



Dialogue 3:

Activating the Forceful Stewardship <2°C Initiative

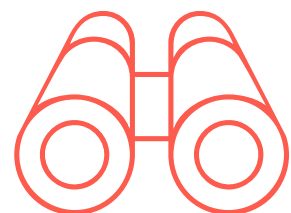
APR 25 - MAY 1, 2016

46 PARTICIPANTS / 261 POSTS

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Background & Objectives

In the third of a series of virtual dialogues, Preventable Surprises convened a group of “positive mavericks” from and close to the investment sector to build momentum around the Forceful Stewardship Initiative. This Initiative advocates adoption of <math><2^{\circ}\text{C}</math> Transition Plans that demonstrate portfolio resilience in a climate-changed, carbon-constrained world.

Each Session featured Guest Experts who instigated discussion threads with provocation statements, which spurred robust dialogue leading to a diversity of opinions and recommended responses. In Session 4, Synthesizers distilled the key elements of the discussion threads, and the facilitation team compiled the proposed Action Steps for further engagement with the Preventable Surprises community to collaboratively determine next steps.

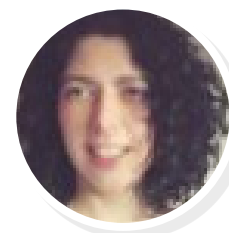




Participants



Bill Baue
Corporate Sustainability Architect
FACILITATOR



Laurence Bascle
Digital Change & Delivery specialist
CO-FACILITATOR



Raj Thamotheram
Chief Executive Officer, Preventable Surprises
Independent **CONVENER**

Guest Experts



Désirée Lucchese
Strategic sustainability expert working with the Climate Disclosure Standards Board and the EU



Julie Gorte
Senior Vice President for Sustainable Investing at Pax World



Mary Beth Gallagher
Associate Director at Tri-State Coalition for Responsible Investment



Howard Covington
Chairman Alan Turing Institute, Senior Adviser, Preventable Surprises



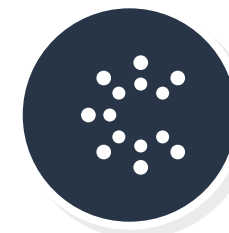
Rich Pancost
Director, Cabot Institute



Sanford Lewis
Sanford Lewis, Attorney



Jillian Reid
Investment Consultant



Helen Wildsmith
Convener - Aiming for A in the UK



Hamish Stewart
Senior Analyst at ET Index



Jackie Cook
Founder and Curator, Fund Votes and Climate Risk Disclosure Project

Organisational affiliations are shown for identification purposes only. Participants took part in this dialogue in their private capacity.

Synthesizers



Lars Nautrup Jensen
Senior Analyst AnsvarligFremtid



Karen Lockridge
Pension actuary & sustainability champion at Mercer



Mark Warywoda
Portfolio Manager at Addenda Capital Inc.



Executive Summary

SESSION 1

Emerging Alignment Between Science and Policy since COP21

The Paris Agreement ratified a global intention to limit warming to <math><2^{\circ}\text{C}</math>, which of course carries significant implications for a) public policy makers (requiring nations to set and subsequently ratchet up INDCs), b) investors, and c) corporates. This <math><2^{\circ}\text{C}</math> target creates a sense of urgency unparalleled until now, though it remains unclear whether government, investment, and corporate responses are “fit to purpose.” This session explored two themes: ‘Science and Climate/Energy Policy’ and ‘The Energy Transition & Systemic Risk’.

SESSION 2

Maximising votes at the North American Annual General Meetings

To maximise votes for <math><2^{\circ}\text{C}</math> Stress Test resolutions at North American AGMs, this session explored two themes concurrently: 1) Lessons learned from “No Action” letter defense strategies and mutual fund proxy voting data; and 2) Applying lessons at current AGMs to a) get the biggest fund managers to vote FOR <math><2^{\circ}\text{C}</math> business plan resolutions; b) nurture cross-border collaboration; and c) activate investment consultants as advocates for more forceful stewardship by fund managers.

