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SHAHRAZAD KHAN: Managers don't earn the money. It's you and your members that do. And so you are the ones with the control, with the purchasing power.

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SPEAKER: Welcome to the "PODfolio," Willis Towers Watson's investment podcast series where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolios.

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LOK MA: Welcome back to this part two of the "PODfolio Podcast" on sustainable investing. I'm your host, Lok Ma, talking with our sustainability experts Adam Gillett and Shahrazad Khan. So welcome back.

ADAM GILLETT: Hi, Lok. thanks for having us again.

SHAHRAZAD KHAN: Hi, Lok. Great to be here.

LOK MA: And so in part one we talked about how much a robust ESG approach can add to your portfolio returns and the dangers of not taking sustainability seriously. We also focused a little bit on the social aspect-- so the S in the ESG. And also talked about different ways of investing sustainably from weightings and exclusions to positive impact investments as well.

So now let's move on and talk about concrete actions. And, I guess, what we in the investment industry can and should do about ESG matters. We're seeing governments, regulators, various interest groups, and companies making demands and promises, especially on the climate front. So for example, getting to net zero carbon emissions by a particular year and so on. So alongside these other players, how big a role, Adam, can asset owners and asset managers play?

ADAM GILLETT: I think the short answer is a pretty big role. I think a lot of governments and regulators and organizations all point to the importance and power of finance in the investment industry being the real engine of the economy and having a lot of influence about where they put their money, what things that they invest in, what things that they don't invest in and support. And we've talked a bit about stewardship before-- about how they look after those investments and assets.

And so I think asset owners, asset managers, everyone involved in the investment industry-- data providers, consultants-- have a big role to play. One of the things that we talked about in the last episode as well, is that the size of the challenge is really big. And therefore, I don't think we can leave it up to just one party to take the bulk of the load-- take the bulk of the work and it will be all right.

And so every single group, I think, and every single individual really needs to try and do as much as they can to tackle these big sustainability challenges. Undoubtedly, people like governments and regulators have a huge amount of power and ability. And so if they set a policy, if they set these big next zero targets, write them into laws and put regulations, then that's a real game changer.

But we don't have to wait for them to do those kind of things. And we can help and influence and push them to be more ambitious as well. So for asset owners, I think that they're at the top of the investment food chain in lots of ways if you like. They hold the assets. They can influence things. They can say, I want this to happen and work with their third parties and managers and everyone else to make those things change.

And then I think in the asset management industry there's just a huge amount of talent and skills and abilities and expertise to be really innovative to come up with new solutions, to push the edge of what's possible. And so I think together, those two groups have a huge role to play. We've got literally trillions of assets under management and that's the kind of size and scale of investment that the world needs to tackle these big sustainability challenges.

LOK MA: And, of course, at the other end of that scale you've also got individuals looking to exert their own influence on these institutions. So for example, members who are suing their pension schemes generally for not doing enough in that sustainability area. It's isolated cases so far, I think. but Shaz, do you see that becoming a trend in the future? And if that's the case, what can the asset owners do to prepare themselves for that?

SHAHRAZAD KHAN: Yes, of course. So we have seen examples of this already in Australia. Hero member Mark McVeigh recently had his case settled against REST Super, essentially around the failure of them to appropriately consider climate change within the investment strategy. So for a while now, we've been hearing about millennial investors caring more about ESG and sustainability. Well, millennials now make up over 50% of the global workforce. And so it's only wise the asset owners, pension scheme trustee boards, et cetera respond to this.

With the growth in DC assets, we've also seen members have more control over their financial choices and therefore, outcomes. And so they expect to see better choices being offered to them or made on their behalf. Even the most passive or dormant investors will still reasonably expect to be protected from this significant downside risks from things like climate change, especially when they are foreseeable as we can now all agree. And it's therefore best for the industry to be proactive rather than wait for similar cases to emerge.

LOK MA: And the other motivation to do more on the sustainability front is, of course, this increasing regulatory pressure. I think there are actually far better reasons for taking a more robust approach on sustainability, but can you just give us a high level view of that general direction for these regulations?

ADAM GILLETT: Absolutely. I think that there's a wave of regulation already. And I think that there's much more to come. Shaz talked about the momentum in other places. I think the regulatory momentum across the world now is really there to see. So one of the big organizations in this space-- the Principles for Responsible Investment-- PRI-- I did a report on this. I think they found over 700 hard and soft law policy revisions across the 50 major economies of the world in the last five years in sustainable finance encouraging more in this space. So there's just an absolute ton of this stuff.

