IFM Investors

Industry super capital:
Investing for the 22nd century

Large pension funds are becoming a distinct form of capital, focused on creating multigenerational value based on safe and secure economic, social, and environmental systems.

NOVEMBER 2023

About IFM Investors

Owned by industry superannuation funds. Inspired by their members. Our purpose is to invest, protect and grow the long-term retirement savings of working people. We prioritise the interests of like-minded investors worldwide who aim to build a real and lasting impact by focusing on assets that combine excellent longterm risk/reward characteristics with broad economic, environmental and social benefits to the community. Operating globally from offices in Melbourne, Sydney, London, Berlin, Zurich, Amsterdam, New York, Hong Kong, Seoul, Tokyo and Milan, IFM manages investments across infrastructure, debt, listed equities and private equity assets. For more information, visit **ifminvestors.com**.

In this paper we examine the systemic challenges faced by owners of industry superannuation capital. As an asset manager which is owned by industry superannuation funds, with a long-term investment approach, and with deep relationships with some of the largest asset owners in the world, we share our views on how pension funds can collaborate and become stewards of economic, social and environmental systems.

Large pension funds have learned something important from the climate crisis, the COVID-19 pandemic and the Ukraine invasion: long term investment returns depend upon safe and secure societies and environments.

Systemic factors have long been acknowledged in investment theory, but are now widely accepted as first order issues in practice. Managing systemic risk requires a different set of investment skills than those that pension funds and other sophisticated investors have historically emphasised.

Many large pension funds can now be considered universal owners – institutional investors that have become so large they own a slice of the whole economy. They can't stock pick their way out of climate change. And they can't swerve systemic issues that affect the entire economic system, such as inequality and biodiversity loss. These risks are impossible to diversify away from. They show up as lower returns across the portfolio over the long term, as well as elevated short-term volatility.

> **Large pension funds can't stock pick their way out of climate change. And they can't swerve issues that affect the entire economic system.**

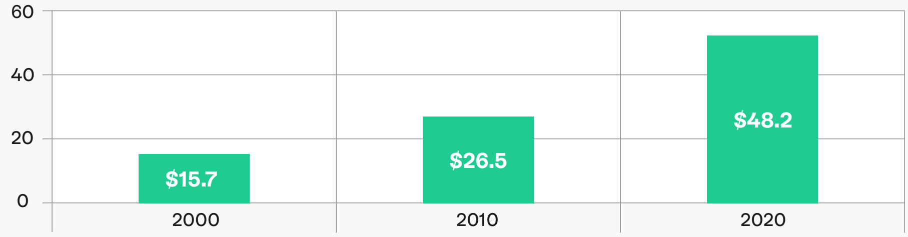
Protecting long-term future investment outcomes involves taking on systemic issues, such as climate change. And this, in turn, involves pursuing real world impact to nurture the health of fundamental systems. Consciously pursuing impact means active ownership, investing in solutions, engagement with policy makers, and working jointly with other institutions to bring about change. Because no investor, no matter how large, can take on these systemic risks alone.

The median member joining a pension fund today is likely to be receiving benefits until around 2080, and some members are likely to be receiving benefits in 2100. And new members are joining every day. Over those ever-expanding time horizons, healthy environmental and social systems are necessary to sustain returns for this generation, and for future pension fund members.

For the past decade or so, pension funds have innovated to integrate ESG considerations into their investment processes, enhancing the performance of companies and assets. The next step for pension funds is to pursue deliberate impact at the systemic level in order to sustainably deliver risk-adjusted returns to their beneficiaries consistent with their fiduciary obligations.

FIGURE 1

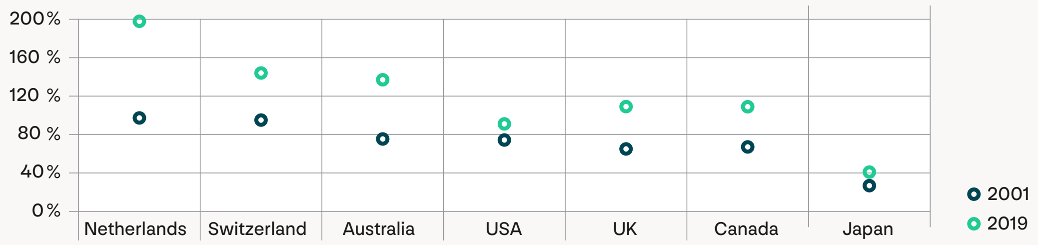
PENSION ASSETS IN SEVEN LARGEST MARKETS (USD TRILLION), 2000 TO 2020



Source: Thinking Ahead Institute

FIGURE 2

PENSION ASSETS IN SEVEN LARGEST MARKETS AS % OF TOTAL GDP, 2001 TO 2019



Source: Thinking Ahead Institute

Pension funds now have the scale, the capacity and the influence to lead change to maximise long-term outcomes on behalf of working people.

