HSBC and Charity Times – January 2022

What will sustainable investments look like in 2022?

Podcast

[OPENING JINGLE]

Hello and welcome to the Charity Times Leadership podcast, where we speak to leaders from across the sector about trends, challenges and success stories. My name is Lauren Weymouth, I'm the editor of Charity Times and I'll be bringing you a series of charity leadership podcasts designed to inspire you as you navigate your way through the year ahead.
As the year draws to a close, there's a need for charities to start thinking about key areas of focus for 2022. Among the key issues for charity investors is sustainability, but a year of heightened anxiety around climate change, coupled with an extremely busy COP26, what will the sustainability agenda look like in the year ahead?
Joining me today is Sophie Ward, who runs the charities and education team at HSBC Private Banking, the sponsors of this podcast. Sophie particularly focuses on how charities can weave sustainable and ethical requirements into their portfolios and holds the Certificate in ESG Investing from the CFA Institute. She has been with HSBC Private Banking since 2010 and is a Chartered Wealth Manager, who graduated with a 1st in International History and Politics from the University of Leeds. She is also responsible for driving volunteering engagement between local organisations and HSBC employees across the UK. In her spare time, she is a senior volunteer at Crisis Christmas and when out of the office is usually found surfing or trail running.
Welcome, Sophie.

- First of all, it would be good to chat a bit about COP26. A number of big goals were set, but what will the impact of COP26 really look like?

    - There was a lot of expectation going into COP26 and many commentators, media & charities largely disappointed by results, as the commitments made will not hit 1.5c Paris target, with a figure of c 2.4c.
    - There continues to be a lot of ambition and urgency from governments, but not concrete policies. They will need to each come back with more concrete policies before COP27 in Egypt next year, which is a positive shift from the previous five year cycle.
    - Other positives:
        - The surprise joint declaration from US & China who put aside their differences.
        - A change to Article 5 of Paris which will allow free carbon trading globally, which gives more flexibility.
        - Financial Alliance for Net Zero to put $130trn to work – Mark Carney – fighting & tackling cliate change – inv man industry getting involved.
        - Commitments around deforestation – although seen those before.
    - However, many felt that youth movement & indigenous communities were underrepresented despite a lot of discussion about including them

- We're seeing a shift in language around climate mitigation to adaptation – so this is addressing things like early warning systems to identify extreme weather events or dealing with health related issues from air pollution.
- Coal is 1/3 of overall GHG and one of the most addressable areas we have. Then language here was watered down – so not about removal, but about phasing down. This was particularly from India and China who have picked up a lot of the coal consumption from Europe and the US. Going forwards we'll see a change in the energy mix for countries, but unfortunately the preparation for COP26 was poorly timed with high energy prices across the world meaning that attention was focused on this. Means the rigidity of the existing system harder to break down if more subsidies and tax breaks are put in place.
- Climate technology – many need a lot of work to be commercially viable.
- Saw serious commitments from the private sector – have stepped up where governments have not.
- The focus is definitely expanding beyond energy firms - need progress particularly in transport, heavy industry, buildings, agriculture
- Key now is the execution and pressure to accelerate change.

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- What will charity investors see specifically and how is this likely to impact charity investment portfolios?

  - All companies will be impacted – through regulation, cost of emissions, risk of stranded assets and will need to invest in adaptation.
  - This will mean that there are clear winners and losers. Winners may be companies which create an important climate technology. 1% of vehicles are currently electric – whoever captures the upside to this and the supporting infrastructure will clearly be very successful. Losers may be companies which fail to realise the environment they are operating in and lose their current business model, or have a large quantity of stranded assets.
  - Significant investment will be made, so financial firms may do well as a result of increasing lending and corporate investment. To add here, HSBC has just launched a £500mn green fund for SMEs, including charities, to support them in their transition.
  - Generally we will see an increase in availability of sustainable asset classes within portfolios. Already this year we've seen three times the quantity of green bond issuance vs the whole of 2020.
  - Another area which will likely grow for investors is illiquid assets – able to provide funding directly to companies creating an impact (e.g. sustainable infrastructure or directly linked to UN SDGs), rather than in secondary financial markets.
  - Economically, we may see increased inflation due to increasing costs.
  - Increased engagement from asset managers – crucial on critical sustainability issues – especially collective engagement through groups like ClimateAction 100+ - allows for more legitimacy as representing more funds and can do more in depth work.
  - Importantly, charity investors no longer have to choose between fiduciary and social considerations.

- Of course climate change is going to be a priority for charity investors in the year ahead, but what are the social impacts that need to be considered when investing in more sustainable assets such as renewable energies?

  - Important when considering climate change that we don't do so in isolation – what are the social impacts of each decision? How does this affect local communities or workers?

