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Bank of America's "Journey to Net Zero"

Conversation with GIC

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SUMMARY

- ESG investments in the near term may not always be the most profit- maximising but are good business in the long run.
- GIC's Sustainability Committee was set up to assess the scientific and policy reasons behind as well as the cost implications of investing more sustainably.
- Large and thoughtful investors are investing early in green technologies to better assess likely winners.

Introduction

As part of Bank of America's "Journey to Net Zero" Series, Dr Jeffrey Jaensubhakij, GIC's Group Chief Investment Officer, speaks to Martin Siah, Singapore Country Executive at Bank of America, about the balance between the pursuit of net zero and profit, shifting the mindset of GIC staff, and the challenges that remain with investing in the global transition.

Transcript

The interview transcript below has been edited for clarity and brevity.

Martin Siah
Singapore Country Executive, Bank of America

Jeffrey Jaensubhakij
Group Chief Investment Officer, GIC

MARTIN: Thank you, Jeff, for joining us today.

JEFFREY: My pleasure.

MARTIN: I'd like to start asking about your personal journey. What motivates and inspires you?

JEFFREY: I tumbled into asset management a little bit by accident. I really thought of economics as mainly about bettering people's lives by changing policy. But I did have a wonderful encounter with a recruiter from GIC and the next thing I knew I was flying out for the interview and was offered a job within two weeks. When I visited Singapore, I had not lived in Asia for more than 10 years and I felt homesick. My wife, who is Singaporean, asked me "How can you be homesick? You didn't grow up in Singapore." But I was just being homesick for Asia, just thinking that the opportunities to build a career in Asia with an Asian company was a wonderful one, so I'm glad to be back.

MARTIN: Today, you are the group CIO of one of the most powerful and global investors in the world. On one hand, you have to safeguard the wealth of a nation. You also have to balance against what the world needs when it comes to climate change and also impact investing. So how do you balance these two well?

JEFFREY: I think many of the people who invest in a capitalist system believe that ultimately the capitalist system will drive behaviour that is good for the investor, good for the saver, but ultimately also good for the world. But in the meantime, actually, sometimes the price signal [can be wrong].

In GIC we try to ask a question: Will investing in companies and in technologies be good for the health of the economy in the long run, the health of the environment, the health of the people in the long run? Will it also be good business?

We think that if we can reconcile that, then eventually it will be good business. Maybe it's not the most profit-maximising in the near term but we know that in the long run it will work out.

I think coal actually has been a good example of that. Think back 10, 15 years ago and coal companies were doing very well. It was the source of a lot of emergent energy but we knew that it was one of the most dirty, difficult to get rid of, polluters in the world. And [we] started to think about it, asking the question if it can remain like that forever. Won't there be taxes? Won't there be restrictions? Won't there be public pressure on these companies and on power generators to use an alternative fuel? So, if you think long term enough, I think, especially with hindsight now, you could see that the pressure would be coming and that maybe the right thing was to already start thinking of alternatives.

MARTIN: You have been quoted as saying that sometimes what the world needs may conflict with profit maximisation.

JEFFREY: In the near term, sometimes it can be. There are two ways you can go about it. One is to look at all the things that I'm invested in that are potentially not very good for the environment. Maybe, governments will eventually have to tax the activities that are not good for the environment. Maybe carbon prices will go up, maybe restrictions will come in that actually prevent certain types of businesses from being done. And you can opt to defend yourself by either engaging the company, asking them to change their practices, or you can decide to divest. But that's only a negative, right? You're trying to avoid what could be a declining asset.

I think just as important is to look for things that will benefit and will do well in an environment in which companies, governments, and consumers are changing their behaviour to take on more sustainable industrial processes. To start using power generation that comes from clean sources and so on. If you can find the positive things then it doesn't feel so hard to remove yourself from the negative things even if they go up in the near term, because you already have something else that is positive.

MARTIN: Did you encounter any internal obstacles or have to educate colleagues to shift their mindset?

JEFFREY: I think ESG has been a journey for GIC. We set up a Sustainability Committee about six years ago with the idea that we needed to have people who dedicate a little bit of their time to making sure that we really understood what the scientific issues were, what the potential policy and cost implications were for the companies and the industries that we're invested in. Then the second question to ask is what are some of the actions that GIC would have to take immediately. Are there companies that we should immediately divest away from because they were most at risk? What were some of the activities that we ourselves were doing that needed change?

So, the Sustainability Investment Fund (SIF) that was set up in GIC tries to take the stance that there are technologies that will be used that will develop and will be helpful for energy efficiency; that will be helpful for climate mitigation; that will be helpful for maybe just resource efficiency.

And if we invest in those [technologies] then the demand will come. And by pulling in people from the different departments it also had a demonstration effect. So, if someone from real estate could find positive investments in clean real estate – better buildings, using better materials or investing in companies that produce better materials – that could make money, the rest of their colleagues within real estate could also see it and say, “Maybe I can do that too.”