With pension funds globally managing US$48trillion[1], the largest pool of capital in the world, their collective actions will continue to shape our economies and societies. Pension funds now have the scale, the capacity and the influence to lead change to maximise long-term outcomes on behalf of working people.

Pension funds are a distinct and growing part of the global financial system

Pension funds are creatures of public policy and industrial bargaining, not for profit, with joint governance by representatives of employers and workers.

FIGURE 3

GLOBAL PENSION FUND ASSETS

Year	$USm	% OECD GDP
2017	28,389,104	56.1
2018	27,573,129	53.3
2019	32,270,567	60.1
2020	34,245,851	63.5
2021	37,700,000	64

Source: OECD Pension Funds in Figures (various years)

Note: OECD pension statistics do not include US individual retirement accounts of approximately $12 trillion.

As many countries grapple with the challenges of ageing populations, pension funds serve an important social purpose as the second pillar of the retirement incomes policies of many countries, supplementing publicly-funded age pensions or social security. A significant proportion of pension funds are themselves public sector entities; a 2022 study by the Thinking Ahead Institute of the world's top 300 pension funds found that nearly 70% of assets were in public sector or sovereign pension funds[2].

Pension funds also continue to increase in size, with growth rates exceeding overall growth in savings and GDP growth. As shown in Figure 1, pension assets have tripled since 2000 in the largest markets to more than USD$48 trillion. They are now equal to about two-thirds of the aggregate GDP of the OECD countries, and over half of global GDP. Consistent with the growth in assets, and a shift to more direct investment management and stewardship, pension fund trustee offices, particularly for large funds, have also grown significantly.[3]

Investing for the 22nd century

Pension funds' growth and evolution as universal owners has important implications because of the intersection between their social policy imperatives and their role in the financial system.

Globally, research suggests more than half of the population believe "capitalism in its current form is now doing more harm than good in the world."[4] The pandemic has highlighted social and economic fault lines, all while the frequency and scale of extreme weather events worldwide have continued to add to the urgency of action on climate change. As we incorporate what we have learned from the pandemic and Russian invasion of Ukraine, there is a growing perception that a return to "business as usual" is not enough.

A central feature of capitalism and financial markets over the past few decades has been the pursuit of short-term shareholder profits, often with insufficient regard for the costs to others, and even the long-term consequences for shareholders themselves. These costs are not always easy to see, yet have destroyed value for many and built up into crises for our economic, social, and environmental systems.[5] In particular, greenhouse gas pollution has created a climate crisis. And rising inequality of income, wealth and opportunity together with insecure work, have contributed to the erosion of trust in our business and democratic institutions, and undermined productivity growth.[6,7] These are material headwinds to prosperity, and impact on the macro investment environment for long-term institutional investors like pension funds.

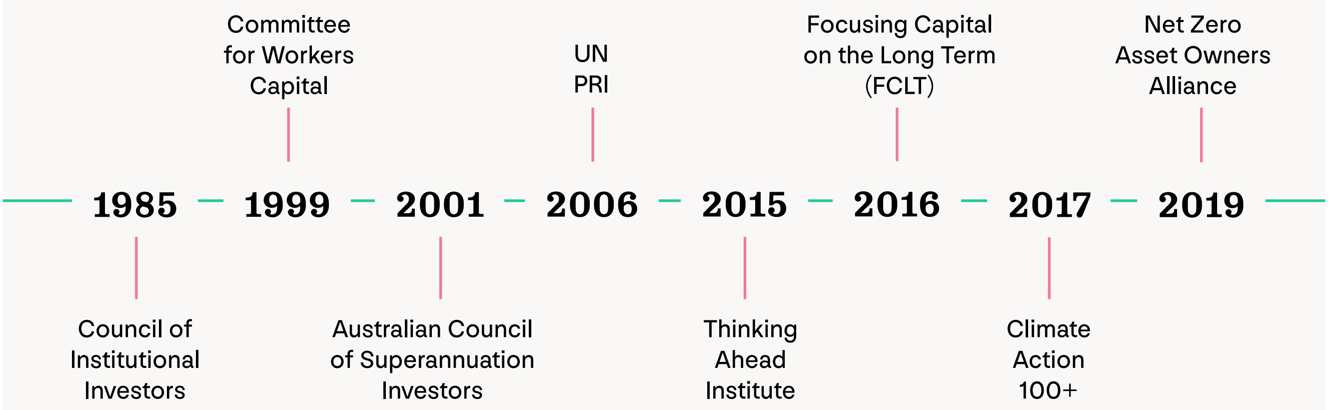
Within a context of rising support for stakeholder capitalism across institutional investment, pension funds – especially but not exclusively the larger ones, found across Australia, Canada, Japan, the Netherlands, Switzerland, the UK and the US – have been evolving to become more purposeful, sophisticated, and deliberate, and leading change in the industry.[8]