- As some examples - battery technology, great for a shift to renewable energies, it's led to a huge rise in demand for cobalt and lithium.
- 50% of the world's cobalt is produced in DRC – where 40,000 children are estimated to work in mines. This creates extreme risk around child labour, modern slavery and trafficking.
- In Norway, two wind farms were recently stripped of their licence to operate as they interfered with the cultural rights of the indigenous Sami herders.
- We don't want to just plant trees to capture carbon – we need to create a diverse forest and habitat.
- So, to create a sustainable long-term equitable solution we need to think about knock on implications to avoid unintended consequences, particularly on people and our natural environment.

- The past 18 months have highlighted stark social inequalities in terms of race and healthcare among other things. How should these issues also be taken into consideration when investing responsibly?

    - Social issues are crucial in the year ahead. 2021 brought inequalities into sharp contrast – particularly around gender, race following the BLM protests and inequitable healthcare. Broader issues to look at include nutrition, education and access to water.
    - Racial diversity – companies increasingly under pressure – its' being mentioned on more earnings calls and 38% of top 100 US firms have added a boarded member from an underrepresented background in the last year – demonstrates that speaking up and demanding change does make a difference – charity sector crucial to this. Increasingly investment managers will be considering specific factors around this when investing.
    - Healthcare in equality – 88% vaccines gone to G20 countries. Governments need to invest into healthcare infrastructure to increase resilience – from an investment perspective – which firms are focus on equitable pricing vs increasing costs, to ensure that maximum patients are supported? It may mean looking at digital healthcare, which solves some accessibility issues
    - BooHoo – summer 2021 – share price lost £1bn in share value in a week after labour standards exposed – Social issues have investment implications and must be considered.

- Let's talk a bit about natural capital, which was a key area of focus at COP26 this year. Can you please explain a bit more about it and how it affects charities?

    - Natural capital is, in its simplest terms, the assets of nature. This includes the land and sea, along with the biodiversity of ecosystems within them. The biodiversity of nature makes natural capital resilient and allows it provide a wide range of services that are vital to life on earth. These are classified as:
        - Provisioning services – the products we obtain from ecosystems such as food, freshwater or biochemicals (such as food additives)
        - Regulating and maintenance services of ecosystem process – such as maintaining the atmospheric gas composition, regulating the flow of water or regulating diseases.
        - Cultural services: these are non-material benefits that people obtain from ecosystems. This includes recreation and wellbeing – think about how the diversity of life has shaped cultures and a sense of self

- As we see natural capital being destroyed we are seeing negative consequences such as cliamte change, biodiversity collapse, lcoal temerature rises, soil loss and the sopread of diseases.
- So, as an asset class, natural capital provides exposure to projects focused on nature including sustainable forestry, regenerative and sustainable agriculture, water supply, blue carbon (carbon captured by oceans and coastal ecosystems), nature based bio-fuels, or nature based projects that generate returns from reducing greenhouse emissions.
- We saw that natural capital was a key area of focus at COP 26 with pledges around stopping, and reversing, deforestation by 2030 by over 100 world leaders and over 30 financial firms.
- How this might impact investors is that it creates new types of investment to go into. As an example, HSBC Asset Management has a joint venture with Pollination to create Climate Asset Management – will rejuvenate land to increase biodiversity and carbon capture.
- HSBC also has a biodiversity pledges which means that we look at the impact on nature when we invest into companies - e. g. developed framework around investing into the food industry, as meat production a key cause of deforestation.

- Finally, CFG research found that 84% of charities don't yet have the climate change commitment built into their organisation. Furthermore, just 14% said they currently report on their carbon emissions. What do you think is preventing charities from taking the right steps forward?

  - I think that it is a very large and overwhelming issue for any organisation to get their head around, let alone a charity which might be stretched on resources, particularly after the 18 months we've just had.
  - I do think that there has been a change in the number of charities looking at the issue, so I would expect more to build in a climate commitment soon.
  - A key area around carbon emissions is data analysis. Scope 1 and 2 – which are the direct emissions from an organisation are easier to track, whereas Scope 3 – which is indirect (such as car travel of visitors to a site) are much harder.
  - We also see with regards to data reporting within investments is that different ESG score and carbon data providers use different methodologies, with good reason, but it's important to understand what is being shown.
  - At HSBC we provide the ESG score and carbon intensity of our portfolios.
  - Different data providers use different methodologies.

- What simple steps can charity leaders and finance teams take to prioritise some of the issues we've discussed today?
  - To start! As I said it's a big topic – so start educating yourself on the different areas and working out how it might fit into your charity's strategy. There's plenty of resources online.
  - For those with investments ask questions of your managers – do they provide ESG scores and carbon intensity? How do they vote and engage on social and environmental issues? Do they include these factors in their decision-making process?
  - Charities have always been an important voice in investment changes and a force for good, so now is a crucial time to speak up.
  - And feel free to contact me with any questions.