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Michael Venne: You're listening to R.P.M., the podcast that explores the world of private markets. I'm your host, Michael Venne. More than a third of the 11 trillion dollars in alternatives AUM is managed by firms committed to ESG, according to Preqin. Here to discuss the rise and evolution of Responsible Investing with me is Suzanne Tavill.

Suzanne joined StepStone in 2014 and is a Partner based in Sydney. Prior to being named the global Head of Responsible Investing, she was a member of StepStone's private equity and infrastructure teams. Suzanne has degrees in economics and finance from University of Cape Town and the London School of Economics.

Hi Suzanne, and welcome to RPM.

Suzanne Tavill: Thanks, Michael. It's great to speak to you on a topic that's both critical to business and something that I'm really passionate about.

MV: Social inequality and climate change are hardly new problems. The efforts to address climate change are at least 40 years old, and social inequality far older. And a few times it has felt as though we were on the brink of major change. Susanne, in just a few words, could you explain some of the historical challenges, and why this time appears to be different.

ST: Yes, well, we've all been bitten by that phrase, "this time is different". I do think that progress doesn't occur in a neat straight line, we seem to lurch forward and backward along some progress glide path. And it seems to me that to prevent a retreat, we need almost a tipping point to occur. I'm sure you remember that great book…

MV: Gladwell…yeah

ST: Absolutely. And so, you know, we need these sorts of reinforcing efforts from different contingence and sectors to adjust forward. When we speak about climate change and the need for social equity, which are arguably two of the most momentous challenges facing our world, today, we've got to recognize that we are standing on the shoulders of all the efforts that have gone before, the work of the scientists, the campaigners, the interest groups, you know, now both virtual as well as real, and then big governmental type organizations like the United Nations and allied organizations like the TCFD, the Task Force for Climate Disclosure, they've all been critical in focusing attention on these issues.

Having said that, I think at the same time, we can't discount the demographic changes that are occurring in our world. You know, by 2030, the boomers will all be retirees and the workforces will be dominated by GenXers and Y, and Greta Thumberg is not an outlier, you know, she's increasingly representing a mainstream perspective of a lot of millennials who are extremely focused on these two issues. For this generation and even for our generation, it's happening to us, it's happening to our children and our grandchildren. And I think this really underscores why things hopefully are really starting to change.

I would say also the role of regulation is critical, because regulation ensures that we don't retreat down that progress glide path and Europe is certainly leading the way in this regard, and many countries are following.

I think the other final factor that I think about in terms of maybe why we are shifting forward in a more concrete fashion on these issues is technology. You know, a lot of the interest groups, the campaigners, the spread of information, that obviously stands on the shoulders of all the technological progress that has happened, but even to issues like how to carbon footprint, how to better understand our world and what we doing to it, all of that has been enabled through technological progress. So, I'm hopeful that this time might be different, she says tentatively.

MV: Ok, so there's been a long and persistent effort to change hearts and minds. It seems like big investors have moved beyond debating the causes of climate change or the benefits of diversity, inclusion and social equality. Is it true that we've now reached a point of action?

ST: Yes, this I can definitely answer in a strong affirmative, because it's very exciting to see asset owners (which include pension funds, sovereign wealth funds, endowments) assuming leadership on these issues. They are recognizing and demanding from their investment providers, which are obviously investment managers in private markets, as we term them General Partners, they are really demanding that the manner in which these groups invest are cognizant of these issues. Now, a lot of these issues get banded under the umbrella of environmental, social and governance, so ESG, but particularly climate change, it gets called out independently as well. So obviously climate change is something that sits across ES and G, as we know, and one of the groups that I would call out that I think has been important in empowering and mobilizing asset owners has been the United Nations Principles of Responsible Investment and allied groups such as Climate One Hundred Plus, which have really elevated the actions of coordinated advocacy to really a new level, and I think that has been critical.

MV: So perhaps a case in point would be the EU's ambitious new taxonomy, as someone who has actually read the entire document, walk us through the taxonomy, and explain what it means for LP’s long term.

ST: So, the taxonomy, yes, it is a long and it is a complicated document. What the European Union has essentially done is that they have said climate change is happening, and they need to decarbonize the entire economy of Europe. In order to do that, they need to channel trillions of dollars to sustainable activities. So, the European taxonomy, or the EU's taxonomy, defines what are sustainable activities in a very comprehensive manner. And the taxonomy continues to be built out. So, what will flow from the taxonomy is that capital is going to flow into those sectors that are blessed as sustainable activities under the taxonomy. As a result, the cost of capital for those sectors will fall over time, whereas for those sectors that are not blessed as sustainable activities, capital will retreat, and ultimately those businesses will find it more and more difficult to be able to sustain themselves with a shortage of capital providers, not just equity, but debt as well we're talking about. And I think what's important here is that when we talk about sustainable activities, it's not just things that are like obviously green, like renewables, but any business in the majority of sectors has the ability to become sustainable, to do activities that mitigate the amount of emissions that they are producing. And this is something that the taxonomy really does recognize, absolutely. There are a few spaces, particularly those around fossil fuels and coal obviously, in particular, that it is very difficult to get blessed under the taxonomy. But for many many sectors, there's a path to sustainability that is laid out under that taxonomy.

MV: Now, this is just one region, granted, a large region, but their efforts to tackle these issues head on. Do you see other countries, other jurisdictions adopting similar legislation or promulgating similar regulations as the EU?

