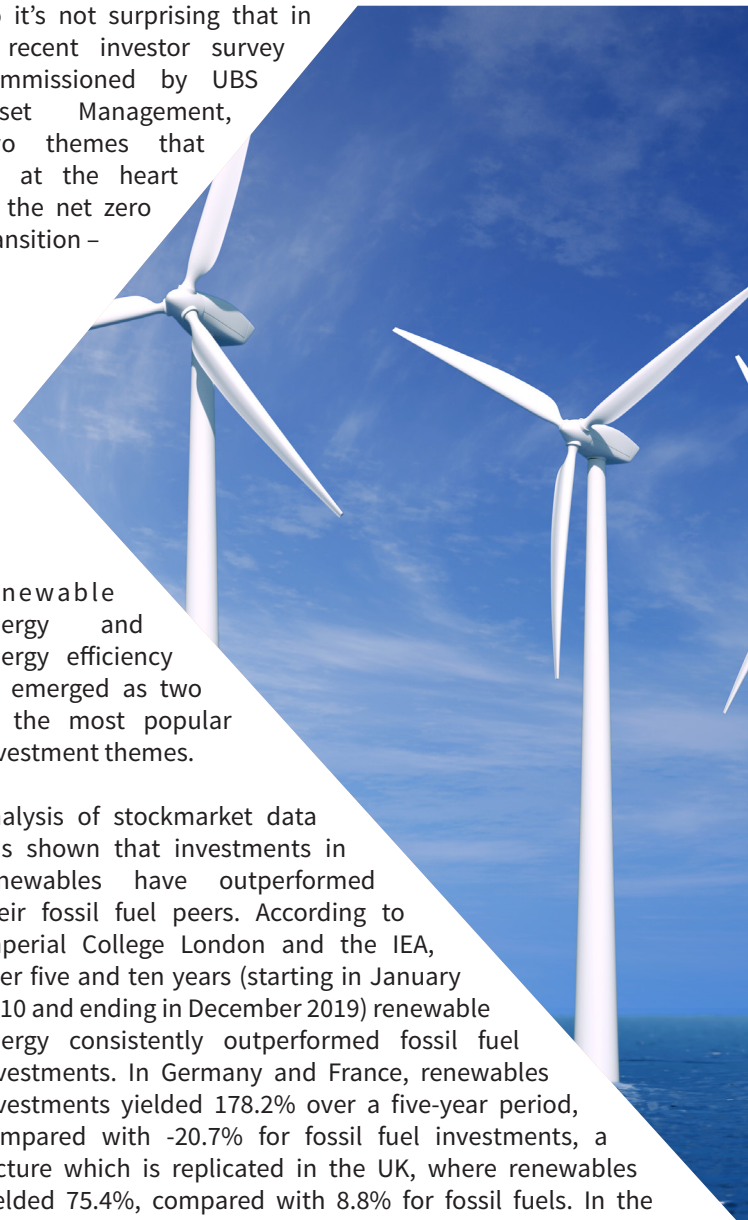
And the markets are moving fast – with value creation in areas like electric vehicles, alternative proteins and renewable energy as well as increased costs for high carbon footprints.

It's very clear that there's a great urgency around this topic – intensified by client demand, political commitment, shareholder pressure and increased transparency. And with that urgency, there is a great momentum and great opportunity for investors.

So it's not surprising that in a recent investor survey commissioned by UBS Asset Management, two themes that sit at the heart of the net zero transition –

renewable energy and energy efficiency – emerged as two of the most popular investment themes.

Analysis of stockmarket data has shown that investments in renewables have outperformed their fossil fuel peers. According to Imperial College London and the IEA, over five and ten years (starting in January 2010 and ending in December 2019) renewable energy consistently outperformed fossil fuel investments. In Germany and France, renewables investments yielded 178.2% over a five-year period, compared with -20.7% for fossil fuel investments, a picture which is replicated in the UK, where renewables yielded 75.4%, compared with 8.8% for fossil fuels. In the US, renewables yielded 200.3% versus 97.2% for fossil fuels. What has also been notable in the past eighteen months is the reduced volatility of renewable energy stocks, particularly during the turmoil caused by the pandemic, when oil and gas prices collapsed.





But as with all transformations, while the shift to net zero will inevitably result in a dramatic decline in some areas, it will also open up a wealth of new opportunities in others

But despite their undisputed importance, renewables are far from the only solution our planet needs to consider as our world warms. Already we've exceeded 1 degree Celsius of warming and many parts of the world are having to live with the consequences. So it's crucial we find ways to adapt to those conditions and mitigate the harm which those higher temperatures are causing.

That means finding the low carbon transition opportunities in sectors such as industry, buildings and transport. And here a wide array of possibilities already exists. For example construction can move away from cement and towards renewable materials such as timber (which in turn opens up the potential for buildings to play a role as carbon sinks). Or, as Ginger Krieg Dosier, founder of bioMASON and UBS Global Visionary has done, companies can innovate to create radically different solutions. bioMason, for example, uses microbes to grow sustainable bricks.

And of course, investors have their own opportunity to accelerate the net zero transition by engaging with those companies in which they're invested to encourage a faster transition towards net zero.

UBS Asset Management currently engages with around 100 carbon intensive companies, especially those which we've identified as laggards in their response to the climate transition, using our proprietary Climate Aware methodology. We firmly believe that large scale investors like ourselves have a clear role to play in influencing companies towards a Paris Aligned pathway.

This is a very fast-moving space – and rightly so. Preserving the planet as we know it for the generations to come will not be an easy task. And climate matters need to be tackled urgently, regardless of geography or starting position.

Net zero sounds like it demands restraint, that it dictates a more frugal future. And to an extent that is true .

But net zero also represents opportunity.

The amount of innovation we currently see happening in the global economy is mind-boggling. We see transformational change happening at a rapid pace in sectors like energy, food or transport.

We see entirely new markets developing, for example around carbon emissions, or carbon offsets. Existing markets, like the one for sustainability data and metrics, are exploding in volume and sophistication.

