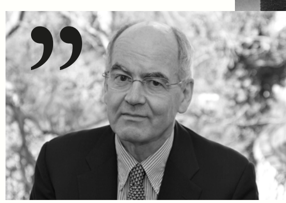
" How can we take the heat out of climate change? "



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John is chairman of Volans Ventures, a consultancy firm that works in partnership with organisations on projects, exploring the business models and technologies needed to deliver the Sustainable Development Goals.

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Zahra is a director at the Investment Institute. She is responsible for providing research and insight on geopolitical, economic and investment trends shaping portfolio strategy and asset allocation decisions.

4 Investor's View: Volans Ventures

SUMMARY: In October 2017, John Elkington, Chairman of Volans Ventures, a consultancy firm that works in partnership with organisations on projects exploring the business models and technologies needed to deliver the Sustainable Development Goals (SDGs), spoke to Zahra Sachak, director of the Investment Institute at Investec Asset Management. They discussed climate change, its impact on the global objective of achieving the SDGs by 2030, and investment implications.

ZS **From your perspective, how has sustainable investing evolved over the past few years?**

JE I have been involved in Socially Responsible Investment (SRI) funds since 1992 — and in venture capital funds continuously for at least a decade. Over that time I have seen immense changes, though they are not yet sufficient to tackle the nature and scale of the challenges we face.

Today, we see parallel trends at work.

On the one hand, sustainable investing is mainstreaming. Green bonds have gone from zero to a $100 billion market in less than ten years. The Carbon Tracker Initiative first introduced the notion of 'unburnable carbon' in 2011; now, thanks to bodies like the Taskforce on Climate-Related Financial Disclosures, discussion of stranded assets is mainstream.

And as the wider world wakes up to the scale of risks and opportunities associated with climate change and the broader sustainability agenda, demand for sustainable investment products is growing.

At the same time, fragmentation and complexity are on the up — and the influence of the impact industry risks being diluted. In headlines, investors are now faced with a cornucopia of different standards and frameworks to choose from.

And many are still grappling with how to integrate frameworks like the UN Sustainable Development Goals (SDGs), or the Nationally Determined Contributions agreed by all countries that have signed the COP21[1] Agreement.

Meanwhile, with demand for sustainable investment products outstripping supply, we're starting to see some fairly dubious products and offerings labelled as 'green' or 'sustainable'.

ZS **What are the most interesting financial innovations that you're seeing in this space of sustainable finance?**

JE Big Data and AI have massive potential to jump sustainable finance into a different space. In July of this year, we co-convened a 1-day 'Breakthrough Money' event in London bringing together a number of leaders in sustainable finance.

One of the people we invited to speak at the event was Omar Selim, CEO of Arabesque Asset Management. Arabesque has developed a tool called 'S-Ray' which tracks the sustainability of 4,000 companies using AI to sift through 200 ESG metrics and more than 50,000 news sources.

Another initiative we think is worth watching in this space is the World Benchmarking Alliance, which seeks to build free, publicly available benchmarks ranking companies on their contribution towards the SDGs. This is something that was first proposed in the Business & Sustainable Development Commission's report, 'Ideas for action for a long-term and sustainable financial system' (co-authored by Investec CEO Hendrik du Toit, alongside Aniket Shah, also of Investec, and Mark Wilson, CEO of Aviva). As Mark Wilson put it at a launch event in New York in September, the goal is to turn the SDGs into 'a corporate competitive sport'.

The Alliance is currently in a consultation phase, so it's as yet unproven, but if it works, it could cut through a lot of the complexity that has developed around sustainable investing—and make it much easier for investors of all types to integrate sustainability into their portfolios.

A final example. Another person who spoke at our July event was Mark Campanale, founder of the Carbon Tracker Initiative and, before that, founder of the Social Stock Exchange (for which I chair the admissions panel).

Mark told us, "we have to really challenge the fundamental basics of how financial markets work: how they price scarcity, how they price risk. We're not going to do that by trying to persuade a big bank to suddenly go green because they will switch back again…we actually have to create the alternatives".

The truth is we almost certainly need both. We do need big institutions to reinvent themselves, but we also need insurgents to build radical new models. The Social Stock Exchange is one such model. It may seem small and peripheral today, but for a sense of where we're headed in the future, it's often useful to look at what's happening around the fringes of today's mainstream.

