Are asset owners ready to finance a transition to net zero?

Ninety One has today published its annual *Planetary Pulse Report, The Rise of Transition Finance*, which explores transition finance, what it means for asset owners, and its role in averting harmful climate change.

Source: World Economic Forum

The study surveyed 300 senior professionals at asset-owner institutions and advisors in the UK, Southern Africa (South Africa, Botswana, and Namibia), Asia Pacific (Hong Kong, Singapore, and Australia), Western Europe (Germany, Netherlands, Denmark, and Switzerland) and North America (Canada and United States), including pension funds, insurers, endowments, foundations, central banks, sovereign wealth funds, and consultants.

Transition finance is a commercial investment approach that focuses on real-world impact to enable an investee's climate-change strategy. It intends to help reduce carbon while achieving profitable returns, and can involve:

- Investing in some of the most challenging industries so that high emitters receive the capital and influence they need to transform their operations
- Investing in new innovations and projects that might not be profitable initially
- Funding vast infrastructure transformations
- Increasing exposure to emerging markets, where emissions continue to grow the fastest and the need for all forms of support is greatest

ESG investment strategies

The investment world has expanded ESG-branded investment strategies, funds and services. In 2022, global ESG assets are expected to rise to $41tn, which is nearly twice the amount of 2016 ($22.8tn).

By 2025, ESG assets are forecast to pass $50tn and comprise one-third of total global assets under management (AUM). However, many assets which are branded as ESG do not in fact encourage change from brown to green in the real economy.

In 2021, more CO2 was released than any other year to date, with coal the main factor behind the rise.

Nazmeera Moola, chief sustainability officer of Ninety One said: “ESG-branded assets are often designed to show small carbon footprints, but this sometimes means they are not addressing real-world decarbonisation.

"Portfolios are created that avoid the problem, instead of solving it — often, by simply limiting an investment universe to only the cleanest industries. Portfolio purity does not work to solve the climate crisis. It exacerbates the crisis."

> *Are investors prepared to finance a transition to net zero? In this year's Planetary Pulse survey, asset owners shared views on transition finance and its role in real world change.*
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> *Read the report: https://t.co/oIRxGdtcbA*
> *Visit our newsroom: https://t.co/i1OwUHWixH pic.twitter.com/ziO6KMtsQK— Ninety One SA (@ninetyone_sa) October 17, 2022*

”Among companies themselves, some in the fossil-fuel industry, for example, have divested high-polluting business units, or contracted polluting processes to third parties, removing the emissions – on paper– from their responsibility, without reducing the real-world impact of the industry."

Investing for net zero?

Ninety One's survey shows that, among the asset owners with climate-related targets, 48% set them at overall portfolio level, while 46% set targets for specific mandates, portfolios or funds.

Only 28% set their targets at asset-class level.The survey found 60% of asset owners say fighting climate change is one of their fund’s strategic objectives, with 51% saying their fund has emissions-reduction targets in place.

This shows most are doing something in response to climate-related risks and opportunities. The findings are less positive when looking for real-world impact.

Changing mindsets is key to the just energy transition
Viren Sookhun 12 Oct 2022

Only 19% say they use transition finance to any extent. Fewer still say their fund invests in transition-finance assets in emerging markets (16%), the regions where emissions and populations are growing the fastest.

For the majority (87%), no more than half of their organisation’s AUM falls under climate-related strategies, and 46% have no more than a quarter in these portfolios.

Additionally, only 11% have from half to three-quarters of their AUM in climate-related strategies, and less than 1% have more than three-quarters.

In the next three years, 19% expect to have from half to three-quarters of their AUM in climate-related strategies, and 2% will have more than three-quarters.

Barriers to transition finance

55% of asset owners surveyed say their fund is not focused on any goal beyond the risk-and-return performance of their assets.

There is a view, held by 40% of asset owners, that climate-related investing leads to lower returns. For funds with positive climate outcomes as an explicit objective, short-termism is a challenge.

With soaring energy costs in 2022, some of the world's highest-emitting companies made large profits.

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Many climate-focused funds will not have owned these companies and would have missed out on associated returns. However, the most cited barrier by 60% of respondents to transition finance is a lack of companies with credible and feasible transition plans.

According to a survey, 55% say it is difficult for asset owners to measure or quantify an organisation's progress in climate strategy or products, though this is likely to improve with the continued enhancements in disclosure and data regulation.

Emerging markets

Emerging markets present an enormous challenge – and opportunity. Transition finance will here be critical to reaching net zero. Investment can transform energy production, infrastructure, efficiency, transport, and several of the world's highest-emitting industries.

Only 16% of asset owners surveyed are invested in emerging-market transition finance, and those asset owners appear to have high conviction about the strategy.

While expanding transition finance in emerging markets is a moderate or high priority for 86% of those who have adopted the approach, 53% of respondents say their fund is concerned about the risk-return profiles available in the universe of emerging market transition-finance assets.

41% of asset owners say their fund is seeking to invest in high emitters in emerging markets with measurable, science-based decarbonisation plans.

Ditching ESG doesn't make sense, especially in Africa

Bryan Turner 6 Sep 2022

Moola continued: "Now is not the time for rich countries, their investors, asset owners, and institutions to abandon the emerging markets. If an effective "buy developed, sell developing" takes hold, emerging markets may be starved of investment capital at the very time they need it to finance their energy transitions.

"We must focus on long-term transition plans consistent with net zero by 2050 for companies and countries, not near-term portfolio emission reductions.

“Asset owners that take a divestment approach to achieve net-zero targets are letting go of some of the most powerful levers in the fight against climate change, as well as return opportunities.

"They have the ability to use their capital and influence to catalyse and enable transitions to low-carbon alternatives and move closer to the Paris Agreement targets — a path that can often overlap with the path to long-term growth and responsible risk management.”

Climate won’t wait

More than half of asset owners (56%) believe that without greater investment in transition-finance assets, the world will not be able to meet the Paris Agreement climate-change goals. Time is of the essence in the fight against climate change.

Hendrik du Toit, founder and chief executive officer of Ninety One said: “To meet international, national and organisational climate targets, we need to decarbonise energy, replace myriad industrial processes with clean alternatives, improve energy efficiency, and transform infrastructure.

Is Africa being left behind in the push for a net-zero world?

Brondwyn Douglas 27 Jul 2022

"Transition finance is the legitimate and effective alternative that enables the move from brown to green while meeting standard risk-and-return objectives.

"Financing even heavy emitters, as long as they are on a verifiable path to net zero and promising attractive risk-adjusted returns, will reap benefits for investors as well as the planet. "We must mobilise transition finance alongside green investment.

"By allocating finance to transition, asset owners can profitably participate in the world’s adaptation to net zero and help mitigate climate change.

"Transition finance is not in conflict with the fiduciary duty of asset owners. It is an attractive return opportunity which at the macro level mitigates the biggest systemic risk of our time.”