The last word should go to Mark Carney, who rightly described the net zero transformation as 'the greatest commercial opportunity of our age'.



# ▶ Race to net zero: Europe continues to lead


Since the European Commission adopted an Action Plan on Sustainable Finance in March 2018, it has been foot to the floor bringing in a raft of rules expected to cause a tectonic shift for sustainable finance across the bloc.

With responsible investment already soaring with record inflows and unprecedented awareness, the European agenda is set to impact the investment decisions and reporting responsibilities of asset owners, investment managers and service providers.

For a start, investors covered by the Sustainable Finance Disclosure Regulation (SFDR) have to start to disclose their taxonomy alignment during 2022, but many have complained the necessary data isn't available, with issuers not required to report the same information until early 2023 at soonest. This has been compounded as the draft rules covering how investors should make taxonomy-related disclosures saw a four-month delay, making the January deadline "practically impossible", according to some financial regulation lawyers.

One set of rules detailing whether an activity contributes to climate mitigation and adaptation criteria have been released, but were subject to politically sensitive and heated debate, particularly around gas, nuclear and forestry, which have led to some market commentators doubting the taxonomy's efficacy in warding off "greenwashing".

The taxonomy could also see significant expansion under the Commission's renewed strategy, with talk of including a "traffic-light" style system identifying "significantly harmful" (red), "harmful" (orange) and "no significant impact" (neutral) to effectively cover the whole economy. This is expected to be deeply controversial, however, as well as raising questions as to how the taxonomy would provide for companies looking to transition to low-carbon business models. There's also scope for a social taxonomy grounded in human rights, with 2021 seeing the publication of a draft report on the issue.



That's not to say the work is complete. The updated Sustainable Finance Strategy – published in July 2021 and expected to bolster the action plan and extend coverage to banking and insurance – is only just getting started, and the complex set of rules to come out so far has been dogged by fierce debate and concern that more red tape for financial institutions could hinder rather than help the sustainability agenda.

The regulation underpinning the action plan's flagship policy, a "taxonomy" defining which business activities can be deemed environmentally friendly, was adopted in June 2020 – but question marks persist around efficacy and useability of the framework.

Meanwhile, SFDR, which entered into force in March ramping up cross-asset ESG reporting expectations for investors, has provoked growing frustration from industry with claims investors still don't have clarity on what must be disclosed and in what form – resulting in investors being given an extra six months to comply.

Particular concern has abounded around product categorisation. The regulation requires fund managers to classify products as article 6, 8 and 9 products, which have increasingly strict sustainability and disclosure requirements. Interpretation of what counts as an "article 8 product" – meant to "promote" green or social characteristics – have varied wildly, with claims many asset managers are using the category for funds incorporating only limited exclusion



policies. In response the Commission published in July 2021 a set of questions and answer to try to clarify but it remains to be seen how far it will allay concerns over whether SFDR can fulfil its objectives of tackling greenwashing and improving transparency and comparability of investment products.

A key strand of the renewed sustainable finance strategy is the Corporate Sustainability Reporting Directive, a revamped ESG disclosure law which will replace the long-standing Non-Financial Reporting Directive following years of criticism that it is too vague and promotes unsatisfactory and incomparable sustainability data. The framework legislation, currently under discussion by the European parliament and council, will require listed companies, including financial institutions, to disclose sustainability targets and their progress towards achieving them. As part of the proposed CSRD, the European Financial Reporting Advisory Group is asked to develop sustainability standards in two waves by October 2022 and 2023 with companies first reporting against them in early 2024 for their 2023 activities. These proposed deadlines are challenging and may yet be adjusted. It remains to be seen how the standards will provide for transition pathway disclosure from companies, increasingly seen as vital to greening the economy, and how this will dovetail with the taxonomy.

The strategy will also include an overhaul of the Shareholder Rights Directive in 2023 in order to bolster stewardship rules, with the Commission having promised changes to acting in concert rules so as not to “impede collaborative engagement by investors around common sustainability goals”.

Following the visceral reaction evoked by the taxonomy in certain sectors, however, it is safe to say that the renewed sustainable finance strategy is being taken forward in a shakier political context – and the complexity of the evolving regulatory framework means investors are facing an uphill battle to ensure both compliance with regulation and a transition to more sustainable portfolios.

The UK, meanwhile, is embarking on its own green finance agenda – including its own green taxonomy and sustainability disclosure requirement regime. Its ambitious Greening Finance roadmap, published in October, confirmed some companies will have to report how their transition plans align with the UK’s net-zero by 2050 target – a “gold standard” guideline for which will be published in 2022.

It’s keen to push its efforts globally, with Chancellor Rishi Sunak saying the rules will “set new global standards for sustainability”. The UK has been an early adopter of mandatory TCFD requirements – expectations that will apply to large pension schemes this year, as well as some asset managers from 2023 – and during its G7 presidency pushed for others to do the same. However, finance players operating in both the UK and Europe are waiting for clarity as to how the UK’s distinct sustainable finance reporting regime will interact with European regulations.



Since the European Commission adopted an Action Plan on Sustainable Finance in March 2018, it has been foot to the floor bringing in a raft of rules expected to cause a tectonic shift for sustainable finance across the bloc

# ▶ Race to net zero: US gets up to speed

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Not so long ago, as the sustainable finance agenda charged ahead in Europe, the Trump administration was determinedly trying to stick a pin in US investors' ballooning interest in ESG. Indeed, the Department of Labor (DoL) all but banned ESG back in 2020 when it proposed a rule preventing fund managers from considering sustainability factors unless they could prove it was improving financial performance.

Fast-forward to the end of 2021, and we see an unrecognisable ESG landscape, as Biden's first year in office has brought swift U-turns on policy and rulemaking and positioned the US firmly back on the sustainable finance map.

Biden made his stance on climate clear from the get-go when one of his first moves as president was to have the US rejoin the Paris Climate Accord. Sure enough, he soon followed up with a series of executive orders mandating US financial rulemakers to step up on climate risk.

