The AMBACHTSHEER Letter
Sustainable Pension Design • Effective Pension Management

October 2020

"SUSTAINABLE INVESTING - A PATH TO A NEW HORIZON"

A NEW BOOK THAT ADDRESSES MARK CARNEY'S 'TRAGEDY OF THE HORIZON'

"We don't need an army of actuaries to tell us that the catastrophic impacts of climate change will be felt well beyond the traditional horizons of most actors, imposing costs on future generations that the current generation has no direct incentive to fix."

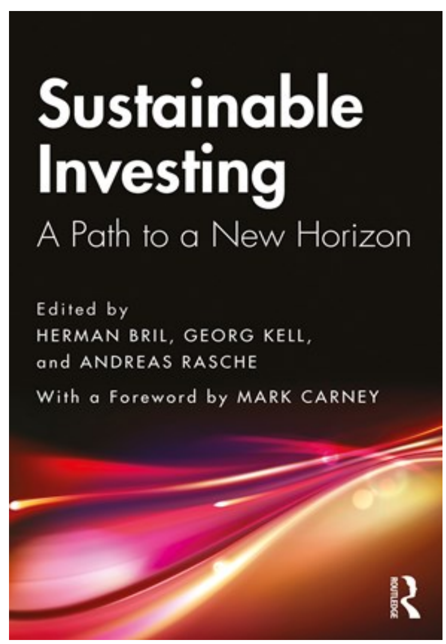
From "The Tragedy of the Horizon"
Mark Carney[i], 2015

"This book was inspired by Mark Carney's reflections set out in his famous 2015 "Tragedy of the Horizon" speech. We believe that sustainable investing can only progress when we address this 'Tragedy'. The contributors to this book chart a path to 'a new horizon' set out by Carney in 2019. They agree that such a new path is necessary, possible, and timely."

From "Sustainable Investing - A Path to a New Horizon"
Herman Bril, Georg Kell, Andreas Rasche, 2020

The Ultimate Handbook on Sustainable Investing

'The Ultimate Handbook' seems like an appropriate descriptor for a 365-page book divided into 4 sections, 18 chapters, authored by 35 people (including this author). The book was formally launched by editors Bril, Kell, and Rasche on September 24. In their own words, the book tells the story "of how convergence between corporate sustainability and sustainable investing is now becoming a major force driving systemic market changes". Stating the obvious, it is hard to think of a more important topic for readers of this *Letter* to address.



To highlight some of the key messages of the book, this *Letter* organizes them into how the book addresses two questions: 1. Why is <u>now</u> the right time for organizations to take sustainable investing seriously? and 2. How should investment organizations go from saying to effectively doing sustainable investing?

Mark Carney's 'New Horizon' Message

Appropriately, Mark Carney gets the book's first word and his 'new horizon' is for us to collectively transition to a net-zero carbon emissions world by 2050. He believes that three drivers now make this a feasible proposition: 1. Younger generations are increasingly demanding it, 2. Governmental actions are increasingly requiring it, and 3. Private innovation is increasingly facilitating it.

What will it take to achieve the 'net-zero' goal over the course of the next 30 years? Carney's 'to do' list includes explicit carbon emission reduction targets, disclosures as recommended by the Task Force on Climate-Related Financial Disclosure (TCFD), measuring corporate resilience to transition risks, and scenario analyses/stress testing to better understand those transition risks. On the plus side, he suggests there are limitless 'brown-to-green' innovation opportunities for the entire corporate sector around the globe. In short, sustainable investing facilitates achieving our planet's essential 'net-zero' emissions goal over the course of the next 30 years.