ST: Yeah, so at the moment, there's a number of other national taxonomies being created. So, China is creating one. Japan, Canada, for starters. And each of these countries wants to create their own taxonomy because they want to protect certain particular aspects of their own economies. So, if you think particularly of Canada, they are trying to figure out a way to get a path to sustainability for their mining sector, as opposed to finding that the entire mining sector is excluded under a taxonomy framework. So, it's going to be quite a long while before I think we have a global taxonomy framework, but I think in time that is the path that we're heading towards.

MV: Very interesting. Changing gears a bit. I've heard you say previously that it's important for LPs and GPs to align their ESG goals with those established by large global organizations. You mentioned PRI and TCFD. I should think that for some investors, particularly those with long established ESG programs, the addition of yet another set of rules/targets can present some challenges. My next question is twofold: first, how are we at Stepstone adjusting our investment process vis a vis the taxonomy, the EU's taxonomy, and second, in the discussions you've had with LPs, how does the taxonomy figure into their ESG related goals?

ST: Yeah, that's a great question, so I'll try and take it in its different parts. So, look, in any fast-evolving space, that tends to be a plethora of interest groups that emerge and then relate to frameworks, and this obviously creates quite a compliance cost within the industry. Ideally, as an industry, we want to push towards a standard and preferably a global standard without having regulation, having to force us to do that. But, and so really to help us on this journey, we strongly argue for participants within the industry to align to peak bodies to further reinforce the dominance of those bodies. So certainly, for us, we regard their principles of responsible investment as a peak body, particularly around setting the tone for ESG, TCFD, particularly around climate change, and then there's now a coalition of groups, particularly around standards and reporting and disclosure. So those are some of the peak groups I would highlight.

With regard to the taxonomy and how one actually applies this very complicated classification system in practice, we embarked on doing a case study for the United Nations where we looked at practically applying the taxonomy to infrastructure investments. And I think our learnings there, reflected what I think we would have seen if we would have done the same in private equity or real estate. And that is that for one to be compliant with the taxonomy, you need a lot of information from the asset itself, which means that the General Partner or the investment manager, will need to work with their companies, they're holding, their investee companies, to track and then report on the required information and then, at the GP level, to aggregate this information up, which then groups like ourselves as well, as asset owners, will then be able to use to be able to look at their taxonomy compliance. So, the first step is really around getting the data and we see the EU recognizing this with a set of disclosure related regulation that is being implemented, which includes things like the non-financial reporting disclosure NFRD as well SFRD, which is the sustainable financial disclosures that are required. And so, you know, the taxonomy, in a sense, has preceded the availability of information, but I suppose under the logic of *if you build it, they will come*, this is what will happen in that space.

MV: Quite fascinating. So, Susanne, how do the Sustainable Development Goals, the SDGs, sync up with climate change and social equity?

ST: So, the social development goals have been…look, they were created in 2015 as really big, audacious goals that the world should aim towards to create a better society for us all. These have got adopted by the financial community, and they have resonated strongly with asset owners who want to be seen to be investing in a manner that is aligned to be obtaining these real-world outcomes. So, the challenge is translating these development goals into really investable opportunities, now, which is something that we at Stepstone spend a lot of time thinking about, and how to help clients align their investment programs with these SDGs. Now, amongst the SDGs there is SDG 13, which specifically addresses climate change. Within there's also SDG 10, that specifically looks to address inequality. But arguably there's a whole bunch of other SDGs that, for example, around education and healthcare, that of course feed into supporting the objective of reduced inequalities. So, you can see that the SDG, the 17 SDGs is very comprehensive, and it's very difficult to say one objective is more important than the other objective. In essence, they really work together as a matrix today. Today, really, we've spent our time speaking about two very big and very important SDGs out of this very comprehensive set.

MV: I'm sure we could dedicate an entire episode to the SDGs, you know.

ST: Yes. Perhaps that's another idea for us. I'm sure we will in the future.

MV: Finally, Susanne, Responsible Investing and ESG strike me as the sort of thing that require passion to be executed properly. What are some of the experiences that have inspired you down this path and shaped the type of investor you've become?

ST: Yeah. So, look, I grew up in South Africa under apartheid, and saw the struggle firsthand. And South Africa reflected the worst of inequities and inequalities, and it was absolutely an unsustainable system. And if it was not for the leadership of people like Mandela and de Klerk, the country would have just tumbled into civil war. But it did not. And I remember running voter education classes in the run up to the first democratic elections and the excitement was palpable. And I remember how people stood in line to vote. For hours, some up and above nine hours, they stood in line and it was peaceful, and it was just, you know, it's impossible to think back to that day without actually getting emotional, because it was so historic and so special. And, you know, people…sometimes today I hear people complaining “oh, I had to stand in line for like 30 minutes or a couple of hours to cast my vote”. And I just reflect back onto those people standing in line for nine hours. But really, in fact, they'd been standing in line for decades during the struggle, waiting to have that change. So, I know that, like when we started speaking about this podcast today, you know, we started speaking about change and how change happens and whether change is really a traction. And one of my concerns is…you know today, attention spans are short, you know, the hashtag movement is very short, attention span in particular, and the topics that we've spoken about (climate change, social equity) in reality, these will take decades to really create lasting change. And just like I saw in South Africa, it takes concerted and consistent leadership to get this change happening. And that is my hope that we've got the strength to maintain that focus for this extended period.

MV: Suzanne, thanks so much for joining us, be well, and hope to see you again soon.

ST: Thanks, Michael. Good talking to you.

MV: That does it for this episode of RPM. Stay tuned for new episodes every few weeks, and please be sure to follow us on Apple podcast, Spotify, Stitcher or wherever you get your podcasts. If you enjoy this episode, head www.stepstonegroup.com where you can find all of our research on decarbonising the economy, ESG and Responsible Investing.