First rolling back the Trump-era ESG ruling, the DoL has recently released proposals paving the way for schemes to choose ESG default funds and consider climate change and ESG factors when proxy voting.

Under new chairman Gary Gensler, the Securities and Exchange Commission (SEC), too, has done an about-face on sustainability issues, creating a Climate and ESG Taskforce to address greenwashing and identify mismarketed ESG funds. The regulator is expected to issue best practice guidance for disclosure on ESG investment products, and could also bring in mandatory sustainability disclosures for issuers, having sparked lively debate when it released a consultation on the topic in early 2021.

The SEC has also ramped up scrutiny on companies' climate risk management processes. In September 2021, the Commission's Division of Corporation Finance reminded companies of their obligations under 2010 guidance to disclose material climate risks and opportunities in their SEC filings, with the publication of a letter companies could expect to receive if they fail to disclose. These obligations will likely ramp up under incoming updated climate disclosure rules, which will likely include requirements for companies to make quantitative disclosures such as metrics related

to greenhouse gas emissions, financial impacts of climate change and progress towards climate-related goals.

It looks likely the SEC will also review the "no action" process, which was employed by many firms looking to throw out ESG-related proposals before Biden took office. Since then, some landmark sustainability-related resolutions have been upheld by the SEC, though Trump-era rules placing limits on filing the same resolution year-on-year could significantly hinder ESG engagement in coming proxy seasons.



**Fast-forward to the end of 2021, and we see an unrecognisable ESG landscape, as Biden's first year in office has brought swift U-turns on policy and rulemaking and positioned the US firmly back on the sustainable finance map**

Spearheaded by Treasury Secretary Janet Yellen, US supervisory supergroup the Financial Stability Oversight Council joined the international community in recognising the threat climate change poses to financial stability, in a report which landed in October. The publication, which was met with widespread fanfare from the international sustainable finance community, detailed recommendations on additional climate-risk disclosure for firms, investors, banks and other regulated entities and laid the groundwork for climate risk oversight processes including stress-testing and scenario analysis, which could have far-reaching implications from Wall Street to beyond US borders.

The Federal Reserve, too, formerly notorious for dragging its feet on climate change, was quick to join the Network of Central Banks and Supervisors for Greening the Financial System when Biden arrived on the scene. Its Supervision Climate Committee, launched in March, will assess the “climate-readiness” of US banks and test loan books’ resilience to climate scenarios. Though still trailing behind central bank peers that are buying up green assets and curtailing fossil-fuel lending, the Fed may soon be under new leadership, with pressure on Biden from some quarters to replace Jerome Powell with a climate leader.

At the same time as beefing up rulemaking on sustainable finance, Biden is stepping up domestic climate action by cutting emissions by up to 45% over the next decade through two wide-ranging pieces of legislation – a \$1trn infrastructure bill and a \$3.5trn Build Back Better Act. However, the latter’s provisions for greening the electricity and transport sectors and taking action on methane emissions are at risk of being heavily diluted amid intense corporate lobbying and the lack of a Democratic majority in Congress.

Biden’s climate agenda doesn’t stop at US borders, however. COP26 in Glasgow saw the president making efforts to assert the US’s position as a global leader on climate change, pledging to “lead by the power of example” and unveiling a plan to slash global methane emissions by 30%.

The Chinese central bank and the US Treasury have been appointed co-chairs of a G20 committee on sustainable finance, and 2021 saw the US and China pledge mutual cooperation in tackling the climate crisis. September’s US Energy Compact, too, saw US agencies committing to assist other nations in reducing emissions, with the US International Development Finance Corporation, for example, pledging to channel one-third of its commitments toward climate-related projects from 2023, with a focus on low and lower-middle income countries.

The US States is still playing catch up, but for the first time ever it looks like the world’s largest economy could be weaponised in the fight against climate change. Now, as Biden himself admits, it’s time to see action, not words.



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Executive Office of the President of the United States

# Race to net zero: APAC gets into gear

Until recent years, China and Japan accounted for the lion's share of sustainable finance-related headlines coming out of the Asia-Pacific (APAC) region.

At the dawn of 2022, however, sustainable finance roadmaps are proliferating across the region from countries as diverse as Singapore, Australia, Taiwan, Malaysia and South Korea, as APAC nations start to step forward with net-zero commitments.



While the European sustainable finance agenda is being felt by fund managers and companies across the region, APAC regulators are rapidly snapping into action on their own green and sustainable finance agendas

While the European sustainable finance agenda is being felt by fund managers and companies across the region, APAC regulators are rapidly snapping into action on their own green and sustainable finance agendas.

The region's major markets now all boast global standard-equivalent ESG disclosure guidance for listed companies, and many are expected to ramp up reporting requirements in the near future. Mandatory climate disclosure for companies will come into play in Hong Kong by 2025 and is being mulled by Singapore's stock exchange, while India's securities market regulator has introduced new reporting requirements from next year.

Climate-risk disclosure is fast becoming expected of financial institutions (FIs) across the region, with mandatory disclosure requirements incoming from the likes of the Monetary Authority of Singapore and the Hong Kong Securities and Futures Commission, while the Bank of Japan and Financial Services Commission of South Korea ask FIs to disclose voluntarily. This comes as central banks and financial regulators in the region are making clear moves towards climate stress-testing and scenario analysis for finance players, with strong APAC representation on the Network for Greening the Financial System.

Singapore, Korea and Thailand are just a handful of a host of APAC regulators that have introduced or are working on their own sustainable taxonomies – partly out of concern that the strict green criteria under the EU's taxonomy would not be suited to Asia-Pacific businesses and their ability to transition. Most recently, the Association of South East Asian Nations published proposals for a regional green taxonomy.

While the tide of taxonomy regulations will mean generally tougher standards for green finance products, as it stands, financial players are still far from having a global framework to convene around, provoking concern that the confusion around green definitions could limit access to capital, particularly for transition finance.