The EU High-Level Expert Group on Sustainable Finance has expressed the view that pension funds are structurally best suited for long-term sustainable investment.

"Pension funds' long-term liabilities make them ideal providers of sustainable finance. They constitute the 'purest' approach to long-term finance, as the

FIGURE 4

INVESTOR AND INDUSTRY COLLABORATIVE INITIATIVES



Source: IFM Investors

beneficiaries of collective retirement schemes expect income streams over several decades. Compared with other institutions, pension funds' long-term investment policies also make their assets potentially more exposed to long-term risks."[9]

Pension funds have an increasing capacity for collaboration

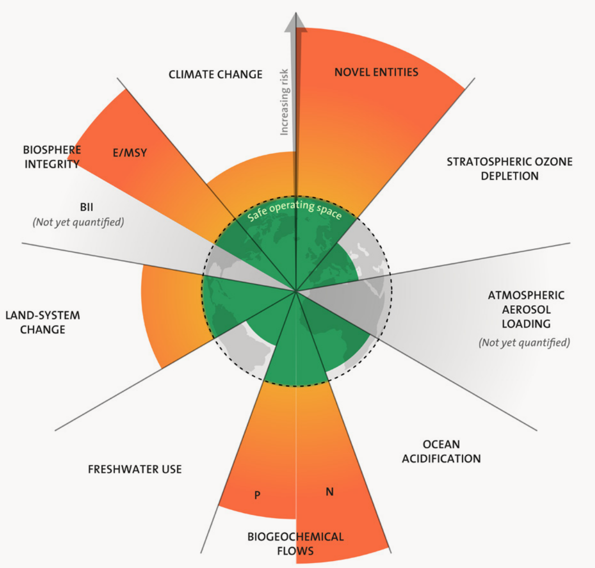
As not-for-profit institutions established by social partners, the largest and most influential pension funds tend to have different cultural norms to their service providers in the financial services industry – a culture focused on serving others which sees the value of cooperation among institutions.[10]

And as pension funds become increasingly large and occupy a greater share of public attention, they are increasingly held accountable by members, governments, regulators, industrial parties, and the broader public for how they invest and the role they are playing in financial systems, economies and communities. With their growing scale and prominence pension funds cannot afford to not integrate these considerations and the risks that accompany them.

Pension funds' continued growth, however, also strengthens their capacity to collaborate with each other and with institutional investor associations

FIGURE 5

SYSTEMIC CHALLENGES AND PLANETARY BOUNDARIES



Source: Designed by Azote for Stockholm Resilience Centre, based on analysis in Persson et al 2022 and Steffen et al 2015.

> **Pension funds' continued growth strengthens their capacity to collaborate ... to tackle global challenges and risks.**

and industry groups to tackle global challenges and risks. As shown below in Figure 4, we have seen the formation of investor and industry initiatives in recognition that working together can generate change more effectively than working apart. Pension funds have played a leading role in these initiatives.[11]

The systemic challenges for pension funds

- Environmental
- Social

Environmental and social systems are integral to long-term prosperity. These systems need to be nurtured and supported – because if too much strain is placed on them, the underpinnings of our economic activity will falter – sometimes in non-linear ways.[12] Long-term financial outcomes for pension funds – and almost everyone else – are undermined when the pursuit of short-term profits erode these systemic underpinnings.

The environmental and social boundaries on economic activity have been an active area of analysis, with the environmental boundaries most well understood. As of 2009, teams of scientists had concluded that humanity had likely already exceeded safe boundaries for three planetary systems: climate change, rate of biodiversity loss, and changes to the global nitrogen cycle.[13] As more data have become available, the safe boundaries for land conversion and the production of chemicals and plastics also appear to have been exceeded (Figure 5).[14]

The importance to long-term pension capital investors of ensuring portfolio companies – and other system actors – stay within these boundaries is increasingly clear.

