NATIXIS INVESTMENT MANAGERS

From where we were to where we stand

Can sustainable investing really save the world?

Amid the clamour for everything ESG today, some argue that modern finance has forgotten its sense of purpose. What do investors want? Is it really just better risk management or outperformance? Or is it more about having a meaningful positive impact?

Whatever it is, asset managers, advisers and investors all need to decide what it is that they want to achieve. As Yogi Berra once said, “If you don’t know where you’re going, you may wind up someplace else”. Sometimes it is helpful to pause and reflect on the path already trodden. Can we draw on past examples to recognise why some were successful and others were not? As Maya Angelou once said, “You can’t really know where you are going until you know where you have been”.

We think the investment community deserves more nuanced insights on sustainable investing. These insights must be grounded in factual reality and should help us to filter through the noise of ESG. This paper kicks-off our sustainable investing series – a collection of insights that delve into the detail of what’s really happening in ESG today, as well as exploring the structural elements that we think are set to evolve in the industry…

OUR FOCUS AREAS

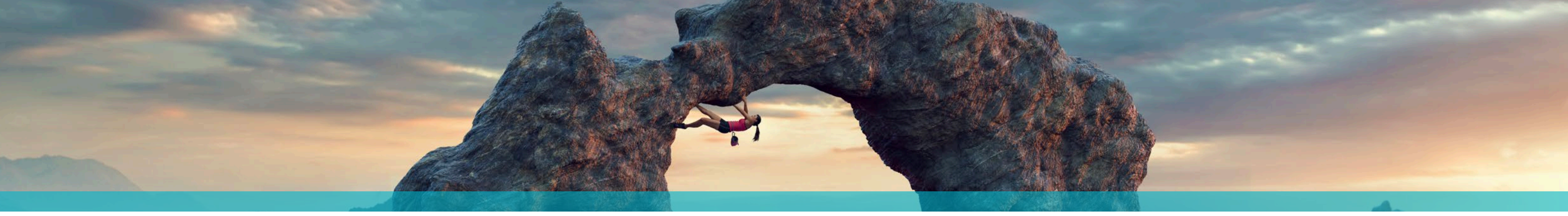
Blended finance
Why investment projects need to find the right mix of public and private capital

Enabling, not labelling
Why an obsession with labels will disenfranchise investors from choice

Meaningful influence
Why investors must play a more significant role in public policy development

Enlightened engagement
Why the concept of active ownership might have lost its way

True climate impact
Why managing climate investment risk alone will not fix climate change



Climate catastrophe, racial injustice, species loss, economic inequality, the devastation of the oceans, continuing human rights abuses. These are just some of the huge challenges facing the world today. However, these challenges have all seemingly fallen under the banner of ESG – environmental, social and governance – investing.

So much so, in fact, that the accelerating demand for sustainable investments already seems like old news. Such has been the flow of industry reports and marketing of 'everything ESG' in the past 18 months, it's easy to be overwhelmed with the surfeit of grandiose claims. We believe these claims should not go unchallenged.

And while we recognise the significance and urgency of the societal issues, we believe that tackling them in a meaningful way requires acknowledgement of the significance of the challenges, a clear diagnosis of the problems and identification of targeted solutions.

Indeed, we work in various international forums either through Natixis Investment Managers or through our affiliated investment firms. These include the UN Principles for Responsible Investment (PRI).

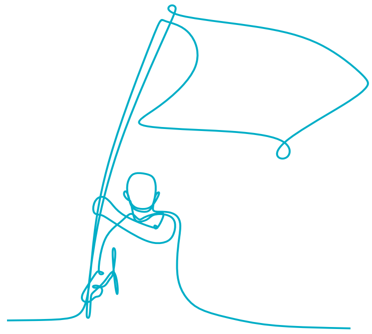
Speaking at the PRI in Person 2019 event in Paris, our CEO Jean Raby said: "Although I like to believe our industry can do a lot, governments and regulators have a key role to play alongside financial institutions and investors. Cooperation is certainly the most powerful tool to fight some of the most pressing issues, notably in the fight against climate change and inequalities of all kinds… "PRI signatories, either as asset owners or as asset managers, manage or account for close to $90 trillion. Together, we have the power to make a difference through our investments."

So, what does good look like?

Working collaboratively with organisations like the PRI, we also take seriously the need for greater scrutiny of all the bluff and bluster around ESG investing. It's almost a given these days to hear those of us in the finance industry say that a more widely integrated approach to ESG would have multiple benefits.

Some talk in terms of the social impacts, others about a healthier planet. Yet, for most current ESG practices, substantial evidence rarely exists today to support these claims – almost to the point where ESG investing has become something of a 'fact-free space'.