In the Book Editors' Own Words

Following Carney, editors Bril, Kell, and Rasche have this to say about their book:

- It tells the story of the unfolding convergence between corporate sustainability and sustainable investing.
- It shows how sustainable investing is transforming the operation of financial markets and impacting the investment practices of the globe's major investment institutions.
- It explains how technology and 'datafication' are accelerating the transformation to sustainable investing. However, it also warns that much divergence in data and reporting quality remains to be overcome.
- It helps readers transition away from traditional investment theories that are now too simplistic, to a new conceptual framework for capitalism more in line with current complexity, behavioral, social, and environmental realities. This new understanding leads to a changing context and meaning for sustainable investing.
- It identifies both the drivers leading to the adoption of sustainable investing (e.g., growing application of systems thinking, growing legislative/regulatory support, growing board diversity, growing evidence we are overstepping planetary boundaries), and the impediments against it (e.g., continued corporate and investor short-termism mindsets, a continued narrow view of the role of public corporations in society).
- It helps readers understand the organizational challenges involved in actually designing and implementing a sustainable investment program.

In short, Bril, Kell, and Rasche caution that while their book shows the understanding and implementation of sustainable investment programs is now essential, "it is a journey, not the flip of a switch".

Key 'Why Now?' Messages

Chapter 2's title is "Business and Sustainability: From Firm to Biosphere" by Levin, Reeves, and Levina. They argue that while the traditional corporate model which focuses on maximizing short-term financial returns is under threat, the shift to placing long-term sustainability at the heart of corporate strategy has been slow. Why? They suggest two reasons:

- There continue to be material gaps in resolving the tension between private costs and public benefits.
- The scale of co-ordination and persistence required to address these gaps is still often lacking.

Removing these impediments will require a new paradigm for corporate strategy development, involving adopting a broader context, a greater emphasis in resilience, building corporate ‘statesmanship’, and inserting more innovation into business strategy development. Chapter 9 by Ruggie, “Corporate Purpose in Play: The Role of ESG Investing” returns to the problematic ‘shareholder primacy’ doctrine and argues ESG investing can replace it with a broader, more inclusive stakeholder version. However, that will require addressing the weaknesses still embedded in many ESG investing processes.

In Chapter 4, titled “Good Governance”, Kocken and Lundbergh note that sustainable investing requires the successful identification of ‘new paradigm’ corporations. Good governance in the face of complexity and uncertainty is a key success driver for such corporations, just as it is for long-term investors themselves. Chapter 6, “Planetary Boundaries: A Compass for Investing for the Common Good” sheds greater light on the nature of these complexities and uncertainties. Authors Rockstrom, Beringer, Crona, Gaffney, and Klingenfeld describe an evolving new systemic risk: the stability of the Earth’s life support system. The 2009 study “Planetary Boundaries” laid out a coherent framework for establishing a safe operating space within these boundaries. Its implementation is becoming increasingly urgent.

In short, the book’s authors tell us that the window between now and the time required to create a fair, livable planet is closing. The time to accelerate the transition from short-term profit maximization mindsets to ones that foster long-term equitable and sustainable prosperity is <u>now</u>.

Key ‘How?’ Messages for Corporations

So what do we need to do to make that happen from a corporate perspective? Polman and Tomasdottir address that question in Chapter 10 titled “What Corporations Can Do to Move Financial Markets to a Longer-Term and More Responsible Mindset”. In short, they must move to business models that focus on generating long-term equitable and sustainable cashflows. That means balancing financial growth objectives with objectives that also protect the planet and the people on it. How? By using the UN’s Sustainable Development Goals as a corporate ‘North Star’. In Chapter 11, “Embedding Values and Principles”, Moody-Smart adds to this corporate ‘how’ list by pointing to internal consensus on purpose and values as organizational success drivers. This requires robust feed-back loops within the corporation, and transparent reporting protocols outside the corporation.

Key ‘How?’ Messages for Asset Owners and Managers

PRI principals Reynolds and Fabian lead this topic off in Chapter 5, “The End of the Beginning: Next-Generation Responsible Investing”. They note that since its inception in 2006, PRI has now ‘mainstreamed’ responsible investment practices around the world. However, even with over 2500 investment organizations managing $83 trillion now PRI signatories, there is more work to be done. They describe two ongoing workstreams: 1. Continued implementation of the Principles (e.g., legal obligations of fiduciaries, raising RI awareness, enhanced reporting and transparency), and 2. Facilitating the transition to an equitable low-carbon economy (e.g., adapting to climate change impacts, delivering on the UN’s Sustainable Development Goals).