So, I think it had a little bit of that desired effect. In fact, so much so that now there are other sustainability-focused investment portfolios that are set up in both public and private markets.

MARTIN: So it's basically an ESG ethos across all your investment teams globally.

JEFFREY: Well, we're definitely trying to get there because we think it is ultimately an issue that has enough breadth that it will affect all the different industries that we're invested in.

MARTIN: Our research demonstrated that every one in ten dollars of global bond funds is focused on ESG investing. I think last year there were about close to a trillion US dollars of ESG-related bond issuances.

Talking about real estate, there are about US$1 trillion of real estate bonds in Asia-Pacific but less than 2% focused on green bonds. What are some of your thoughts in terms of the entire ecosystems of investors, issuers, financial intermediaries to accelerate the pace of ESG-related investing?

JEFFREY: The fact that there are so many funds that are set up specifically targeting ESG investments gives us a glimpse of the mindset of savers and investors today. That the population at large, savers at large, think that this is a moment-defining issue and want their fund managers to be doing the right thing, to be invested in these industries. That's why all fund managers are raising ESG funds because they know that the demand for it is there. There's a real interest and in fact they might even be willing to accept a more pedestrian return in exchange for being able to be invested in the right thing.

The problem is that the number of really good green investments that the money can go into is still somewhat limited. For many companies, it doesn't represent an existential threat yet. It's not as if all governments have a regulation saying that by year 2030 you need to be out of this business or you need to have net-zero carbon emissions by this year, otherwise the fines will come or the cost of carbon will come, because that has not been determined by policy yet.

For most companies there isn't a real need to put [transition policies] in place yet. So long as that need isn't there, then the technologies that can help, the CapEx that can help, won't get spent. And so in actual fact, the opportunity set for which ESG funds can go into is still somewhat limited. I think that's the difficulty. That there is a timing consistency problem between the desire to do good today and the opportunities to actually put that money to work.

I think it will come. We are taking the approach of saying that while some of the technologies are not yet at commercialisation stage — previously we would have said "Oh it's not commercial yet, we can't put a lot of money in, maybe it's not worth looking at." Now, we are so convinced that this is a trend that will pick up that we've gone earlier in the process. We've gone to venture firms that are focused on environmental sciences, green technology, and agritech. Things that save on resources. We don't know which technologies will win but we know that the tailwind is behind them and it's better to get in early. Get to know the company, get to understand whether or not this is one of the likely winners, whether they will actually be able to take their cost to a commercial level where they can compete with non-green. And to also put ourselves in a position to give them growth capital in future rounds.

We're not the only people who are taking that approach and I think large investors, thoughtful investors, are doing that more and more.

MARTIN: I know it's very tough to pivot with the reserves that GIC is managing now, with more coming from the MAS. But do you think that in the near future, as part of the KPI, for GIC and for your teams, you'll set a minimum in terms of ESG and portfolio allocation?

JEFFREY: That's probably not the best approach. We discussed a little bit earlier about all these ESG funds that are looking for things to invest in. And in the end, they actually all crowd in on the same kind of investments. But if you do that then you force the rate of return lower and actually in the end you don't get the outcome you want. Actually, we're seeing that in some of the renewable energy projects. What used to be a 12% return has become 11, 10, nine. Now it's around six. At 6% you can't really get a lot of money in. Too much money chasing after the very narrow set of investments can lead to that and so in the end not enough money goes into setting up new projects.

I think there are a couple of ways we can address that. The first is that governments need to think about how they can de-risk some of the projects so as to make that 6% return investible.

As I mentioned, in emerging markets where there's a lot of construction risk, political risk and so on, I think investors will find it difficult to accept a 6% return with so much risk and volatility in the project still. Either governments or multilateral organisations like the World Bank or the IFC, if they can help de-risk some of this, maybe take the first-loss risk, then I think at that lower hurdle rate, because money is chasing for safe but decent return assets, [it] can then come in. Then you can have enough flow to fund the projects that you need.

MARTIN: Once GIC has made the decision to invest in a company, what is your focus in terms of helping the company to transition faster or stay on track towards net zero in terms of emissions?

JEFFREY: There isn’t just one metric that you can look at and then that'll be enough. There are lots of different measures that can speak [to] the health of the company. What we are very thankful for is that there are now a lot of organisations, a lot of data providers, who are willing to measure all these different things and put them together.

In fact, there are now international organisations like the International Sustainability Standards Board (ISSB) that are trying to narrow down and put together a list that everybody can agree on so that companies are also very clear what are the targets that investors care about. However, I think it still doesn't take away from the fact that each company will approach sustainability differently and their practices may look different but may be equally effective.

And I think the only way to know that is to have a fundamental team that understands what the company should be trying to achieve from a sustainability perspective, and can go in and take a look at the company, understand it, maybe engage with the management if we think that some of the practices are not good.

So, one of the things that we've done in the last year is really to put additional resources into our equities investing group to make sure that in addition to our normal financial analysts, we put in sustainability analysts who can work with our financial analysts to understand the companies.