I think it's hitting different regions slightly differently. And for us in the UK there's been a lot of those regulations coming, a lot of pressure put on pension funds, for example, to disclose their policies, to then report against it-- kind of evidence of what they've done-- and upcoming mandatory climate change reporting as well for some of the biggest schemes.

In Europe, the EU's kind of taken a leading position on sustainable finance generally-- really wants to be at the front of the pack on it. And so it's rolling out a whole swathe of regulation across the industry. A lot hitting investors directly on that front. And Shaz mentioned in Australia the REST Super case-- there's regulatory pressure coming in Australia as well.

I think the one area that people have had a kind of question mark over recently has been in North America, and particularly the US. I don't think the regulation there is in any way being prohibitive of sustainability or ESG. It's just kind of given an atmosphere where it's probably slightly harder to do. It's made investors slightly more nervous doing it in those kind of places.

But I think there's a lot of hope and expectations with the new administration about a real sea change in terms of policy direction, not only from that kind of finance perspective but also the big ticket items like rejoining the Paris Accord and setting maybe a net zero target as well. So I think just to sum, there's a huge amount of regulation in existence tapping all different areas of the finance industry. So it's a really joined up kind of chain, if you like, of investment and finance regulation. And I just expect there to be more and more to come.

LOK MA: More to come. More to come. And so I think now we're coming on to maybe the big question of this discussion for me. So here it is. What should institutional investors be thinking about or really doing in this area of sustainability? So why should people be doing? And maybe I'll ask for both of your views this time, starting with you Shaz.

SHAHRAZAD KHAN: Sure. So I think you're quite right to say that there are much better reasons to take action than the kind of stick of regulation, as Adam always calls it. Firstly, I think when you're talking about climate-- yes, [INAUDIBLE] sustainability-- it's really important to keep it real. So what do I mean by that?

I think it can be really helpful when decision makers sit down together, that they remind themselves of the actual nature of the problem and challenge at stake. Namely, that the reason we care about any of this at all in the first place is that we love our planet and we therefore want to preserve our quality of life here. So all investor actions from the top all the way down to the individual, while they might sound three steps removed, they ultimately link to this point.

It's really important that investors don't forget that their managers don't earn the money. It's you and your members that do. And so you are the ones with the control with the purchasing power and the ability to make informed purchasing decisions. I think remembering this can give a lot more focus to enable challenging managers to focus on the engagement and voting aspects of your managers, essentially to realize that the buy, sell, vote decisions have implications on the ground for who gets your money and funding and who doesn't.

And so the way in which those companies deal and treat with their suppliers, customers, employees, all of the things we've kind of spoken about in the part one of the podcast, really are what's important and what can drive investor action. So I think that's the main thing to keep it real. And Adam?

ADAM GILLETT: Yeah. I think there's an awful lot that investors can do. I think, absolutely, they need to keep it real. And you talked a lot about stewardship within that. And I think stewardship is one of those elements of what investors should be doing that they're not doing enough of at the moment. And that stewarding their managers, as you say, their managers stewarding the underlying assets, but also stewarding the system, if you like, and engaging with collaborative initiatives, regulators, and policy makers because they really have a lot of power to help people because there is such a long list of things that they could do.

The other area that I'd probably like to pull out is climate change. And I think that we've talked an awful lot about it and rightly so. It's getting the billing that it deserves. It's the defining challenge of our time. And how can investors kind of approach this, if you like? Then one of the ways that we've done it with a few of our clients and increasing numbers of them is set out what we call a carbon journey plan. And that's basically to treat carbon or climate risks and opportunities in a similar way that investors have treated their funding challenges in their long term objectives previously.

So talking in terms of similar languages. What's your end objectives? When do you want to get there by? And what levers can you pull along the way to make that journey happen? And so when people commit to a carbon target or a climate target like net zero by 2050 or earlier, then they can first of all, understand where they are today, measure their climate footprint, measure the risks and opportunities in their portfolios, and then set a path from charting from where they are to where they want to be over time and understanding how quickly they can get there.

What's the ways in which they can do it? So the leaders and the tactics they can pull-- can they get rid of a load of assets that are real pockets of concentrated risk that they're not getting rewarded for? Can they invest in climate solutions? Can they engage with their managers of their underlying company so that they themselves can get back onto a net zero trajectory?

And so I think the framing of that carbon journey plan has really resonated with a lot of investors and, I think, gives a really neat framework for tackling that kind of climate change challenge. But there's an awful lot that people can do. So I guess the message is, either get started if you haven't already. But if you're on the way, then great. But there's an awful lot more to do.