Three book chapters deal with data and modelling. In Chapter 12, “ESG and AI: The Beauty and the Beast of Sustainable Investing”, author Selim discusses the uses of technology, big data, and artificial intelligence. He writes of the corporate sector’s ‘X-Ray Moment’ as these new tools allow investors to look under corporate hoods in new ways, facilitating the observation of actual corporate behavior and promoting ‘conscious capitalism’. In Chapter 13, “Future-Makers and Climate Change Modeling: Method to the Madness”, author Birgden describes how scenario analysis can be useful in helping assess climate change-related risks (even if the data is not yet as good as it should be). In Chapter 14, “Data Defense in Sustainable Investing”, authors Monk, Prins, and Rook discuss the use (and potential dangers) of using unconventional data sources (e.g., geolocational, social media, remote sensing), and advanced machine-learning algorithms. Organizational ‘defense’ postures and processes are needed to ensure this new technology does not become an organizational liability rather than an asset.

Three book chapters deal with implementation processes. In Chapter 15, "Investing Sustainably: Transforming Asset Owners from Sayers to Doers", Ambachtsheer makes two contributions: 1. Summarizing the recommendations of two separate 'sustainable investing' taskforces, one in Canada and the other in the USA, and 2. Showing how an Australian asset owner organization adapted the <Integrated Reporting> Framework to tell its value-creation story to its stakeholders and the wider world. Chapters 8 and 16 each tell an organizational implementation story. The former, by Bolton, Levin, and Samana, is titled "Navigating the ESG World". The latter, by Karniol-Tambour, Stendevat, Hochan, Davidson, and Kreiter, "Building a Balanced and Scalable Strategic Asset Allocation to Meet Financial and ESG-Impact Goals".

A Building Momentum

The timing of the book's launch is propitious. It arrives at a time when momentum for all things sustainable finance and investing are building. Just two recent examples:

1. Due to a "groundswell of demand", five organizations working on the disclosure of sustainable finance and investing activities and outcomes (CDP, CDSB, GRI, IIRC, and SASB)[ii] have just published a ***Statement of Intent*** to work together to create a common framework and comprehensive set of standards for sustainability-related disclosures. The *Statement* concluded by asserting that "*transparent measurement and disclosure of sustainability performance is now a fundamental part of effective business management, and essential for preserving trust in business for a force of good*".

2. The green front-cover headline of a recent issue of *THE ECONOMIST* publication proclaimed "21st Century Power: How Clean Energy Will Remake Geopolitics". The issue carried three related articles: "Power in the 21st Century", "Energy's New World Order", and "Business and Climate Change". This quote conveys the essence of the message: "*A picture of a new energy system is emerging….oil and coal use will drop….decarbonizing energy will avoid the chaos of unchecked climate change, including devastating droughts, famine, floods, fires, and mass dislocation. Once mature, it should be more politically stable too, because supply will be diversified, geographically and technologically…..*".

These two 'building momentum' examples confirm that "Sustainable Investing - A Path to a New Horizon" is a book whose time has come. In their "Good Governance" chapter, Kocken and Lundbergh noted that successful organizations have a clear purpose, a principles-based culture, and the requisite tools and processes to deal with the uncertainty and systems complexity that lies ahead. In the book's final chapter, editors Brill, Kell, and Rasche invite readers to visualize a transformative 'believing-to-acting' process. Their book provides not only the tools and processes, but also the motivation for investment institutions to become future-makers rather than future-takers in the 21st Century.

Keith Ambachtsheer

Endnotes:

i. *Mark Carney has been Governor of the Bank of Canada (2008-2013), Governor of the Bank of England (2013-2020), and Chair of the Financial Stability Board (2011-2018). He is currently UN Envoy on Climate Action and Finance, and Vice Chair – ESG Implementation at Brookfield Asset Management.*

ii. *Carbon Disclosure Project, Carbon Disclosure Standards Board, Global Reporting Initiative, International Integrated Reporting Council, Sustainability Accounting Standards Board.*

Published by KPA Advisory Services Ltd., 1 Bedford Road, Suite 2802, Toronto ON Canada M5R 2B5
416.925.7525. www.kpa-advisory.com