SESSION 3

Guidance Notes & Peer Review Scrutiny Process for <math><2^{\circ}\text{C}</math> Transition Plans

This session focused on the last 2 phases of the Forceful Stewardship process: Producing guidance notes (generic and sectoral) for strong <math><2^{\circ}\text{C}</math> transition plans; and Creating an innovative and robust peer review scrutiny process for assessing <math><2^{\circ}\text{C}</math> transition plans.

Forecast: Volatility, Not Incremental Change



Guest Expert Rich Pancost

- ◆ Most investors don't understand the particular nature of climate change risk the risks will manifest not as gradual change but as volatility, shocks and tipping points in both natural and social systems.
- ◆ Investor culture values financial analysis, devalues environmental and science-based analysis.
- ◆ Minimizing positive climate change feedbacks and restoring climate stability will take unprecedented global action across all systems coordinated by some trusted but not yet in existence global organisation.
- ◆ If we wish to avoid catastrophic outcomes we must take emergency action now to halt new fossil-fuel investment, and rapidly wean ourselves off established fossil-fuel use. We have solutions, but thus far have lacked the will to implement them.



"A very uncertain volatile future (and with fat tails!) is all the more reason for forceful stewardship."



Mark Warywoda

Portfolio Manager at Addenda Capital Inc.

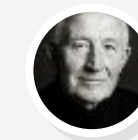
"A cultural revolution is of the essence."



Désirée Lucchese

Strategic sustainability expert working with the Climate Disclosure Standards Board and the EU

"Divestment has been very important in focusing attention on the need to move away rapidly from fossil fuels, but henceforth it has to be replaced by sterilisation of those resources to avoid worse emission outcomes."



Ian Dunlop

Independent Advisor & Commentator, Climate Change & Energy

The Energy Transition & Systemic Risk



Guest Expert Howard Covington

Central bank theme

- ◆ Why are G20 central banks – with the notable exception of the PRA, Bank of England and the Dutch central bank – so reluctant to dip their respective toes into the climate risk water?

Which assets should come out of the system immediately?

- ◆ Suggestions include: High cost fossil fuel extraction; High cost transport infrastructure; Livestock, cement, and early generation biodiesel; Coal mining, power, distribution; Infrastructure and assets in low lying coastal regions.
- ◆ Or, which assets will be competed out of the system by wind, solar and electric vehicles and which will be wrung out of the system by an increasing carbon price.

How to convey climate risk to investors

- ◆ Locating climate systematic risk in the context of other risks is central.



“We have a very small budget of carbon that can still be burned. It is not enough to think about limiting our use of it but HOW we use it.”



Rich Pancost
Director, Cabot Institute

“Getting supply out of the system as rapidly as possible and dealing with the social and economic disruption this will cause is a necessary structural adjustment step. Ian Dunlop calls it asset sterilization.”