LOK MA: Adam, this idea of the carbon journey plan-- it's kind of intrigued me a bit actually. So at least from my own perspective, a lot of the clients that I work with are on a kind of-- if you think about the overall journey plan, it typically involves quite a large feature of derisking over time-- so moving away from high returning, equity like assets and moving to maybe lower risk bond like assets that tend to be quite a good match for the liabilities. And just what you said just made me wonder, do you see that it's easier or harder to invest sustainably across different asset classes?

And especially, if you've got an investor moving from higher returning to lower returning assets, does it make the job easier or harder in terms of their carbon journey plan and kind of being more sustainable over time?

ADAM GILLETT: I think it makes the job different. I think there are different challenges in different asset classes. And I think that there are different levers that you can pull more or less effectively in those asset classes. Historically, a lot of the subject has concentrated in listed equities. So people are most comfortable with that area. There's a lot of data in that area. The aspects of stewardship are really kind of direct and easy to understand. I can engage with a company's board with its management team. I can vote at its annual meeting and so forth. And so people are quite comfortable in that area.

But as you rightly say, a lot of investors are moving away to more liability matching or fixed income type assets. And so you might say, well my voting rights have gone away for example. But switch that out to say, actually, in terms of companies looking to the investment market-- relying on the investment market to raise new debt financing-- then you've got a fantastic opportunity to invest around that refinancing or debt financing point-- a real ability to influence and shape the company.

And we might have mentioned as well before, kind of green financing, green bonds, sustainability bonds, which are a real growth area. And then also, some of the matching assets people look towards-- things like real estate or infrastructure, those kind of secure income type assets or cash flow matching type assets. And again, they've got huge possibilities. We talked about some of the positive impact investments before in those areas.

So I think the challenges are just different in different asset classes. And I think understanding that and then tailoring your approach to sustainability as your portfolio evolves over time is a really good way to meet that challenge.

LOK MA: Well, thank you very much, both of you. Let's finish with one concluding thought. Or if you like, I guess a call to action for our listeners. So if you've got a magic wand say, what's the one change that you would make in the investment industry? And why don't we start with you again, Shaz.

SHAHRAZAD KHAN: Sure. So I think you did start the podcast on a bit of a downer.

[LAUGHTER]

You were quite right to. Without wanting to be a doomsday prophesiser, the future is not that rosy. So we're not currently on target for a 1.5 or 2 degree world. The [INAUDIBLE] are increasingly unlikely to be met by 2050. And of course, David Attenborough keeps reminding us every other day that we're losing a species forever. And so I would like to say to those in positions of sway and influence-- so investment teams, consultants, and the like-- that they should capitalize on this moment and opportunity where the ESG stars are aligning and move to genuinely prioritize sustainability.

So even schemes with less maneuvering potential, for example, those in run-off or more restricted in resourcing, they should perhaps look to delegate or consolidate their responsibilities to others. So delegating in and of itself is a very powerful decision. It requires trust to the party your delegating to, to act in your best interest. And it requires a humbling and sort of admission that perhaps you are not best placed to effectively take on these really very significant challenges. Over to Adam.

LOK MA: And Adam, before you start, just to make an observation-- the people listening can't see this, but the three of us can actually see each other. There's a video link. And Adam's screen-- he's standing in front of a kind of like a light bulb in the background. And as he talks it does look kind of like there's a light glowing from around your head. So I want you to kind of channel that energy to give us your call to arms as well, Adam. Go for it.

ADAM GILLETT: Wow. There's a real religious pressure on this moment.

[LAUGHTER]

So I think I might borrow one of Shaz's phrases from before about keeping it real. I also like the way that Shaz always talks about the power of the individual. And I think individually we've got the ability to make changes from our personal life and leverage that through our organizations. And those of us lucky enough to work in the investment industry have huge leverage through our organizations and the assets that they control.

But I think fundamentally, it's being prepared to make that change and linking that change back to the real world. That's ultimately the point of all of this stuff. I think for a long time we've separated stuff in finance and investment. We separated stuff between a personal life and a work life. We almost kind of pretended there's this division and that the real world-- the natural world and other animals and species-- is separate and distinct from us.

I don't think that that's a viable strategy going forward. It's not really a true one either. And so just remembering that this is about the real world, the impact that we can have on the real world, and trying to make sure that impact is positive and regenerative and ultimately one that symbiotic with the natural world.

LOK MA: So thank you very much, both. Really exciting times on the sustainability front. And for me, you know, someone who works in the kind of financial world which could feel a bit kind of insular sometimes, I do find it very fulfilling to have this area of our professional life that links up so much with the wider world in this way.

Enjoy this episode, and do please tune in for the next one. In the meantime, hope you all take care.

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