So while the growth of ESG and the numerous investment products that have been launched can, and should, be welcomed, fears of greenwashing are not unfounded. And there are still many issues around the subjectivity of labels, definitions and ratings, as well as a lack of clear standards to measure impact, allow comparison and monitor progress.



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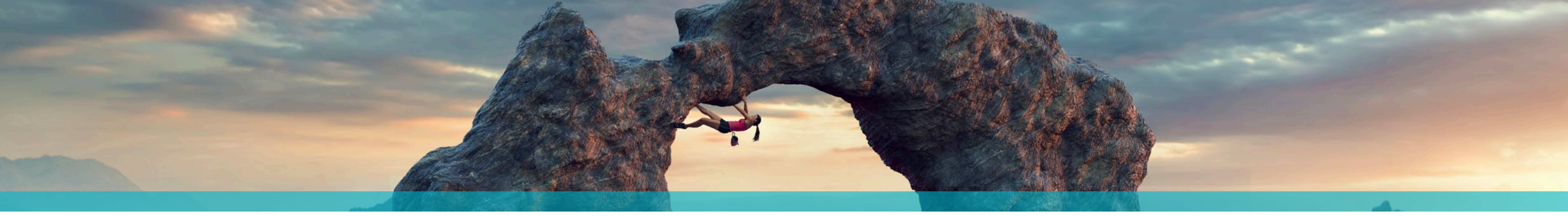
>
> **Maya Angelou**
> Writer, poet, civil rights activist



Just good risk management?

There are certainly remarkable differences between the ESG benchmarks compiled by different ratings agencies. During a Natixis Access Series video talk in June, Bloomberg's John Authers said: "There are many different versions of ESG and, particularly when it comes to the G, there's a difference of opinion between the ratings agencies over which companies demonstrate good governance… almost zero correlation between them."

One issue is that, when it comes to ESG ratings there is significantly more subjectivity involved, which is largely due to the amount of extra-financial data that underlies the methodology. As a result, the dispersion between ESG ratings across different ratings agencies is a lot higher.

A case in point is the company Tesla. Arguably, Tesla has been the catalyst for the rapid shift towards electric vehicles in the automobile sector. However, corporate governance at Tesla, as well as workers' rights, are somewhat lax. Then there's the infamous founder and CEO Elon Musk who has been investigated by the SEC after one of his tweets was alleged to amount to securities fraud.

The question as to whether the good that Tesla has done for society – in terms of the positive environmental impacts of electric cars – should outweigh the bad elements of corporate governance is a subjective one, which is why Tesla has very different ESG ratings from one agency to the next.

In short, data and reporting on ESG is still an emerging area for many companies. As such, there remain wide variations in the availability of such information across sectors, industries and geographies, which serves only to add to the challenges.

Furthermore, not all of them get it right all of the time. Take Boohoo. Just weeks before the fashion retailer was hit with fresh allegations about poor working practices in its factories, one ratings agency issued a 'double A' rating, highlighting how Boohoo scored far above the industry average on supply-chain labour standards.

Clearly, Covid-19 has focused investors' minds on labour issues (the S in ESG) more than ever before. And while ratings provide a useful starting point for fundamental analysis, ESG managers need to do their own research to ensure that their clients are not compromised by having investments that are not aligned with their values.

Yet the seemingly endless discussion about ESG data, and whether alpha can be derived from that data, often obscures a perhaps far more important discussion. That is, whether or not the incorporation of ESG factors into investment processes also has 'impact'. We would argue that this impact – or achieving societal outcomes through ESG integration – is what we had in mind when we started our ESG journey many years ago.

The evidence we have uncovered thus far seems to support the claim that ESG integration is a good risk management tool. However, to 'make a better world', other ESG practices are likely needed.

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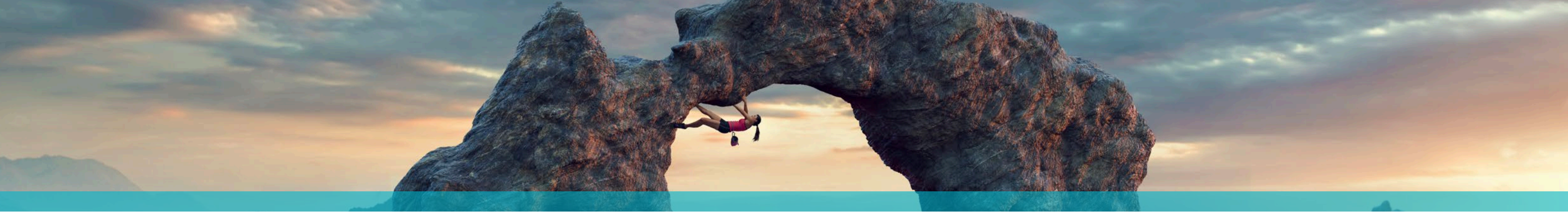
Jean Raby
Chief Executive Officer,
Natixis Investment Managers



How can investors have an impact?