Nathan Fabian
Director of Policy and Research, PRI

The Energy Transition & Systemic Risk



Guest Expert Howard Covington

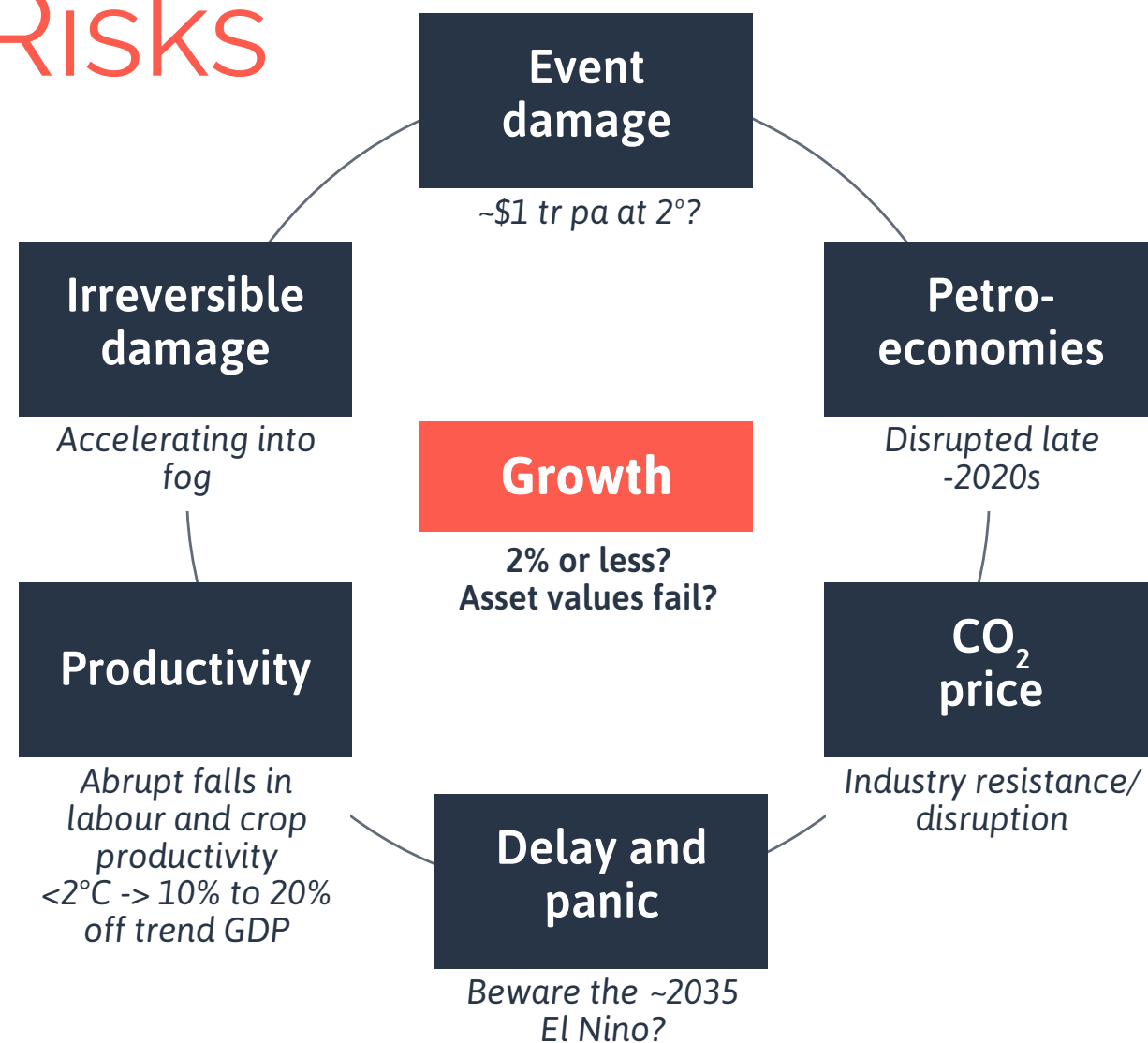
Systemic Risks

Irreversible changes

Weather, ice, soil
Acid oceans, species loss

Possible consequences

Food, water, coastal cities
Mass migration, state failure 4°
->5% to 50% off trend GDP
5% probability var ~10%



Narrative to 2030

- Oil demand down ~5mb/d and falling
- Oil price ~\$30 and headed downwards
- Petro-economies disrupted
- Saudi Aramco fundamental value at \$20-\$30/b
- Coal and gas demand headed downwards
- CO₂ price ~\$50/tonne
- Steel, cement, chemicals economics change
- Stranded assets in generation and industry
- Carbon-free index outperforms market
- Systemic risks emerging
- Growth and valuation assumptions change

Forceful Stewardship is needed

Lessons Learned: 'No Action' Letters



Guest Expert Sanford Lewis

Consolidate Focus on <2°C Resolutions

- ◆ There is a debate within the investment and campaigner community whether it is better to have one resolution/one message or whether multiple resolutions are preferable/unavoidable. This debate warrants further attention.
- ◆ The more directive resolutions are easily dismissed - rightly or wrongly - by the big fund managers.
- ◆ In a post dialogue survey, participants voted heavily (73%) in favour of the following action: "Focus on the top 6 US managers, ask their "climate aware" asset owner clients to persuade managers who 'abstained' to vote 'for', and managers who voted 'against' to 'abstain' on all remaining <2°C resolutions .

DataPoint

Over 22 climate resolutions that came to vote at fossil fuel companies in 2015, those that sat alone on the ballot received about 3% more support on average than those that shared the ballot with at least one other climate-related resolution.

