Pragmatic approaches to transition investing and the need for green populism

In November, **Tell Media Group**, in cooperation with **Blackrock**, **IFM Investors** and **Robeco**, organised a roundtable event at the Thief hotel in Oslo, discussing climate transition investments.

By: Niklas Tell Photo: Agnes Tell

With the roundtable being held only days after the US presidential election, the initial discussion centred on change in leadership in the US and what that could mean for climate transition investments in terms of political risks and regulatory frameworks.

LARS ERIK MANGSET: "It remains of course to be seen what the more long-term effects will be. I think the short and most obvious answer is that the uncertainty around policies for green industries will increase. Will we see a pull back from the Paris agreement? Will we see a pull back from the IRA programme and so on? Another aspect is the impact of trade policies on production and innovation of green technologies."

GJERMUND GRIMSBY: "I think we need to remember that wind and solar are cost-efficient technologies. So even if we will see a pull back of incentives and changing policies, I do think that the economics of it all will be a balancing factor."

NIKLAS TELL: WERNER, YOU FOCUS ON INFRASTRUCTURE INVESTMENTS, WHICH ARE TYPICALLY LONG TERM IN NATURE. WHAT IMPACT ARE YOU SEEING?

WERNER KERSCHL: "We do take a long-term view because we don't have to exit our assets, so we can look through political electoral periods and focus on the fundamentals. Sustainability and renewables make sense for a country in the long term and is a trend that's here to stay. Before the election, I would have said that we will see more interesting renewable investment opportunities in the US under the IRA. Now, it remains to be seen."

CHARLES LILFORD: "I don't think there are any doubts that there will be significant changes ahead. There are, however, also positives if you revisit the previous Trump presidency. Wind and solar investments actually went up quite remarkably in comparison to the previous four-year cycle with solar capacity increasing by 52 per cent and wind increasing by more than 80 per cent during Trump's administration. Furthermore, there were in fact more drilling permits on federal land issued during Biden's administration than during Trump's. Perhaps more notably, the energy outlook is fundamentally more important and particularly different today than it was in 2016. This is due to a heightened focus on domestic energy security and also fundamental growth in energy demand. We are seeing ever increasing focus on energy security and domestic energy resilience – notably in Europe but elsewhere globally, including the US. Furthermore, fundamentally there's an increasing demand for electricity, driven by the switch to electrification, re-industrialisation and the evolution of artificial intelligence. Renewables will play a key role here given the rapid deployment model, cost competitiveness and low reliance on commodity inputs."

YANXIN LIU: "If we look at the macro picture, the Trump win will play a critical role and if he moves ahead on all his trade policies, which will add friction, that will probably mean that rates will stay higher for longer. What does that mean for infrastructure investments? Another question is of course the renewable energy supply chain and I think it's fair to say that the ultimate goal of Trump is about national security on energy. I think that means we will see less wind and more nuclear within the clean energy mix in the US."

NIKLAS TELL: WHEN INVESTING IN THE CLIMATE TRANSITION, YOU COULD EITHER FOCUS ON DECARBONISING YOUR PORTFOLIO TODAY OR FOCUS ON THE PATH AND FINANCE THE TRANSITION. HOW DO YOU BALANCE THIS?

GJERMUND GRIMSBY: "For KLP as an owner and responsible for the future pensions of our clients, our starting point is that increased global warming will result in higher pension costs. With our primary focus being to minimise the pension costs for our clients, we invest with an aim to have a real economic impact with respect to actually reducing emissions. We have a dual-track strategy where we on the one hand focus on the transition of high emitting sectors and on the other hand financing the solutions."

CHRISTOPHER GREINER: "We have a perpetual time frame, so the main focus is that we should keep the real value of the portfolio – inflation adjusted and also taking into account the grants that we give out annually and the cost of running the foundation. We do, however, also have a mandate to reach a net-zero portfolio, so we're mindful of that. As of right now, it's more about establishing the reporting functionalities of the portfolio to ensure we have a base level and are able to track the transition going forward. We only invest in funds, so we lean very much on the fund managers that we select. We currently don't have any requirements that says that we need a certain percentage in climate transitions funds, so it's very flexible. Once we have the reporting structure in place and are able to follow the development, the plan is to engage with the fund managers to ensure that they don't deviate from the needed path. As of today, it's, however, a little bit too early to make any changes in the portfolio based on the net-zero pathway."

NIKLAS TELL: AT GRIEG, WHAT DO YOU HEAR FROM CLIENTS WITH REGARDS TO BALANCING THESE DIFFERENT PRIORITIES?