However, China is making efforts to advance global alignment on sustainable finance standards and taxonomies. The People's Bank of China has updated its "green catalogue" – which determines business activities that are eligible for green bond financing – to clarify that "clean coal" projects would no longer be included, bringing it more in line with international green bond guidelines. China is also co-convening the International Standards Organisation's efforts on creating a standard on sustainable finance and overseeing an international taskforce alongside the EU charged with issuing a "common ground taxonomy" to bring more clarity around the similarities and differences between taxonomies – starting with the publication of an in-depth comparison of the EU and China taxonomies in November.

Sustainable bonds represent an important part of the APAC green finance effort. The first half of 2021 saw APAC borrowers more than double sustainability-themed bond issuance to \$69.1bn, compared with the same period the previous year – with green bonds accounting for 70% of the deals. Just over 50% of the bonds were issued by China, with South Korea coming in second at 21.2%. 2021 saw a number of landmark issuances in the sustainable fixed income space for the region – with the launch of a Chinese ESG bond index in Beijing and Luxembourg as well as climate transition and biodiversity bonds from the Bank of China.

Regulators have played a part in fostering sustainable bonds and other climate finance, with the Hong Kong Monetary Authority and the Monetary Authority of Singapore subsidising issuance expenses for various types of sustainable bonds, and the Bank of Japan soon to offer zero-interest loans to lenders financing climate change projects through green bonds, sustainability-linked bonds and transition bonds.

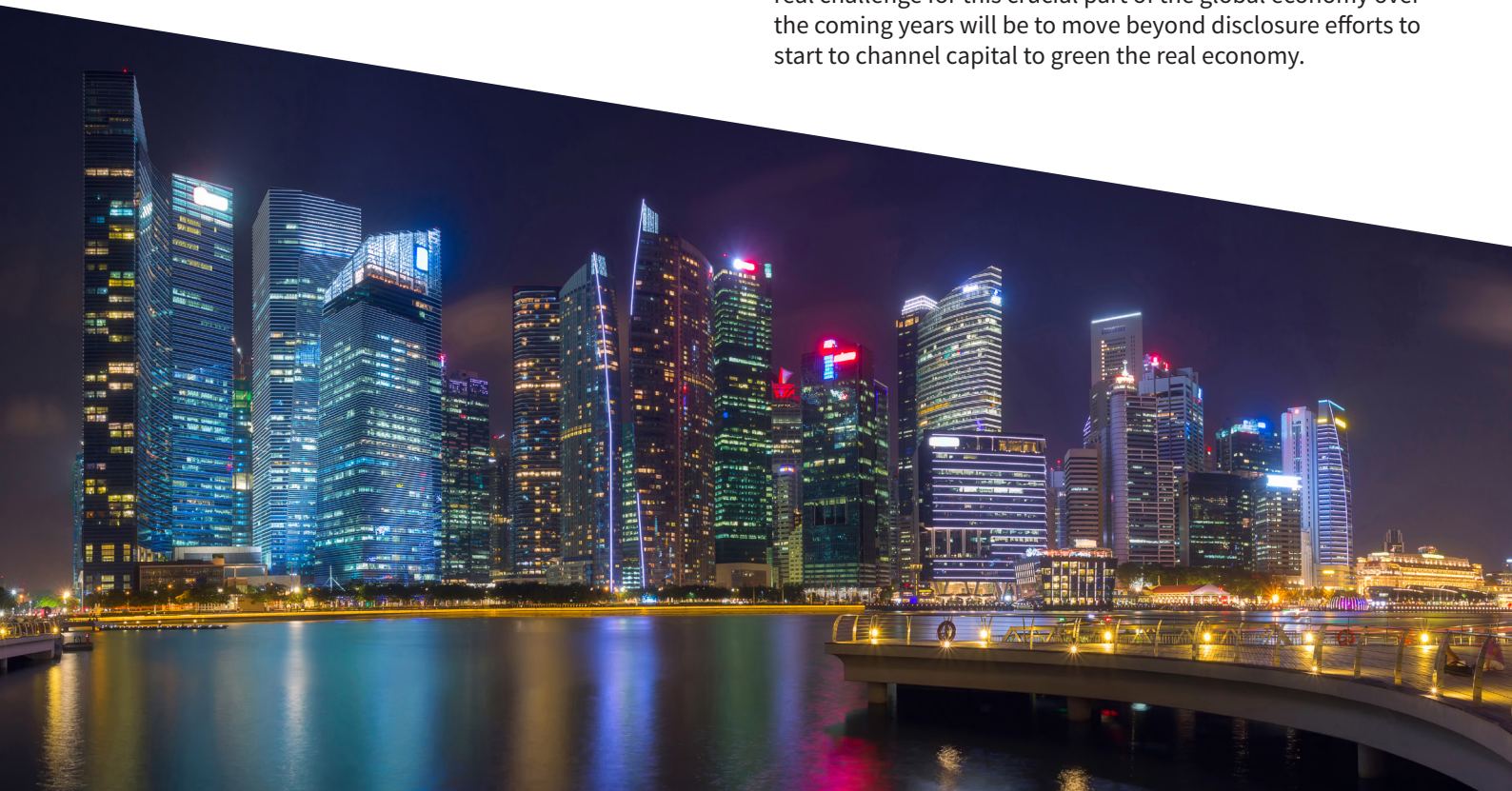
Meanwhile, stewardship codes are now widespread across the region, with the likes of Japan bringing in updated iterations to clarify how investors should approach sustainability in their engagements with companies. Collective engagement in the region, which has historically lagged behind Europe, is gearing up with force, with a particular focus on shepherding companies to make and upload their climate commitments. A notable example of this is the Asia Investor Group on Climate Change’s recently launched \$8.8trn-backed engagement programme to drive net-zero emissions transitions in Asian electric utilities.



With robust investor and regulator support, the APAC region is showing its potential to become a considerable force in responsible investment

Asset owners in the region have been influential in flying the responsible investment flag, putting pressure on asset managers to play ball. Recent research from Willis Towers Watson found that Asian asset owners expect to treble the ESG-aligned proportion of their portfolios and are demanding more and better quality ESG investment products. One of the earliest ESG movers, Japan’s \$1.54trn Government Pension Investment fund, has shifted billions of its assets to ESG indices since 2017, and integrated ESG into its manager selection and monitoring processes – an approach rapidly being adopted by other Asian asset owner heavyweights including China’s Ping An and South Korea’s National Pension Service.