Long-term financial outcomes for pension funds - and almost everyone else - are undermined when the pursuit of short-term profits erodes systemic underpinnings.

Environmental challenges

The relationship between climate change and long-term investment returns is a clear example of the necessity of healthy systems to financial performance.

For example, the European Insurance and Occupational Pensions Authority's first climate stress test for the pensions sector found that the 187 funds surveyed would see losses of 12.9% from a disorderly climate transition, with its scenario based on work by the Network for Greening the Financial System (NGFS). Defined Benefit funds are more affected by the modelled economic shock, which assumes a steep increase in the price on carbon, coupled with an inaction to limit global warming to Paris Agreement-aligned targets prior to 2030.

Similar scenario analysis by the European Central Bank found that European investment funds in a NGFS disorderly transition scenario see losses of up to 14% of portfolio assets relative to an orderly transition through 2035. These losses are concentrated (i.e., some funds suffer higher losses) and could be amplified in the case of fire sales or procyclicality. Past 2035, the physical impacts exceed the transition impacts, meaning that losses would be even higher if there is a failure to transition to net zero.[15,16]

Estimates of these future physical climate impacts vary, but are significant, with some indicating a reduction in the value of a diversified portfolio of up to 40%,[17] or a 50-60% loss to existing financial assets.[18]

These estimates are generally considered to understate the reductions in asset values because (i) they do not include second-order knock-on effects (such as network effects and balance sheet effects), and (ii) the estimated climate and economic impacts that drive the financial impacts do not include second round effects (e.g. the economic impact of mass migration due to drought, famine, and conflict, which can destabilise economies and societies, causing further effects that are difficult to estimate).

Many central banks and prudential authorities consider climate change one of the most significant economic and financial risks currently faced.

Importantly, while most financial risks can be managed on a company-by-company basis, and diversified at a portfolio level, the investment risks arising from climate change can be overwhelmingly systemic. For example, even if an investor divested all of its portfolio companies involved in upstream fossil fuel production, and thereby reduced a portfolio's transition risk, the remaining portfolio companies would still be exposed to the impacts of global heating if global greenhouse gas emissions do not decline.

As asset owners have better understood the systemic effects of climate change, they increasingly consider the mitigation of climate change necessary for them to achieve their purpose, and necessary to comply with their fiduciary duties of care (prudence and risk management) and loyalty (including intergenerational equity among beneficiaries).

Social system challenges

A similar outcome could occur as the relationship between long-term investment performance and social system settings, such as inequality, is better understood.

Inequality across income, wealth and opportunity is high and has been rising across most of the OECD[19]. In advanced economies (accounting for around two-thirds of world GDP) the labour share of national income has been declining for decades.[20] Within the labour share, the highest earners have captured an increasingly large portion, while those at the bottom have seen their shares decline significantly.[21]

Landmark IMF research in 2014 found that "lower net inequality is robustly correlated with faster and more durable growth",[22] which was extended a few years later to identify human capital accumulation as a key channel through which inequality undermines economic performance. OECD analysis also found that "income inequality has a negative and statistically significant impact on subsequent growth."[23] Inequality also has spurred harmful populism, reduced trust in government, and political instability.[24]

Insofar as it relates to wages, economic opportunities and contribution levels, inequality is relevant to the core purpose of pension funds given the direct impact on members' retirement savings. It is also an important issue for pension funds as investors. The literature on the impact of inequality on the macroeconomy and financial system lacks the certainty of climate science, but suggests that inequality affects the investment environment for institutional investors through a number of channels including lack of education/training opportunities; the impact on demand and consumption driven by lower wages; and political instability driven by populism. Significantly more work is needed to understand the impacts of economic inequality and exclusion on long term economic stability and investment performance.