LARS ERIK MANGSET: "Firstly, I think it's fair to say that we see investors with different ambition levels. Some are very ambitious and have set net-zero targets for 2040 and are intent to meet them, even though they're not quite sure how to do that. We're in the process working with them on exactly how to do it. It needs to be a connection between the goals in the net-zero target and the decisions that they make and it needs to be done in a sensible way where the boards and asset owners are aware of the trade-offs they're making. For many, I think it's a new way of thinking, because you're bringing in a completely new target and it doesn't necessarily balance perfectly with the traditional way of thinking around portfolio construction. I also think that for clients that set these short-term targets, it's extremely important that there's some stability in the way that you measure it. What we see is that when we apply science-based data, there's more stability in the Paris alignment results over time, while the opposite is true when applying financial carbon intensities, which can be influenced by changes in interest rates as opposed to actual emissions reductions, for example."

PARTICIPANTS

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Chief advisor climate change at KLP. Before joining KLP in 2022, he spent some 14 years at Menon Economics in different roles, most recently as head of Menon's team on industrial policy, antitrust and evaluations.

YANXIN LIU: "I agree with the challenge when it comes to the availability and correctness of the data. At Robeco, we've built an internal sustainability database over many years and we have internal climate analytics. We take a forward-looking approach by establishing sector decarbonisation pathways. The benefit from a portfolio construction and fund management perspective is that we can work with a universe that offers both the depth and also breadth. We have identified companies that are transition leaders across both high emitting industries and in the low emitting industries and through this approach, we're able to build a very diverse portfolio. The challenge is still how we can aggregate the sector decarbonisation pathway data on the portfolio level because the denominator varies per sector. For cement and steel, we use unit as the denominator, whereas we use kilometre driven for the auto industry. We're actively looking at it and it remains a work in progress."

GJERMUND GRIMSBY: "At KLP, we've also set targets with respect to financed emissions and we also have milestones every five years. In the short term, we're prioritising investing in companies that have credible transition plans and we focus a lot on the high emitting sectors because that's what will have the biggest impact. It is, however, a challenge when it comes to communication because we basically put our hope in the fact that these companies actually deliver on their strategies and that's what will eventually take emissions down, also in our portfolios. On the fixed income side, about a third of assets are in hold-to-maturity bonds and as of this year, we only invest in companies that have set science-based targets or are part of the solution space. The companies that set these targets are typically high emitting companies so when we report on our financed emissions, they will potentially go up in the short run but then follow the path downwards over time."

NIKLAS TELL: YOU MENTIONED COMMUNICATION. HOW MUCH OF A CHALLENGE IS IT TO DEFEND THAT YOU INVEST IN COMPANIES THAT ON THE FACE OF IT LOOK "BAD" FROM A SUSTAINABILITY POINT OF VIEW?

GJERMUND GRIMSBY: "I think that remains an open question. We don't know. From our perspective, I think we will be able to communicate because we have one dominant group of owners but I think it would be more difficult for an asset manager with a diverse group of investors."

WERNER KERSCHL: "Our fiduciary duty to investors is to create returns. However, focusing on sustainable targets, especially in infrastructure, will be the social licence to operate and it also helps us avoid the stranded asset risk. The infrastructure that we invest in is by definition carbon emitting, for example airports, and the fund structure gives us the time to work on this. All assets have net-zero target and then we have milestones in 2030 and 2050. However, we also have a separate strategy that invests in a portfolio that is already decarbonised and part of the net-zero transition world, such as renewables and electrification, and we've distinguished the two between SFDR Article 8 and 9."

CHARLES LILFORD: "I think that's exactly right. We've seen a significant evolution over time. Previously, we saw a phase of divestment. Larger companies looked to divest assets that had high carbon footprints in the aim of getting a re-rating on the basis of sustainability metrics or higher ESG characteristics. This has since evolved. Today, the approach is more holistic and we see that companies are embracing the opportunity to be credited with improvement as opposed to being branded as good or bad and I take that as a true positive. I think this is positive because it brings more companies and more investors into the fold and that will help us move towards a more decarbonised economy."

NIKLAS TELL: IS THAT A SIGN OF THE INDUSTRY AND INVESTORS MATURING?

"We basically put our hope in the fact that these companies actually deliver on their strategies and that's what will eventually take emissions down, also in our portfolios"

– Gjermund Grimsby, KLP

LARS ERIK MANGSET: "I think it's increasingly more awareness around what will have an effect in the real economy. In Norway, and in many other countries, the focus on divestments, for example from coal, was very much in vogue around 2010 to 2015. However, later we've seen studies showing that it's unclear whether it had any real effect. I guess you can say that we've matured as an industry. We understand that using divestment as a tool to achieve real impact is a more complicated theory than perhaps anticipated 10 years ago. If you want to be a net-zero conscious investor, it's not only about going into green bonds or hide in 'good' companies. You need to figure out what to do with the rest of your portfolio as well. That's why the focus on the transition is appealing because you realise that there needs to be some improvement everywhere and it needs to start with the high emitting sectors."

