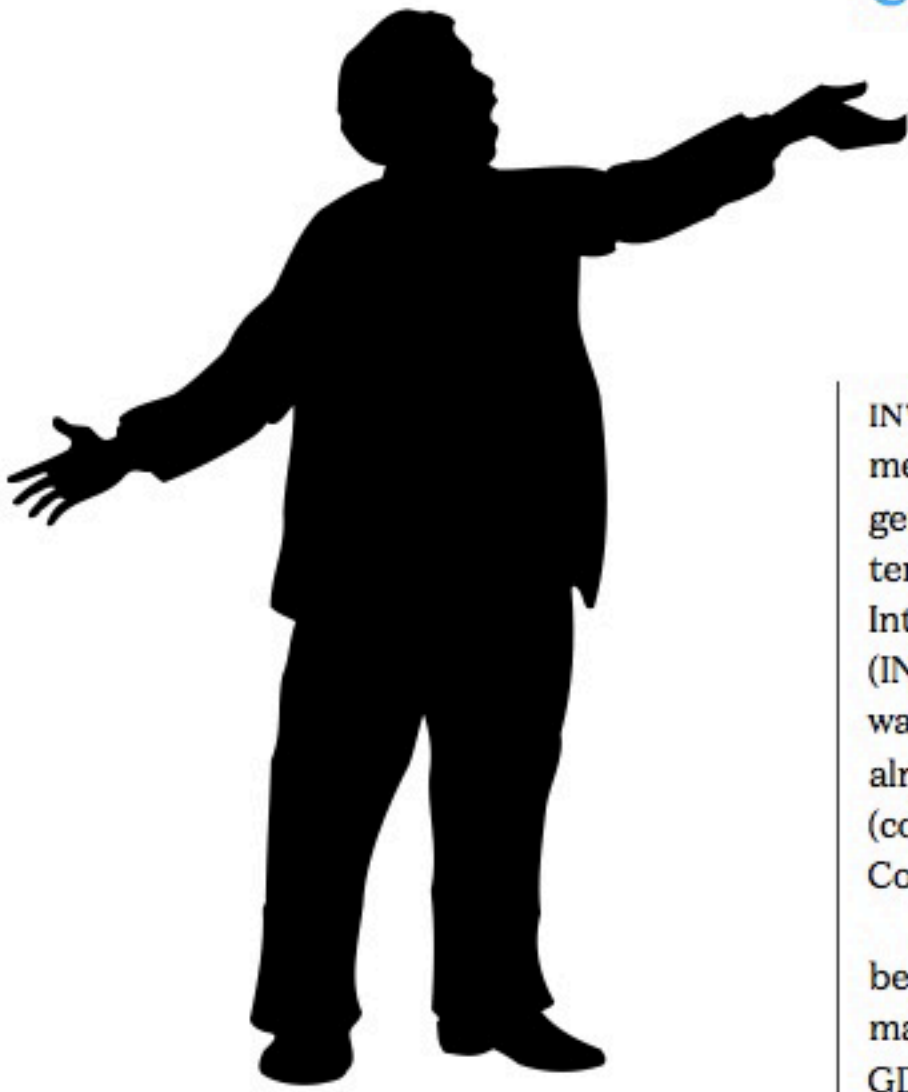


The challenger



The make or break factor

CAROLYN HAYMAN OBE

Chair

Dr RAJ THAMOTHERAM

CEO and Founder,

Preventable Surprises

“Investors now need to take a hard look at the impact on emissions of previous strategies and consider whether, in the light of COP21, they constitute a sufficiently urgent response”

Investors can't avoid making choices on climate finance

INVESTORS DID WELL in terms of their involvement at COP21 in Paris (compared to Copenhagen). And COP itself was a great success in terms of political messages. But even if all the Intended Nationally Determined Contributions (INDCs) are implemented, we can expect warming of 2.7°C. And several countries have already started to backslide, including Australia (coal), Brazil (chaos) and now the US (Supreme Court).