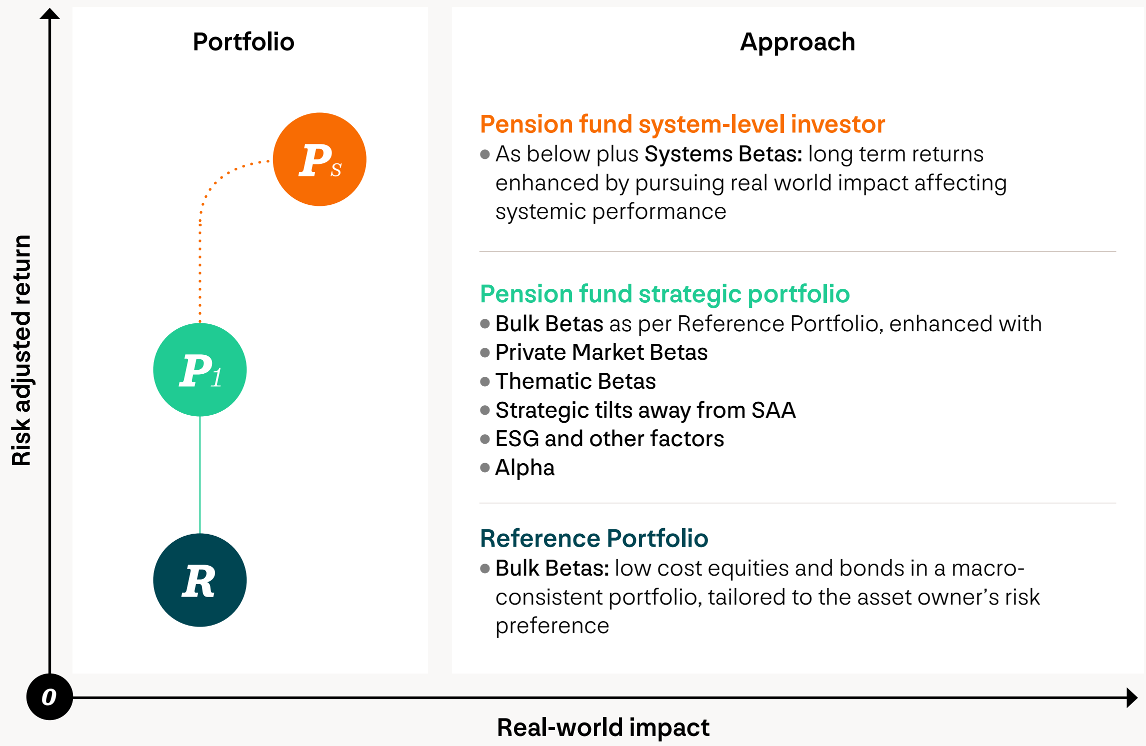
Policy context

Despite criticism of ESG from some in the global business community and among some politicians[27], global public policy is increasingly focusing on sustainability. This includes the Sustainable Finance Disclosure Regulation and accompanying taxonomy; anti-greenwashing task forces in the United States, United Kingdom, and Australia; the UK Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021; and formation of the International Sustainability Standards Board to develop, in the public interest, a comprehensive global baseline of sustainability disclosures for the financial markets.

The policy agendas of major countries and multilateral institutions are aligned. The OECD and G7 are aligned on the need to "build back better"[28] globally, and set the world on a "path to strong, sustainable, balanced, inclusive and resilient growth by not only addressing the immediate challenges arising from the pandemic, but also the long-term shifts in the global economy and society, including demographic, technological, and environmental trends, and inequalities between and within countries".[29]

FIGURE 6

EVOLUTION OF PENSION FUNDS TOWARD SYSTEMS INVESTING



Source: IFM Investors, adapted from Thinking Ahead Institute

Recognising that sustainability and healthy economic, social, and environmental systems are necessary for them to achieve their purpose, pension funds will need to continue to engage in public policy debates and potentially increase their efforts. This is not only to address the substantive issues, but also – as their importance to financial systems and economies grow – the need to meet their members' expectations and build their social licence will increase in importance.

As explained by McKinsey & Co., "Asset owners' collective size affords them a built-in incentive to strive for broad-based improvements in the economies and societies in which they invest. As Hiromichi Mizuno, former CIO of Japan's Government Pension Investment Fund, noted: "Our portfolio performance, particularly long term, is actually the product of what happens in the global economy. So we just need to make sure that the global economy and global capital market remain sustainable." Asset owners' efforts to contribute to society can thereby support their ability to deliver returns."[30]

Conclusion

Pension funds are collective undertakings that have long benefited individuals directly. By aggregating workers' savings, pension funds can access economies of scale, including lower per-member costs for services and access to major private market investment opportunities. They can provide ordinary workers with access to investment advice and the ability to ride out short-term market shocks.

Pension funds are now evolving to benefit their members indirectly, through a more considered approach to capital allocation that involves stewardship of economic, social, and environmental systems, which will enhance the direct benefits by lifting overall beta. (Figure 6, which reflects the evolution of the concept of beta, illustrates how pension funds have created better risk-adjusted returns by providing their members with access to more difficult-to-access betas and how they can increase the overall level of systemic performance by promoting the health of environmental and social systems.)