[1]COP21: COP stands for Conference of the Parties, referring to the countries that have signed up to the 1992 United Nations Framework Convention on Climate Change. The COP in Paris was the 21st such conference.

ZS **What is holding back even more capital from being aligned to principles of sustainability and climate change?**

JE This is an issue of both supply and demand. What we often hear from investors is that there is a lack of investible sustainable assets and projects. This problem is compounded by the fact that, globally, we have too much capital chasing too few good long-term investment opportunities. In that market context, we often hear that there isn't a strong enough incentive for companies and issuers to jump through an extra hoop in order to offer a sustainable product.

Complexity and a lack of consistent, high quality data are key problems too. Whose definition of sustainability should we use? And whose data should we trust? These are big, challenging questions for investors — but by no means insurmountable.

ZS **Geographically speaking, which parts of the world have taken up sustainable finance quicker than others? Why do you think that is?**

JE It's very encouraging to see the G7 and other similar supra-national institutions starting to pay serious attention to sustainable finance. Chinese leadership — alongside European commitment — has been critical at a time when the US federal government is abdicating much of its responsibility in this area.

At the same time, there is another big challenge: the growth isn't necessarily where we need it most. This point was made by Tessa Tennant, co-founder of NDCi.Global, at our Breakthrough Money event. She noted that many of the biggest and most urgent sustainable investment opportunities are in emerging economies, but often these countries are deemed too risky by mainstream investors.

Unless we can get capital flowing towards investment opportunities in countries currently deemed too risky, we are likely to to fall a long way short of achieving the SDGs.

ZS **How do you define impact investing? Do you see the concept of impact investing as a useful paradigm?**

JE Defining impact has always been problematic — and it almost certainly always will be. That said, we see the Future Fit Business Benchmark as an impressive attempt to bring scientific rigour to the measurement of impact.

Is impact investing a useful paradigm? Up to a point. We need to mainstream the principles of impact investing though, and in that regard I think 3D investing — risk, return and impact — is, perhaps, the framing with the most potential.

ZS **Can analysing factors such as physical, technological, social, and regulatory risks as part of a holistic environmental, social and governance (ESG) approach, strengthen portfolios?**

JE Absolutely, but only up to a point and only if the data are credible.

The bigger challenge today is systemic risk and, particularly, climate risk. If the banking system collapses, good banks are no safer than bad banks.

When a hurricane strikes, companies with a good record on environmental protection aren't any less at risk of disruption than heavy polluters.

Of course there are things that companies — and banks — can do to increase their resilience, but the further we go in destabilising social and environmental systems the harder it will become for investors to mitigate the potential impact of these risks on their portfolios.

ZS **How can investors maximise the benefits and minimise the risks created by a changing climate?**

JE They need to go beyond ESG and look at the underlying assets they're investing in. Investing in an oil company with an excellent ESG record relative to its peers won't protect you from the threat of stranded assets.

It makes sense to look at which firms, through their core businesses, are addressing future market opportunities, such as those identified in the '*Business & Sustainable Development Commission's Better Business, Better World'* report.

To profit from sustainability, invest in the companies that are building the sustainable infrastructure we need, the sustainable energy generation and storage capacity we need, the affordable housing we need.

ZS **What is the next chapter in the story of sustainable finance?**

JE Whether we like it or not, more and more crucial decisions in the investment industry are going to be made by algorithms over the next decade. So we need to do everything we can to make sure the algorithms are on our side.

As Nick Robins, Co-Director of the UNEP (United Nations Environment Programme) Inquiry into the Design of a Sustainable Financial System, puts it, we have to make sure sustainability is "part of the code of the fintech revolution".

ZS **What worries you most about the sustainability space today?**

JE Many things, but particularly the continuing prevalence of incremental mindsets. Totally understandable in uncertain times, but the longer we leave tackling some of these big challenges the higher the ultimate cost will be.

Many people think that by doing a little bit more of what we're already doing, a bit better and a bit faster, we will get to where we need to be. Not true. Though many of their most enthusiastic champions have still to rumble the fact, the Sustainable Development Goals and the Paris Agreement represent an exponential change agenda.

So our biggest challenge today is to learn to think and act exponentially. Exponential trends can take us downward to breakdown outcomes, but they can also — properly understood — drive us towards breakthrough outcomes.