Only investors can bridge the gap between what was agreed and needs to be done; many manage assets equivalent to large country GDPs.¹ But they have to aim significantly higher.

The energy transition choice is between a dramatic push on renewables with significant changes in lifestyle (eg, less consumption) versus the attempt of going through the transition with no major lifestyle changes, a lower renewable energy growth rate, and relying on carbon capture and storage (CCS) and nuclear to fill the gap. The first strategy is difficult, although it can maintain its promises if put into practice. The latter looks easier, but it probably promises more than it can deliver.

There's a similar choice about the optimal investor strategy. The first wave was ESG integration and 'business as usual' engagement. The second was divest-invest, decarbonisation and investor engagement to encourage 2°C stress testing. The third wave is forceful stewardship with investors pushing for 2°C transition plans. We don't know for sure what the fourth wave will be. It may involve litigation or regulatory action, even to the point of instructing companies to incorporate COP21 commitments into their constitutions.

To observe and acknowledge the weaknesses of the earlier waves is not 'negative'. But, investors now need to take a hard look at the impact on emissions of previous strategies and consider whether, in the light of COP21, they constitute a sufficiently urgent response.

For example, it is widely known within the ESG community – but rarely acknowledged in public – that ESG integration and 'business as usual' engagement won't avert major climate-related systemic risk.² This is due to the way investment performance is measured and rewarded and the conflicts of interest that prevent robust engagement when it is done entirely behind the scenes.

So this has led to the second wave of strategies. These strategies are better suited to dealing with climate risk, but each faces significant questions.

On divestment: how will we get social change by transferring the ownership of greenhouse gas emissions from investors concerned about climate change to those who

don't? Will investors that have divested coal also divest from oil and gas to the same extent? What about problem sectors other than fossil fuels (eg, automobiles and construction)?

Concerning green investment: will the increases match the need? Will decisions by institutional investors generally interested in the short term result in major business strategy change and capital being redirected at the investee firm level?

Decarbonisation is a divestment technofix. Commitments can be quite soft (eg, the Montreal Pledge), but it covers all sectors, not just fossil fuels. It sensitises investment professionals, albeit in a way that is easy to game (think VW, Scope 3 etc).

For engagement on the disclosure of 2°C stress testing: will companies plan on how they can help drive the change, or will this strategy just result in them thinking through how they would cope with this (unlikely) scenario?

These questions are why we and others advocate investors pushing for 2°C transition plans.

Influential elites also haven't raised much awareness of the costs of corporate capture of politics by companies with clear short-term interests in preventing change. Such awareness would increase pressure on diversified investors either to rein in these companies (and this includes auto, utilities and many other non-fossil fuel companies) and/or act as a policy counterweight.

Philanthropic foundations are also relatively silent. Many seem to be funding activity that is closely aligned with their own strategies. Yet on other complex challenges – eg, peace building or economic change – foundations generally don't prescribe a theory of change. Will this norm extend to the climate debate as foundations become more confident?

Litigators could be a key constituency: will they be able to push investors to move faster?

Will ESG rating agencies include corporate political influence in their core rankings? Similarly, will credit rating and sell-side researchers and voting advisers bring climate risk into their core analysis? Will asset owners go beyond stranded asset risk to focus on systemic risk? Will global fund managers vote consistently on 'Aiming 4 A' resolutions? Will investor trade groups take the 'cottage industry' approach to resolutions to an 'industrial scale' (eg, sector level) and so remove concerns about first mover disadvantage? Will corporations that have committed to science-based targets show willingness to publish 2°C transition plans?

On all of these questions, investors are the make or break factor!

¹ <https://preventablesurprises.com/blog/country-gdp-vs-investor-assets-under-management/>

² <https://preventablesurprises.com/blog/why-we-need-forceful-stewardship-and-why-bau-engagement-isnt-fit-for-purpose/>