Estimates suggest that a whopping $6 trillion a year is needed to fully meet the UN Sustainable Development Goals (SDGs). The SDGs are the world's to-do-list of large problems to solve. They have also become a key reference framework for managing and investing for positive impact, ranging from the fight against poverty and hunger to the development of sustainable cities to the emergence of responsible methods of production and consumption.

It's clear more needs to be done to get capital flowing, particularly to developing countries. The burning question for investors, therefore, is how can they contribute more effectively to addressing some of the world's most significant challenges?

Innovative thinking is certainly required when looking to shift capital into the areas that most need investment. One workable solution is 'blended finance'. This uses public funds to encourage private investment, the result of which can finance projects or businesses that, under normal circumstances, would be 'un-investable'.

Typically, these projects provide not only financial returns for investors, but also economic, social and environmental benefits for local communities. And in recent years, thanks to blended finance, hundreds of millions of dollars have been poured into areas like sustainable forestry, fisheries and agriculture to help protect the natural world.

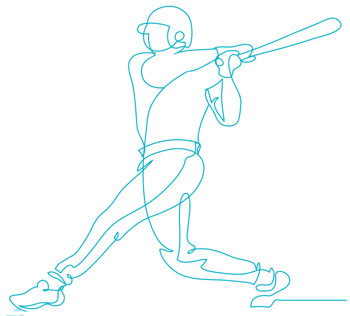
Solutions like blended finance, while highly complex, are more likely to achieve meaningful change than other impact investment approaches that have become popular. Of course, that's only true if the market for this type of blending is spurred on by both governments and companies.

But governments have a broader role to play than simply mobilizing private capital through blended finance. Indeed, to solve sustainability challenges this will mean, in many cases, transformation of entire industries, which is unlikely to be achieved by sustainable investing alone, and will require far-reaching public policy measures.

Governments, after all, have the primary responsibility in addressing many societal issues. Which is not to suggest that investors cannot or should not play a role, but that investors who genuinely want to solve these problems need to become the true enablers for the solutions of sustainable investment.

Furthermore, investors need to have better engagement with corporate management. Shareholder engagement is perhaps one of the most promising ways to ensure investor impact, even if there are still question marks around how best to organize engagement activity, and how best to quantify the impact of engagement activities in a comparable way.

Investors that genuinely want to address climate change, for example, can look to active fund managers who hold meaningful stakes in companies and have credibility with company management. As active owners, they will already be very familiar with the company's management, strategic plans and competitive challenges, and are best positioned to challenge managers to plan for, or even contribute to, the energy transition.



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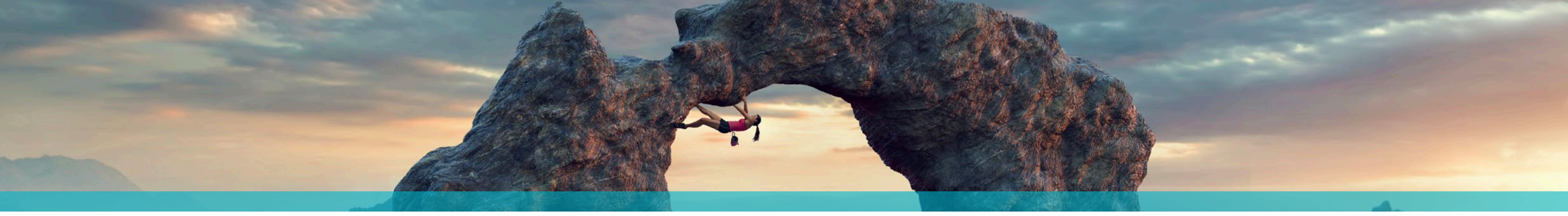
> **Yogi Berra**
> American baseball player and manager



Time for collective commitment?

For our part, 94% of our assets are managed by PRI signatories. We also work with the Coalition for Environmentally Responsible Economies (Ceres), Focusing Capital on the Long Term (FCLT), the Institutional Investors' Group on Climate Change (IIGCC) and the Investment Leadership Network (ILN) – over the next two years, Jean Raby will serve as co-CEO of the ILN. We are also members of the World Economic Forum's Alliance of CEO Climate Leaders and the One Planet Asset Managers' program – part of the One Planet Sovereign Wealth Fund initiative, which is aimed at integrating climate consideration into wealth fund management.

Working with these forums helps us to advance our thinking on a range of issues, particularly climate change, which we see as a salient ESG issue. It also strengthens our voice, as asset managers, with regulators and policymakers. If we're to shift more capital to sustainable activities, we need the right framework of rules and incentives. Working with others in the industry also gives us 'soft power' – influencing companies and opening up new investment opportunities.