Put simply, if we don't have safe and secure societies, where people have access to safe and secure work, housing or other critical infrastructure and services, then it lessens the ability of pension funds to deliver long-term returns.

"Ultimately, global pension funds are increasingly recognising systemic risk as well as own-portfolio risk, and they understand that their returns will be produced by a system that works, and those returns are worth more for their beneficiaries in a world worth living in."[31]

Some current members of pension funds will be relying on their retirement savings at the turn of the 22nd century. Over this timeframe, factors that appear to be externalities in the short-term, such as geopolitical instability, increasing carbon pollution, declining trust in institutions and political/economic systems, and deepening inequality ultimately erode financial returns.

Strengthening the environmental, social, and economic systems on which broad prosperity relies will require long-term pools of capital with the

Collaborative platforms of like-minded pension funds will help to support an industry-wide prioritisation of long-term systemic challenges.

capacity to fund new capital formation, and the acumen to support the best ideas. The transition to a net zero economy, for example, will require trillions of dollars of new investment, funded through capital raising and through changes to the allocation of retained earnings within existing companies.

Another area that pension capital can be deployed to improve the health of the broader system is in supporting safe and secure countries. While national security rightly remains the domain of sovereign states, pension funds could work closely with aligned governments to invest in assets like defence estate infrastructure. We believe such investment has characteristics consistent with core infrastructure and presents another opportunity for pension capital to address broader systemic risks.

Pension funds have been on a journey in recent decades. Fifteen years ago, few were signatories to the UN Principles for Responsible Investment (UNPRI). From a handful in 2006, nearly 200 pension funds have signed-up. 20 years ago, few trustees thought seriously about ESG risks to their portfolios or sought to integrate their mitigation into their investment decisions. Today, many prudential regulators now expect pension trustees to actively consider such risks as a routine part of how they manage their responsibilities to members and the broader financial system.

Looking ahead, the grounding of pension funds in social and public policy, their growing scale and sophistication, and their duty to beneficiaries will – in the context of the climate crisis and impacts of the pandemic, inequality and geopolitical insecurity - drive increasingly significant changes.

We will see pension funds seeking to nurture the safety and security of the environment and societies, pursuing long-term company-level and portfolio-level impact, because it is fundamental to the pursuit of financial return. Ten years ago, many pension funds began to focus on stewardship of companies. Tomorrow, they will increasingly focus on stewardship of economic, social, and environmental systems.

To be effective in their stewardship, pension funds will need to place an emphasis on aligning their organisations and their resources with their long-term investment and sustainability goals. Collaborative platforms of like-minded pension funds will help to support an industry-wide prioritisation of long-term systemic challenges.

Pension funds will also need to continue to expand their advocacy efforts with policy makers and regulators. This would either be collectively through industry associations or directly, to support public policy and regulation that will help address risks to social and environmental systems and set out long-term strategies, targets and incentives.

Representing the largest pool of capital in the world, and with a responsibility to promote regenerative environmental and social systems, pension funds working collectively are now on a path to reshaping our economies and societies in order to maximise long-term investment returns for working people.

End notes

1 Thinking Ahead Institute https://www.thinkingaheadinstitute.org/research-papers/global-pension-assets-study-2023/

2 Thinking Ahead Institute https://www.thinkingaheadinstitute.org/research-papers/the-worlds-largest-pension-funds-2022/

3 For example, the UK National Employment and Savings Trust Corporation had around 250 total staff (including directors) in March 2016, which increased to around 370 average full-time equivalents in March 2022.

4 Edelman Global Trust Barometer 2020.

5 These costs are often referred to as "externalities", to reflect that the costs were (at least in the near term) borne by persons other than the person creating them – they are external to the parties of a transaction or course of conduct.

6 See, e.g., GIC, Inequality and what it means for investors, April 2021 (finding that "economic inequality hurts growth and exacerbates inflation; is correlated with higher political instability, and breeds populism that undermines multilateralism and democratic institutions. All these lead to increased economic and investment risks over the long term.")