With robust investor and regulator support, the APAC region is showing its potential to become a considerable force in responsible investment. But with APAC nations accounting for more than half of the top 10 coal-generating countries, the real challenge for this crucial part of the global economy over the coming years will be to move beyond disclosure efforts to start to channel capital to green the real economy.





# Race to net zero: ESG goes global

The tide of sustainable finance regulation is reaching new corners of the world, as governments throughout Latin America, Africa and the Middle-East look to harness the swell of international interest in ESG to further their low-carbon and sustainability agendas.



And further progress on green finance is set to accelerate through the Africa Green Finance Coalition, unveiled at COP26 by the National Treasury of Kenya and FSD Africa

For the African continent, where green finance policy and regulation has been slow and patchy, sufficient capital isn't yet being unlocked for countries to respond to the climate emergency, recover from Covid-19 fallout and move towards sustainable development.

Africa accounts for only a small share of the global sustainable finance market. Its green bond market, for example, accounts for just 0.3% of green bonds issued by region to date – just 25 issuances raising \$4.3bn, heavily concentrated in South Africa, according to the Climate Bonds database.

However, recent developments could push Africa towards an inflection point for sustainable finance. South Africa has shown notable momentum, with the Johannesburg Stock Exchange introducing clear rules for green listings and a platform for green bond issuances. South Africa's Treasury is working on its own green taxonomy, adapted to its economy and covering biodiversity, with a final version expected in 2022.

Kenya has been a leader through its sustainable finance initiative, led by the Kenya Bankers Association, and in Ghana, the government has implemented a range of incentives for green finance. The Central Bank of Nigeria has also directed and incentivised the uptake of ESG for banks and development finance institutions.

Labelled sustainability-related bonds present a crucial opportunity in Africa, with core infrastructure needs such as renewable energy and low-impact housing ripe for green financing. Mauritius was the latest African country to release a sustainable bond framework, joining the likes of Kenya and Nigeria. 2021 saw the launch of Africa's first SDG bond, while Ghana announced plans to issue the continent's first sovereign social bond.

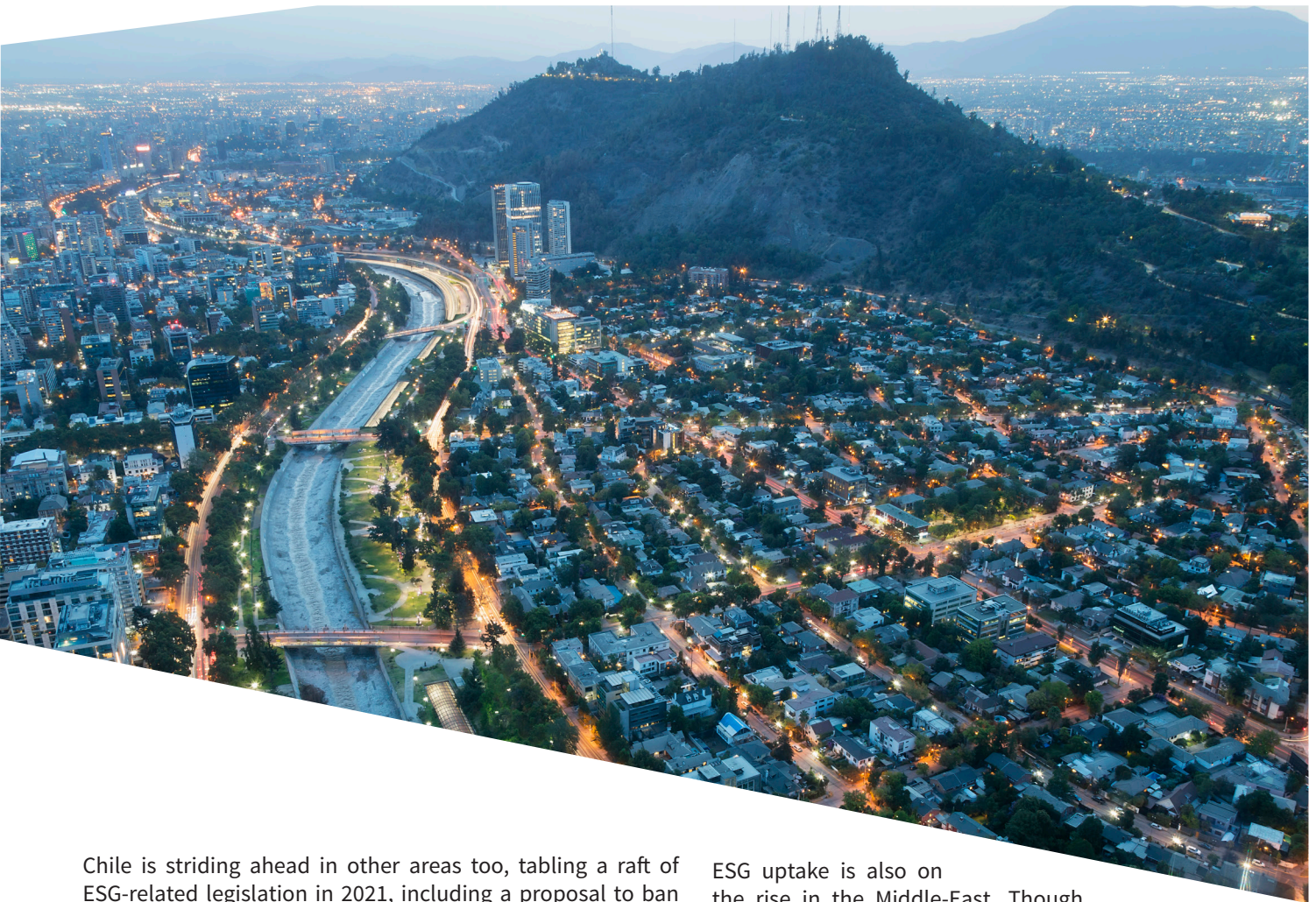
The private sector is also stepping up, with African financial institutions signing up to the Net-Zero Banking and Insurance Alliances, and the Mauritius Commercial Bank launching a climate change centre in 2021.