Our work fits with a broader international agenda to tackle climate change and other ESG issues. Some of our affiliates already use SDGs and the Paris Climate Agreement as a framework for ESG investment. Overall, we take a selective approach to these initiatives. We join only if we're certain that we not only comply with the forum's basic principles, but we can also actively contribute to its purpose or goals.

We would argue that, at its core, sustainable investing should fundamentally be about change. Companies, systems and societies can and do change over time, and investors do have a role to play by triggering or accelerating such change.

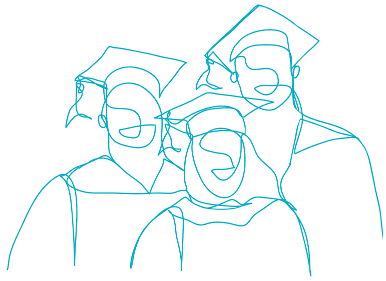
In their 2020 paper, '*Can Sustainable Investing Save the World*?', the academics Kölbel, Heeb, Paetzold and Busch conclude that, from a societal perspective, investor impact is the essential feature of sustainable investing. They point out that: "If sustainable investment does not make a difference, policymakers would have no reason to foster it, and academics would have little reason to study it".

Can investors invest with impact? We believe they can – but not every investor can. Investing in an impactful way, for example, in a way that alleviates poverty, helps to mitigate the effects of climate change, promotes diversity, allows more affordable housing to be built, and so forth, is all possible, but for it to be meaningful, for it to really make a difference, is very difficult.

It requires in-depth understanding, not only of these themes, but also of how to structure complex investment vehicles, understanding of how to work with governments, development banks, philanthropists or NGOs. Only investors who truly understand how capital moves through financial markets, and how capital allocation decisions are made, can truly invest with impact.

Get that right and sustainable investing has the potential to be transformative. As Philippe Zaouati, CEO of sustainable investor Mirova, and a leading figure in green finance in France and Europe, says in his recent book '*Sustainable finance: time for a second chance*': "If the political will is there to bring about a real transformation of the economy, green finance is ready to seize this new opportunity."

Written in January 2021



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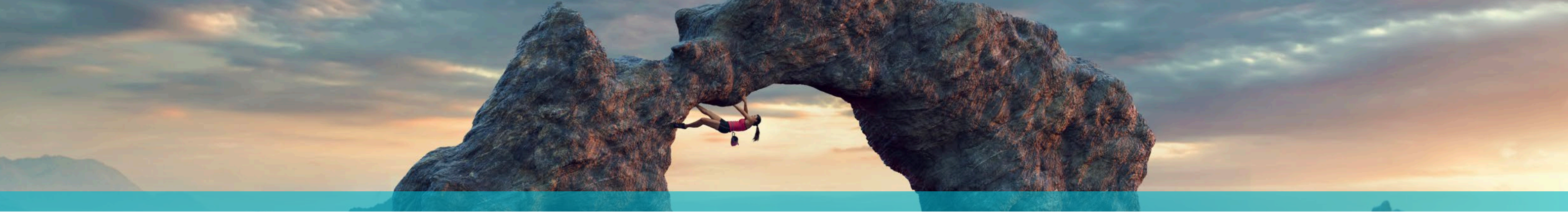

A roadmap for success

Our forthcoming series of insights take a closer a look at how blended finance, enabling rather than labelling, policy influence and shareholder engagement are already becoming key instruments in enabling investors to have a meaningful impact in sustainable investment. It's all part of a roadmap that paves the way for ESG and the future of finance...

From 'impact' investments.... to 'blended finance' that meets risk/return requirements of large institutional investors.

To actually 'shift' capital and enable ambitions to become reality, investment projects need to have a clear idea of purpose and need to find the right mix of public/ private investment.

From climate risk management... to proactive influence and true climate impact.

Managing climate investment risk does not equate to fixing climate change. Investors can have a climate impact, however, by active ownership, working with governments to implement meaningful policies like carbon pricing, and being proactively involved in innovating investment tools that aid the development of new technologies.

From working groups and forums... to collaborative advocacy for systemic change.

With governments having the primary responsibility in addressing social issues, investors surely need to play a more significant role in public policy development.

From taxonomies and labelling... to enabling.

Sustainable finance has become too dependent on the assumption that ESG standards, data and labels will drive the change we hope for. Change requires a more rigorous diagnosis, and identification of the appropriate change mechanisms. Only when this is agreed can ESG standards, data and labels help us make and measure progress.

From engaging on ESG issues... to enlightened active ownership.

Investors have a significant role to play in a company's governance: holding managers to account, and challenging them on strategy. They need to take this role much more seriously if they are also to help companies deal with ESG issues. Meaningful engagement 'incorporates' ESG factors, rather than centring on' ESG factors.

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