7 Investor focus on inequality as a systemic issue has been rising over the past few years as a result of focused analysis by investor bodies such as the PRI and the Initiative for Responsible Investment at the Harvard Kennedy School in Wood (2018), PRI Discussion Paper: Why and How Might Investors Respond to Inequality; see also Lydenburg, Musuraca, Burckart and Clark (2018), Why and How Investors Can Respond to Income Inequality.[8]

8 This paper focuses on pension funds, however other long term investors, such as certain sovereign wealth funds and endowments, may share similar structural features and may behave similarly. In addition, pension and superannuation funds are not monolithic – some funds might behave differently despite similar structures and purposes.

9 Page 74 at https://ec.europa.eu/info/sites/default/files/180131-sustainable-finance-final-report_en.pdf

10 Thinking Ahead Institute (2020), The Impact of Culture, at 4 (stating that "The special factors applying to institutional investment start with the differences between asset owners (not-for-profit entities) and asset managers (usually for-profit entities). The ownership model turns out to be quite significant in culture formation through the explicit and implicit incentive structures that go with each model. … The cultural differences between asset owners and asset managers are most evident in the client-centricity area where asset managers have, over time, been increasingly drawn to more self-centred values in response to commercial pressures."). See also, Industry Super Australia (2016), Risky Business, (stating that [Australian] Industry super funds are different [from for-profit/ retail funds] because of culture and values. …[It] is no accident that having a structure and a culture that exists to serve others is the key thread joining the best performing superannuation funds in this country and in the leading retirement income systems in other countries.)

11 The initial meeting that led to Climate Action 100+ was convened by the California Public Employees' Retirement System (CalPERS) at the French Mission to the UN. https://www.climateaction100.org/approach/how-we-got-here/ The Net Zero Asset Owner Alliance, launched in The Alliance was initiated by Allianz, Caisse des Dépôts, La Caisse de dépôt et placement du Québec (CDPQ), Folksam Group, PensionDanmark and Swiss Re at the beginning of 2019. Shortly afterward, Alecta, AMF, CalPERS, Nordea Life and Pension, Storebrand, and Zurich Insurance joined as founding members. Was described as the "gold standard" for net zero target setting by UN Secretary General António Guterres, inspiring the launch of sister groups for asset managers, banking and insurance. https://www.unepfi.org/net-zero-alliance/about/ https://www.unpri.org/pri-blog/asset-owner-alliance-accelerates-pace-of-change-in-net-zero-targets/9394.article

12 See, e.g., Steffen et al., Planetary boundaries: Guiding human development on a changing planet, Science, 347 1259855 (2015). DOI: 10.1126/science[1259855 at 1259855-2 (noting that "The classic example is the possible weakening of natural carbon sinks, which could further destabilize the climate system and push it closer to large thresholds [e.g, loss of the Greenland ice sheet (18)].").

13 See, Rockström, J., W. Steffen, K. Noone, Å. Persson, F. S. Chapin, III, E. Lambin, T. M. Lenton, M. Scheffer, C. Folke, H. Schellnhuber, B. Nykvist, C. A. De Wit, T. Hughes, S. van der Leeuw, H. Rodhe, S. Sörlin, P. K. Snyder, R. Costanza, U. Svedin, M. Falkenmark, L. Karlberg, R. W. Corell, V. J. Fabry, J. Hansen, B. Walker, D. Liverman, K. Richardson, P. Crutzen, and J. Foley. 2009. Planetary boundaries: exploring the safe operating space for humanity. Ecology and Society 14(2): 32. [online] URL: http://www.ecologyandsociety.org/vol14/iss2/art32/

14 Linn Persson, Bethanie M. Carney Almroth, Christopher D. Collins, Sarah Cornell, Cynthia A. de Wit, Miriam L. Diamond, Peter Fantke, Martin Hassellöv, Matthew MacLeod, Morten W. Ryberg, Peter Søgaard Jørgensen, Patricia Villarrubia-Gómez, Zhanyun Wang, and Michael Zwicky Hauschild (2022), Outside the Safe Operating Space of the Planetary Boundary for Novel Entities, Environmental Science & Technology 56 (3), 1510-1521DOI: 10.1021/acs.est.1c04158.

15 See, European Central Bank and European Systemic Risk Board, Climate-related risk and financial stability, Section 8.3 et seq.

16 The ECB scenario analysis primarily focused on the NGFS disorderly scenario. However, the DNB policy shock scenario saw significantly larger negative financial impacts. See id. at note 103 and associated text.

17 See, Campiglio, E., Monnin, P., & von Jagow, A. (2019). Climate risks in financial assets [Discussion]. Zurich: Council on Economic Policies.