And further progress on green finance is set to accelerate through the Africa Green Finance Coalition, unveiled at COP26 by the National Treasury of Kenya and FSD Africa, which will support African countries to bring in green finance reforms including climate and biodiversity policies, green bond guidelines and green fiscal policy incentives.

Meanwhile, the African Development Bank and the Global Center on Adaptation have just launched a programme to mobilize \$25bn for adaptation activities in Africa by 2025 – a critical undertaking in a continent that is home to 27 of the world's 40 most climate-vulnerable countries.

Home to immense swathes of the world's rainforests and economically heavily reliant on industries depending on natural capital stocks, Latin America has also seen ESG shoot up the regulatory and policy agenda.

Colombia, Costa Rica and Chile have green bond frameworks or standards, with \$126.4bn of green issuance across the region to date. This has been led by the private sector but also furthered by significant deals from the Chilean government, which has issued over \$14bn in multicurrency ESG bonds.



Chile is striding ahead in other areas too, tabling a raft of ESG-related legislation in 2021, including a proposal to ban coal-fired power plants from 2025, and a Framework Law on Climate Change. The country's financial regulator is mulling mandatory ESG reporting for listed companies, while its environment ministry has launched a Natural Capital Committee to make recommendations for how to measure the country's natural capital stocks.

Brazil's central bank, meanwhile, is at the forefront of emerging economy supervisors, having this year put out a batch of mandatory ESG regulations, which include mandating climate scenario and stress testing across the country's banking sector. It's even mulling social scenario analysis, a global market-leading practice.

Mexico is also developing its own taxonomy of green finance, broadly modelled on the EU framework but expected to give more weight to water and biodiversity alongside the EU's climate focus.

Other Latin American countries are undertaking or working towards similar initiatives – accelerated by this year's launch of the Network of Regulators for Sustainable Development, a group of financial regulators from Latin America and the Caribbean dedicated to supporting the development of national sustainable finance strategies and rules in the region.

ESG uptake is also on the rise in the Middle-East. Though known for its oil dependency, there's a tide of moves across the region to diversify into lower-carbon economies, capitalise on low-cost renewable resources and improve water management, in one of the world's driest regions.

Progress is patchy, but Egypt, Jordan, Morocco, Bahrain, the United Arab Emirates (UAE) and Saudi Arabia have adopted green growth strategies, with all bar Saudi Arabia adopting ESG guidelines and actively building capacity around sustainable finance.

Saudi Arabia has been at the forefront of renewable energy in the region, forcefully procuring clean energy projects under its Vision 2030, with its Private Investment Fund tasked with developing and arranging consortiums for a pipeline of projects over the next decade. Green and sustainable finance is also a key policy of the UAE government, with increasing support from the private sector.

With regulatory support still in its infancy, financial institutions aren't yet centring environmental risks and opportunities into business strategies. However, ongoing financial sector reforms could mean the region soon moves towards fuller integration of environmental and social factors, with Islamic finance principles presenting an opportunity to further foster sustainable finance in the region.

# ► Climate engagement digs deep for change

UBS's climate engagement begins with encouraging companies to set carbon reduction commitments and targets. Next, the team engage on underlying corporate strategy, the management of the individual business units and divisions, capital allocation and reporting transparency in an approach that is reaping rewards

UBS has just completed the first evaluation of its climate engagement programme, set up three and a half years ago to encourage and cajole companies to begin transitioning their operations and business models to a low carbon world. The findings are encouraging. An engagement programme that began with members of the asset management team talking with a small handful of companies around their greenhouse gas emission targets, has grown into a forum for much deeper discussion on the strength of corporate emission targets (now universally in place), what companies are doing to meet them, and broad climate risk management.

Often, particularly with companies in the energy sector, the conversation goes further still getting into the weeds on corporate strategy, capital allocation and sometimes the business model. "Significant numbers of the companies in our engagement programme have made excellent progress in terms of having effective governance, targets, and a strategy to meet those targets. It amounts to meaningful progress," enthuses Francis Condon, head of UBS Asset Management's thematic engagement programme, tasked with deepening ESG integration across the whole asset management division.

UBS's climate engagement programme emerged out of the asset management division's Climate Aware investment strategy. In its simplest form, the enhanced index, rules-based strategy involved tilting away from companies that metrics showed as disadvantaged in terms of the transition and towards those more advantaged.

From this base, the team saw the opportunity to build out an engagement layer, extending the programme to connect with what the 45 companies in the index selected for engagement were doing about the transition, with a particular engagement focus on the oil, gas and utility groups in the index. "We felt there was a significant amount we could add to the engagement process, and a significant amount of change the companies could make," he says, describing a process that always begins with commitments and targets, the "north star" in terms of how companies should approach the transition.

*Francis Condon, Head of Thematic Engagement & Collaboration, Sustainable Investment Research, UBS Asset Management*



Next, engagement extends into the underlying business strategy, exploring the management of the individual business units and divisions, capital allocation and degree to which investors can monitor progress. Reporting in line with Taskforce on Climate related Financial Disclosure (TCFD) guidelines and alignment with the investor expectations of UBS's partner organisations like the Institutional Investor Group on Climate Change (IIGC) is also key.

UBS Asset Management's engagement team has around 1200 face-to-face conversations a year during which they actively express a requirement or encourage a particular corporate course of action. More than half the conversations are with C-suite executives and more than a third are with Chairs and non-executive board members. The team also work closely with companies' in-house sustainable investment and investor relations specialists.

## Carrot and Stick

The final element of the process comes when Condon and his team weave corporate progress on meeting the climate risks raised in the engagement process into investment decision-making. “We are looking for broad improvements on climate preparedness,” he says. Looking back over the past three years, he notes significant changes in many of the oil, gas and utility companies most challenged by the transition, with nearly a quarter hitting original objectives. It’s encouraging progress, particularly given three years ago many were still unfamiliar with the TCFD reporting framework.