NIKLAS TELL: SO WHERE DO WE PLACE TRANSITION INVESTING IN THE TERMINOLOGY OF ESG, SUSTAINABILITY, SDGS, IMPACT ETC? SHOULD IT SIT UNDER ONE OF THOSE OR IS IT AN ADDITIONAL LABEL?

YANXIN LIU: "The terminology of transition originally came from transition finance for the fixed income credit market where we have the direct impact on the project level. I think initially, it was more about the direct impact but of course it's less so for the listed equity space. Our industry recognises the importance of investing in companies that are currently brown, so many asset managers are increasingly adopting this transition or climate transition concept and blend that into the portfolio design and branding."

WERNER KERSCHL: "We've seen a big push for more regulation and we see that coming through in each geography we're working in. At the same time, we also see more sophisticated ways to measure transition. We need to find a way to demonstrate, measure and make transition paths comparable. I don't think we're there yet but going forward, I think transition will be just part of business as usual and we will move away from particularly strategies. I think all investments needs to be transitioning and it has to be sustainable in the very long term. For heavy emitting investments, the banking market have started to stop funding and insurance companies are starting to ask more questions."

CHRISTOPHER GREINER: "In terms of how we look at our portfolio, we have a more pragmatic approach where the

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CHARLES LILFORD
Portfolio manager in the fundamental equities division at Blackrock. He joined the company in 2016 and is a member of the thematics & sectors team and is responsible for managing various sustainability, decarbonisation and thematic equity portfolios. He is also a member of Blackrock's climate infrastructure investment committee.

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>
> *– Lars Erik Mangset, Grieg Investor*

focus is that we need to have a portfolio that's robust not only now but also in the future. That means that we focus more on engagement than divestment. We believe that oil and gas will still be a part of the energy mix going forward. We will not be rid of it until 2050 or beyond and then we would rather own Norwegian oil and gas companies than companies in other parts of the world where we don't have that much control. We also think that it's better for us to be owners of listed oil and gas companies than them becoming private companies without the same oversight from owners such as us."

CHARLES LILFORD: "It's about the ability to reinforce the licence to operate. I think that this is key, particularly from an institutional investors' framework where there are significant responsibilities. But it doesn't detract from the fact that you still need to produce suitable returns. The value proposition from an investor's perspective is that you do need to solve the ESG elements, but you need to also show that there's value creation. Those two go hand in hand and they cannot be mutually exclusive. The ability to show returns that are in line with the expectations of investors is key and critical for the viability of any strategy. We also need to be supporting a company's licence to operate and its ability to credibly show that it's a sustainable business operating within the correct frameworks. That's core to any sustainable investor today."

GJERMUND GRIMSBY: "We're just about to implement a strategy where we have identified 35 high emitting sectors in our listed equity portfolio that we will have an increased focus on. Within each of these 35 sectors, we're going to divest gradually from the companies that have showed the least ability and willingness to transition and then reallocate within the same sector to those companies that have credible transition plans in place. We think and hope that this can be a wise strategy from a financial perspective as it will reduce our transition risk within those sectors. But by being very open about what we're doing, we hope that can have a broader impact as well."

NIKLAS TELL: YOU'RE A BIG ASSET OWNER BUT HOW IMPORTANT IS IT TO COOPERATE WITH OTHER INVESTORS?

GJERMUND GRIMSBY: "That's key. We value the partnerships that we get through Climate Action 100+ but also through bilateral engagements as shareholders in particular companies. But also by communicating through media and being open about what we're doing. We hope and believe that can actually have some wider impact."

CHARLES LILFORD: "This is important because it creates a circular event whereby success breeds more success. If this type of strategy can identify companies that are at the forefront and leading, then financial markets will follow. The helps to bring the cost of capital down and equity availability is enhanced. That reinforces sustainable success around those companies that can outperform over the long term while laggards will need to revise their strategies and effectively change and transition accordingly."

GJERMUND GRIMSBY: "Exactly. On the fixed income side, we've seen that we're now able to engage in a constructive dialogue about the company's transition plan and this is through the debt financing part. It looks promising from what we've seen so far but we haven't started on the equity side yet."