18 See, Thinking Ahead Institute, Pay now or pay later?, 2022. Available at https://www.thinkingaheadinstitute.org/content/uploads/2022/11/Pay_now_or_pay_later_LR_FINALv2.pdf

19 See, e.g., Reserve Bank Bulletin, The Labour and Capital Shares of Income in Australia, 21 March 2019.

20 G20 briefing paper, 2015, Income inequality and labour income share in G20 countries: Trends, Impacts and Causes, prepared by International Labour Organization, International Monetary Fund, Organisation for Economic Co-operation and Development, World Bank Group. https://www.oecd.org/g20/topics/employment-and-social-policy/Income-inequality-labour-income-share.pdf

21 Ostry, Berg, and Tsangarides (2014), Redistribution, Inequality, and Growth, IFM Staff Discussion Note.

22 Cingano, F. (2014), "Trends in Income Inequality and its Impact on Economic Growth", OECD Social, Employment and Migration Working Papers, No. 163, OECD Publishing, Paris, https://doi.org/10.1787/5jxrjncwxv6j-en.

23 See, Engler and Weisstanner, The threat of social decline: inequality and radical right support, Journal of European Public Policy, 3 March 2020; Han, Inequality and voting for radical right-wing parties, Electoral Studies, June 2016; Stoetzer, Giesecke and Klüver, How does income inequality affect the support for populist policies, Journal of European Public Policy, 10 October 2021.

24 See, e.g., Andrew Ross Sorkin, Vivian Giang, Stephen Gandel, Lauren Hirsch, Ephrat Livni, Jenny Gross, David F. Gallagher and Anna Schaverien, "The Pushback on E.S.G. Investing", New York Times, 11 May 2022.

25 See, Thinking Ahead Institute, Pay now or pay later?, 2022. Available at https://www.thinkingaheadinstitute.org/content/uploads/2022/11/Pay_now_or_pay_later_LR_FINALv2.pdf

26 See, Freshfields Bruckhaus Deringer LLP, A legal framework for impact: sustainability impact and investor decision-making, 2021. Available at https://www.freshfields.com/4a199a/globalassets/our-thinking/campaigns/legal-framework-for-impact/a-legal-framework-for-impact.pdf. This report seeks to "establish whether the law currently requires or permits [investing for sustainability impact] (looking at the main categories of asset owner and their investment managers in 11 jurisdictions)". It notes that, although "[t]here is no single or simple answer to the question of how far [investing for sustainability impact] is legally required or permitted across the jurisdictions covered, … it is still possible to reach a set of broad conclusions". These broad conclusions include: "If an Asset Owner or investment manager concludes, or on the available evidence ought to conclude, that one or more sustainability factors poses a material risk to its ability to achieve its financial investment objectives, it will generally have a legal obligation to consider what, if anything, it can do to mitigate that risk (using some or all of investment powers, stewardship, policy engagement or otherwise) and to act accordingly." The report considered the legal obligations arising from systemic risks like climate change in respect of portfolio companies and the portfolio as a whole, stating that: "[S]ome sustainability crises, such as climate change, pose systemic risks that are likely to damage the prosperity of whole business sectors and societies. This is the main reason for a potential obligation to consider engaging in instrumental [investing for sustainability impact]. There is no doubt that Asset Owners and investment managers have a duty to understand sustainability risks relevant to their ability to achieve the financial goals they are required to pursue and to take these into account as appropriate in their investment process. We consider that this would be accepted as the position in all the jurisdictions surveyed and is the starting point for our discussion of [investing for sustainability impact]. Notwithstanding the relative absence of court decisions specifically on the question, we consider that based on its general duties an Asset Owner would, if one or more sustainability factors posed a material risk to meeting its investment objective over the timeframe that is relevant to it, be legally obliged to consider what steps it can take to mitigate the risk. An Asset Owner would generally have a legal obligation to consider (within the range of options open to it) whether there are reasonable steps it can take to bring about specific sustainability impact goals that can reasonably be expected:

- to help influence the relevant sustainability factor(s) or the exposure of investee enterprises to it/them; and
- to do so in ways that mitigate the financial risk for the portfolio, or even create potential for value growth; and, if so, to act accordingly.

Possible approaches might include use investment powers, stewardship activities and/or policy engagement."

27 McKinsey & Co., Purpose for asset owners: Climbing a taller mountain, 23 Feb 2021

28 Nikulina, Luba, "Global Pensions and ESG: Is There A Better Way?" (2021). Wharton Pension Research Council Working Papers. 715. https://repository.upenn.edu/prc_papers/715

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