MARTIN: I read that in recent years GIC has partnered with a group of global equity investors in highlighting five power and utilities companies in Asia-Pacific that contribute to about 27% of the carbon emissions in Asia-Pacific right

now. This group of investors, including yourself, have more or less imposed a timeline for these companies to reduce their net carbon emissions. Do you think the GIC will be doing more of such partnerships going forward?

JEFFREY: I think there's only so much that one individual investor can do. Ultimately, if we don't invest in this company, somebody else will. So I think there is power in pulling like-minded investors together and, as you mentioned, maybe in Asia we've come to the game a little later than, say, Europe. There is an opportunity for investors in Asia to start helping our companies to realise that these are very important not only because the investors say they're important, but they're important for the health of the company in the future where governments may well raise carbon taxes.

So, we indeed did sign up with the Asian Investor Group on Climate Change (AIGCC), which pulls together Asian investors who look at Asian utilities. We are also signatories to the CDP as well as a couple of other international organisations.

But at the end of the day, each investor is responsible for their own funds and we know we have to do the work to analyse and to engage our investee companies to make sure that the outcomes are right.

MARTIN: Some of the sovereign wealth funds have taken a firmer stance in terms of requiring their portfolio companies to achieve net zero in terms of reduction by certain years. Temasek has also made a similar statement. GIC has been quite silent on this in public, in disclosure, thus far. Is it about maintaining your investing flexibility?

JEFFREY: There is the issue of announcing a destination and then figuring out how to get there.

I think we're still in the process of trying to figure out, if we announce a destination, whether we can get there.

Now for fund investors announcing a net zero by whatever year, there's an easy way to get there, right? Which is to sell all the companies that are high emitters and unfortunately that means you sell a lot of the emerging markets because the poorer countries haven't been able to transition to more costly but cleaner technologies.

But does that mean that the world will actually see fewer carbon emissions? Because what we sell may go to a lower price and somebody else will pick it up and will just let the company run as it is. I think we are very engaged and very concerned about how the world would actually get to that lower emissions level that is necessary for maintaining a temperature path that is acceptable.

I think we're really thinking through our part, the part that we play. So, some of it may be indeed announcing divestment of some types of investments. Some of it will be working with companies that can make an easy transition. I think a lot of it will be investing in the types of solutions that will help the global economy make that transition.

MARTIN: My colleagues and I would like to do our part when it comes to our personal ESG investment and consumption decisions. So if there's a "Dr Jeffrey" advising me and my colleagues, what would that advice be? So, not the GIC advice, but how can we as individuals do our part?

JEFFREY: I'm not a paragon of virtue by any means but one of the things I'm most concerned about is the wastage of materials especially now with e-commerce. You think about the packaging that comes and you throw away. Does it get recycled properly? There are ways in which we live our life that add to the problem. For me personally, I have been trying to reduce my use of plastic bags.

MARTIN: [laughs] I thought you were going to say online shopping.

JEFFREY: [laughs] I have to support our company investments also. But I've taken to bringing along a 'tingkat' or a carrier with me when I buy food on Saturdays and Sundays. So I'll ask for the economic rice to be put into a metal container that I take home and I just wash and I don't have to get rid of the styrofoam and so on. Look, it's not a big thing, it doesn't help very much, but I'm hoping that it's the start of some other things that I will also do in order to reduce wastage in my household.

I have kids, they're a little bit more grown now but what we do as parents in front of our kids really matters because they will remember it and they will keep it as a habit through life. My parents grew up during the Second World War. Very frugal, never threw anything away.

So when my kids look at me and every morning my newspaper comes, I take out the rubber band and hang it there. And they ask me “Dad, why don't you just throw away the rubber band?” I tell them, “Oh, because it can be reused right? You can use it to tie your hair, you could use it to tie up plastic bags.” So I think that mindset where we care about the world, where we try to economise on things that could be wasted and where we try to reduce the kind of behaviour and usage that will pollute the world. I think every bit helps.

MARTIN: Looking into the future, if we were going to have this same conversation in five years’ time, what would you like the world to do from an ESG and impact investing standpoint?

JEFFREY: I think it is a wave that is coming. It's not yet fully here even though it feels like there's been a lot of talk about it. I think that a lot of industries will need to make tremendous CapEx spending in order to become greener to get better industrial processes, and to use different sources of energy that will require a lot of financing. I think BofA really has a role to play because you are that intermediary between companies that need to spend that CapEx, that need the funding for that CapEx, and the savers and investors, both your retail investors as well as your institutional investors in matching that up. So we look to partnering with you in this journey. Those opportunities to invest will come and they will earn good returns.

At the same time, we'll be exiting some of the others where the cost pressure will come and things will be compressed. Anyway, we look forward to working with you on this and really thank you for your tremendous help already.

MARTIN: Thank you.

JEFFREY: My pleasure. Thank you.

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