WERNER KERSCHL: "We see that from our investors as well and we produce reports annually to demonstrate our transition path and that creates a lot of interest. We then also have to break it down to our management and investment teams in order to provide them with the tools to implement their own objectives. A lot comes down to the credibility of the reporting and we see a lot of regulatory requirements here and a lot of teams are being built at the moment to just fulfil the reporting. At the same time, we also need to spend time on implementing, so we're trying to find the right balance there."

NIKLAS TELL: HOW MUCH OF A CHALLENGE IS IT TO FIND THE RIGHT PACE FOR INVESTING IN THE TRANSITION? I GUESS THAT ALSO TIES INTO IF YOU BELIEVE THAT WE WILL REACH THE 1.5 DEGREE TARGET OR NOT.

CHARLES LILFORD: "You have to break it down into sectors and it's very much dependent on where you see breakthroughs. If you see a breakthrough in the cement sector or one of these heavy-emitting sectors, that can certainly accelerate the pace. It's necessary to go deeper down into the sub-sectors and into the specific companies to understand what would drive such change. Is it up to the companies and the management teams themselves to strategically refocus or is there something further that's needed in terms of a breakthrough or maybe even regulatory or government support?"

YANXIN LIU: "I agree that it's critical to look at the sector level but we should also realise that many sectors are interdependent. One example that we have in the portfolio is on the engineering and construction side and they are facilitators for the decarbonisation. However, they still need diesel to fire up their vehicles and how to decarbonise that part of their fleet remains a critical challenge for them. When it comes to the decarbonisation, certain sectors really depend on solutions provided by other sectors."

LARS ERIK MANGSET: "I just want to agree on the sectoral perspective. In the global equity space, we see the electrification of cars and most companies are planning to be close to 100 per cent electrical. The same goes for many utilities companies. We also see things happening in more difficult sectors, such as steel production or aluminium production, even though you would need a fundamental change in the underlying chemical technology or you would need carbon capture and storage. But there are usually some things all companies can do and what I think is perhaps most interesting now, especially that here in the EU, where it will be mandatory to make climate transition plans under the CSRD regulation."

WERNER KERSCHL: "Coming to back to your question on the pace. We often think about this from a technology perspective and that there's a first mover advantage. There's, however, also a first mover disadvantage and I think we're very mindful to be investing in the right pace. There needs to be the right incentives in the marketplace, such as carbon taxation."

NIKLAS TELL: YOU MENTIONED REGULATION AND I GUESS THAT THAT'S A BIG QUESTION. WHAT'S NEEDED OR LACKING WHEN IT COMES TO REGULATION?

GJERMUND GRIMSBY: "First of all, we lack global carbon

ROUNDTABLE – INVESTING IN THE CLIMATE TRANSITION

WERNER KERSCHL
Executive director at IFM Investors, responsible for the origination and execution of infrastructure transactions and the related asset management. Since joining the firm in 2006, he has worked on numerous global acquisitions and more recently, he was leading the acquisition of a stake in Vienna Airport in Austria and SQ Renewables in Italy.

YANXIN LIU
Portfolio manager and member of the global equity team and responsible for fundamental global equities with a focus on information technology as well as portfolio construction. She is also a portfolio manager of the Robeco Global Climate Transition Equities fund. Prior to joining the global equity team in 2022, she spent 11 years in the emerging markets equity team. Before joining Robeco in 2011, she worked for DSM Pension Services in the Netherlands.

taxes. Only a quarter of carbon emissions are taxed and that's a problem. Either we need to tax emissions or we need to subsidise the alternatives. The European regulation for the financial industry is creating transparency and that makes it easier to assess risk and it creates a sort of yardstick competition within the financial sector. However, at the end of the day, you need real economic incentives. This is a global market failure and it's not something that the market will solve by itself. You need policies in order to create a level playing field."

CHARLES LILFORD: "You need the support structures to enable that regulation. I think a good example would be what we've seen in the US with the Inflation Reduction Act. There's an enormous amount of capacity that's either waiting to be constructed or waiting to be fully permitted because it does not have the necessary grid connections or permitting in place. That really comes back to the regulator and the capacity to process and efficiently enable the backlog. I totally agree with you in terms of regulation but you also need the implementation of that regulation and I think that's as critical as the idea or the regulation itself."

YANXIN LIU: "I agree but I also think that it goes beyond just regulation. It's also about industrial policies and a system design that have been catering to the fossil fuel industry."

WERNER KERSCHL: "I think we all agree on what's been said on taxation, policy and permitting. The other aspect to regulation is subsidies and creating the frameworks. Some 20 to 30 years ago, renewables were that new thing with support schemes, tax benefits and investment. We see something similar when it comes to the sustainable aviation fuel space today. The concept is so obvious because aviation needs this fuel to actually transition but we don't have enough supply even if the demand should be there. It's a chicken egg situation where we would welcome regulation to make it mandatory to use sustainable aviation fuel. The problem is that it could disadvantage European aviation compared to other countries and that's where the global aspect comes in. I think we do need more mandatory use of new technologies and also financial subsidies to make it economic viable to develop."