Still, around 10% of corporates in the index have made limited progress, unable to step up and engage with the transition. “The climate transition is a risk for companies, especially those in fossil fuel sectors, and companies that are not able to grasp the scale of the challenge, highlight a potential investment risk.”

Condon’s proximity to corporates’ climate preparedness informs his other key role at UBS: advising credit and equity teams on investments in the energy and utility sector and flagging key risks to watch. The materiality of companies’ climate preparedness for debt and equity investors is nuanced, he says. For example, both equity and bond holders will look at the ability of a utility to, say, retire its coal fleet and move into renewable energy sources. However, equity investors may be more alpha driven and focused on the growth and opportunity side. In contrast, bond holders are typically more concerned about the risk, and how this could impact the company’s ability to service and retain debt over the maturity of the bond.



Significant numbers of the companies in our engagement programme have made excellent progress in terms of having effective governance, targets, and a strategy to meet those targets



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# ► Materiality and why it is the beating heart of a responsible corporate

UBS's ESG advisory unit espouses the importance of materiality. Only then will companies be able to reframe their conversation with stakeholders, particularly investors, and gain control of the ESG narrative.

Integrating ESG risks and opportunities into corporate decision-making processes related to strategy, operational quality, capital allocation and financing is complex. It requires a set of new skills. Finding what is and isn't material in the abundance of data requires a careful thought process. Corporate calls for a helping hand to operate in the ESG jungle have never been stronger, says Laurent Bouvier, a few months into his role as global head of UBS Investment Bank's new ESG Advisory group, tasked with helping UBS' clients maximise stakeholder value and seeking to leverage the bank's positioning as the posterchild for sustainable finance in investment banking amongst its corporate clientele.

## Investors

Bouvier argues companies need support in re-framing their dialogue with ESG investors, bringing clarity back to the conversation and connecting companies to the financial markets : 'One of our jobs in investment banking is to connect corporate issuers with investors. At the moment, ESG is creating some fog and the connections are not happening as they optimally should. I believe that the market has lost some efficiency.'

Part of the solution consists in helping companies identify their most material ESG risks. It involves drilling down to which of the Sustainability Accounting Standards Board's (SASB) key sixteen-odd categories are most pertinent to the company in a searching and introspective process he likens to corporate therapy. "It requires real self-awareness and some external help can be beneficial.

## The what and the how

He advises corporate teams to begin by distinguishing *what* the company does from *how* it does it. For example, a company

can do something that holds little ESG risk like, say, making wind turbines but in a way that might hold considerable risk, like working with suppliers using unsustainable business practices, underpaying their personnel or lacking employee diversity.



Laurent Bouvier, Global Head of the ESG Advisory Group, Chairman of the Global Industries Group and Member of the Global Management Committee in Global Banking

Looking at the sustainability of a company's operations, i.e., the 'how', is more complex than analysing the ESG aspects of the 'what'. It involves new benchmarking tools, a new expertise and the building of a new type of judgment. Employee health and safety, supply chain and energy management, particularly fossil fuel, electricity and water consumption, can be material-risk areas in the 'how' bucket. The process will reveal important distinctions between different companies, says Bouvier. "Investors are learning how to assess the quality of a corporate's operations based on new key performance indices, and how to interpret the data as a signal of management quality."

Once companies have clarity and perspective of their most important material risks, they can regain control of the narrative of their equity story. “Understanding materiality puts companies in the position to guide investors towards the risks that define their value creation potential for all stakeholders beyond the short term,” he says. Investors in turn, he argues, welcome such corporate leadership.

### Revaluation ahead

Bouvier observes that the S&P Global Clean Energy Index has trended lower in 2021 in contrast to the rest of the market, irreflexive of the increasingly apparent climate challenge ahead. “I think we can all agree that the perceived issues the world faces from a climate perspective have not come down this year” he says.

The distortion is the consequence of investors buying into mainstream companies’ transition stories and net zero pledges and keeping capital flowing to most companies to the detriment of truly green endeavours. Reading this ESG cycle, he predicts that within the next couple of years investors will increasingly distinguish between the most compelling companies from a sustainability perspective, and the rest.

### Ladder out

It leads him to conclude with a final piece of advice: in the next 5-10 years, expect much more of an ESG valuation premium.



Integrating ESG into corporate decision-making around financing strategies or optimal capital structures, the best operational setup or how to combine sustainability with long-term growth is highly complex



# ► Passion and helping others. Sally Bridgeland talks about what she's learnt

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Sally Bridgeland learnt about the importance of passion and helping others early on in her career. Today, as a sought-after non-executive director, she applies maths to problem solving and espouses the dangers of social inequality and the importance of impact investment.

Sally Bridgeland can distil the key criteria to career fulfilment and enjoyment into two pithy soundbites: do the things you are passionate about and offer to help others wherever you can. It is a guiding mantra that she grasped early on in her 35-year career that began as a pensions and benefits consultant at actuarial firm Bacon & Woodrow (later Aon Hewitt), where she climbed the ladder through a 20-year tenure; stayed with her through seven years as CEO of the BP pension scheme, and now shapes her five non-executive director roles. "Focus on what you can do to help. It's the most satisfying thing you can do," she says.

Bridgeland's extensive non-executive portfolio reflects how valued her breadth of experience, underscored with broad, practical ESG knowledge, has become in the boardroom. Her non-executive roles span transition asset manager Impax Asset Management, the £22 billion Local Pensions Partnership, Royal London, insurer RSA and the Pension Insurance Corporation. She also sits on a variety of charitable investment committees, is involved in charities that pursue maths education and is an honorary group captain of the RAF, a role she was offered when the RAF made diverse, external thinking a priority amongst its leadership team.