NIKLAS TELL: A LOT OF WHAT YOU'RE SAYING IS THAT WE NEED GLOBAL POLICIES WHILE MORE AND MORE COUNTRIES ARE BECOMING MORE PROTECTIVE AND LESS GLOBALISED. ARE YOU OPTIMISTIC THAT WE WILL WE SEE A SOLUTION HERE?

CHARLES LILFORD: "We need to have hope that the market enables change. Long-term investments require confidence. The market needs to see these types of solutions providing higher long-term returns than some of the legacy solutions. I do, however, think you're entirely correct when you say that the world seems to have become far more inward looking in certain respects. But at the same time, I think the drivers are the same. Each country focuses on energy security, the availability of affordable energy for citizens and the resiliency of the energy grid. There's a need for capital allocation to long-term infrastructure. These are very consistent across any country. What I take away from this is that these sustainable solutions are actually unlocking exactly what governments and societies want. We want a future that's more resilient, more secure, more prosperous, more affordable."

GJERMUND GRIMSBY: "There are a lot of market failures and we need to put the right incentive structures in place to develop in the right direction. For example, the whole infrastructure that we have in our societies are built on fossil fuels, which makes it cheap to continue with fossil fuel."

WERNER KERSCHL: "We do see that foreign direct investment has become much more difficult since COVID especially and now we also see more inward looking and protective political trends. I still think, however, that it's a global capital base and that the development will continue to be driven by global capital flows. Once these technologies create the return that's expected, I think that trend will not go away and I haven't seen any country that has completely moved away from their net-zero targets or the idea that global warming should be avoided."

> "There's, however, also a first mover disadvantage and I think we're very mindful to be investing in the right pace"
> – *Werner Kerschl, IFM Investors*

LARS ERIK MANGSET: "I'm actually quite pessimistic. It's not that I disagree with everything that has been said but I can also see it from less optimistic side. If you look at the numbers, emissions are still increasing even though we had a 7 per cent dip during 2021 when we had the Corona shutdown. Now we're back on the longer-term trend. The development of renewables, the grids and the batteries are going way too slow according to any scenario. Also, and this is just my personal speculation, even though the concern for climate change from a public perspective isn't falling, we do see that climate policies are becoming increasingly more unpopular and becoming this divisive political topic. Now, when the Norwegian Government are providing their longer-term perspectives, they're not talking about climate change at all. It's not even mentioned because it's a difficult political topic. We need the public support in order for this to develop faster."

CHARLES LILFORD: "I agree but I think it goes beyond climate policy because it's in fact industrial policy. It's based on economics and what is the cheapest, most easily deployable solution of energy generation today? Notably, solar is one such technology. What is the most efficient way of transporting people and goods? It's already or in other cases evolving towards electrified transportation. So even if we may see societies polarised around what defines climate policy, there will not be polarisation around industrial policy and the ability to create successful working economies based on that."

LARS ERIK MANGSET: "I fully agree on that but we might also see more expensive flights, more expensive houses, more expensive food etc. Some sectors will probably develop in the right direction regardless of policy but then there's still a lot of emissions out there. Maybe we need more green populism in the climate space, where we start by addressing things that people would agree with and postpone the more difficult things. Just to get the first effects of the low hanging fruit."

YANXIN LIU: "I think both sides are right, even if I'm personally still optimistic. I also think we need to ask ourselves if we can rely on capitalism alone to solve this decarbonisation problem and here I think we see a clear difference between east and west. In China, power infrastructures are nationalised and there we see an acceleration in greening everything, which is different to for example the US. So ownership and how to balance public and private is a challenge that we need to solve."

WERNER KERSCHL: "Before Corona, climate change was a number one priority but with the pandemic many government balance sheets became being very indebted and since then we've had the war in Ukraine, energy crisis and a cost-of-living crisis and now more spending on defence. Where is climate change on this list? Hopefully this is a phase that we're going through but it's something to watch going forward."

NIKLAS TELL: GJERMUND, YOU MENTIONED THAT THERE'S A CLEAR COST TO YOU IF WE'RE NOT SOLVING THIS.

GJERMUND GRIMSBY: "Yes. If we look at the climate model that we use to create scenarios, we see that if we compare a 2 degree world to a 3 degree world, we will see pensions becoming 15 to 20 per cent more expensive."