Bridgeland insists that each role feeds into and informs the other. Using a maths analogy – she studied at Imperial College, London – she describes a Venn diagram, where her directorships often call on the same expertise, particularly regarding financial regulation. "There is a win-win in a busy portfolio," she says. She describes how non-executive roles require a helicopter view of the direction organisations are travelling, ensuring that boards have the right culture, environment and skills. Her task is to think longer-term, spotting what is going on in the world and how it could impact the organisations she represents.



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Elsewhere, she endeavours to find the area in each company where she can be most useful, and particularly enjoys being involved in fast-growing companies making decisions that will shape their future.

However, it is Bridgeland's ESG knowledge, experience and straight-talking demystification of responsible investment (she coined the phrase in an assignment working with the Universities Superannuation Scheme when she was head of investment research at Hewitt in the 1990s) that is arguably most sought-after. Governance was an early interest in her career when she first started noticing - and understanding - how decisions are made. Later, drawing on years of being "the only woman in the room" she became expert at finding her voice.

Bridgeland's approach to the 'E' of ESG is characterised by her love for the natural environment, acknowledgement of the challenge of change and the dangers of hypocrisy – and leading by example. She holds precious her rural childhood; doesn't own a car (she's been cycling London's streets for 37 years) and endeavours to live her life as responsibly as possible. As chief executive of BP Pension Trustees between 2007 and 2014, overseeing the oil company's £20 billion final salary pension fund during the Deepwater Horizon disaster, she noticed how colleagues understood the risks and rewards of using oil much more than "the average person filling up with petrol".



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Today she uses her energy to cajole boards into not letting the challenges of the transition be an excuse for inaction. The investment world needs to raise the bar; stop worrying about benchmarks, data and targets and get on with doing the right thing, she says. "Diversity is about statistics and inclusion is a way of life; the 'E' of ESG is about data and metrics but the transition is a way of life that involves thinking and doing things differently."

Perhaps her most enduring legacy from her time at BP had to do with the 'S' of ESG. She blazed a trail for working parents by insisting on a part-time role despite being in the top job at the pension fund. Determined to spend time with her longed-for baby and "to not juggle but do it properly", she raised the bar for others to follow in a company that had never had a part-time group leader in its 100-year history. It would have daunted some, but Bridgeland was instantly comfortable in the role of guinea pig, reminded all the time that others would benefit from what she was doing. "After a tough day, it was a source of strength for me to remember that if I didn't do this, someone else would have to."

Today she is increasingly vocal on rising social inequality in old age. "The quality of life for pensions matters; it's not about the amount of money we are giving them," she argues. Her hope is that as allocations to illiquid investment grow, new thematic strategies that allow people to invest in the causes they care most about will emerge. New technology that is changing how we access data and make investment calculations will accelerate the trend. "If I was starting from scratch with the computer power we have today, I would be trying to optimise impact as well as financial returns," she says.

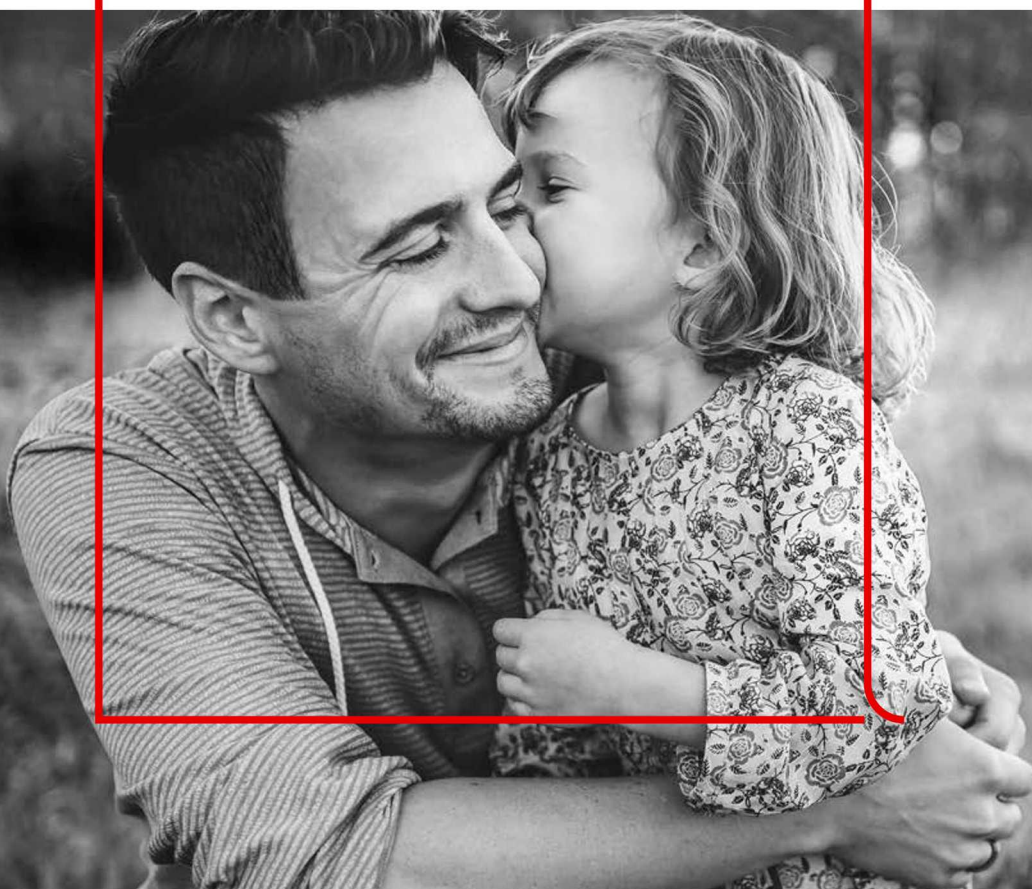
Indeed, she finds the growth of impact investment and the fact more investors are taking risk, reward and impact into consideration in their allocations a key source of hope and inspiration for the future. Her own belief in the importance of impact is captured in the irony that throughout her BP years she never knew Impax Asset Management operated just two doors down. "They've been there since 1998 doing the right thing. Now their time has definitely come."





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