Lessons Learned: Fund Voting



Guest Expert Jackie Cook

1. Strategically target asset managers

- a. “Out” the laggards

2. Leverage governance pressure points

- a. Withhold votes for ‘blacklisted’ corporate directors with poor track records on climate risk
 - i. Or propose directors with positive climate records
- b. Pressure fund board members
 - i. ICGN Model Mandate contains a recommended Investment Management Agreement clause for notifying managers of concerning practices

3. Pre-publish voting intentions

- b. Particularly for funds that support <2°C resolutions

DataPoint

As of 2015, shareholders are able to file proposals at mutual funds holding them accountable for the inconsistency between their public commitments to address climate change and their poor voting records.

<http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/fairbanks112415-14a8.pdf>

Applying Lessons: Support from Big Funds



Guest Expert Mary Beth Gallagher

1. Enhanced carrots & sticks for sustainable investing consortia (e.g. PRI, INCR, etc...)

- a. Report vote totals & proportions on all 4 categories (aye, nay, abstain, non-vote) on climate / <2°C resolutions.
- b. Stricter membership requirements -- evict funds that don't support <2°C resolutions.

2. Cross-pollinate groups working on common cause

- c. "It's easier to act together than alone."

3. Sector focus

- d. Eg. the key automotive sector... with the current emissions testing scandals and massive investors losses, all mainstream investors can see the need for a detailed <2°C plan -- including how they will comply with real world testing, make sure there is no cheating and how they will phase out GHG-emitting engines by 2040.

”

"This does not have broad agreement. The dynamic in the US with US companies is different and it is much more difficult to file a resolution that captures all the arguments whether because of SEC rules or the various dimensions of the issues. Having multiple resolutions is important."

"This call for simplicity provides an avenue to navigate complexity - it would allow us to pull back from the mire of specific causes and initiatives and create a near-universal framing."

Crowdsourced Opinions & Recommendations

Applying Lessons: Cross Border Collaboration



Guest Expert Helen Wildsmith

- ◆ Is there room for an outside strategy to mobilize people who have 401k and 403b funds invested in mutual funds?
- ◆ LAPFF has been advised by two fund managers that pressure from member funds who are clients 'helped' in their deciding to publicly declare that they will vote in favour of <math><2^{\circ}\text{C}</math> resolutions for the UK listed diversified miners AGMs
- ◆ INCR has a declaration website for the nine resolutions CalPERS is providing proxy solicitation for
- ◆ The core Aiming for A investor coalition members have been focusing on getting early voting declarations from the c\$1tn UK and continental European fund managers for Exxon Item 12
- ◆ Students are joining forces with professors to raise awareness generally and amongst college endowments specifically: PositiveInvest.org
- ◆ VoteYourPension has a rolling programme for the AGM season



"Cross-border collaboration can be key for creating a 'pincer' movement. Recognising and respecting the different roles that stakeholders across the spectrum can play is important – so long as they're coordinated, divergent groups can stay true to their own objectives and messaging whilst enforcing the arguments of others."

"A quick public thank you to Shanna, Sanford and Mary Beth for all your support last summer as we planned the 2016 transatlantic work. A great outcome from last August's online Preventable Surprises Virtual Dialogue."

What happens when investment consultants become interested in stewardship



Guest Expert Jillian Reid

Embed Forceful Stewardship into IC mandates

- a. Link IC fee to voting patterns of selected asset managers 2. Cross-pollinate groups working on common cause.

Mercer best practices

- a. Recently implemented a stewardship program for its equity funds in Europe, covering 22 managers.
 - i. “This process for asking questions is already having an impact, not only with managers, but also with our CIO and portfolio managers with monitoring and hire & fire decisions”
- b. Incorporate fundamentals as ‘standard’ for all advisory clients e.g. ESG ratings. Start using highlevel estimates of climate change impact on returns by scenario during strategy reviews.

”

“My impression is that most consultants don’t have the general practice of reporting on sustainability, proxy voting, or any of these issues when it comes to manager selection and assessment.”

“Asking questions and emphasizing through engagement that climate is a concern and decarbonization is necessary, not just for fossil fuel companies, will help to shape behavior and give companies far more information on what investors are interested in than market signals probably ever will.”

Guidance Notes: Engaging with Banks



Guest Expert Hamish Stewart

- ◆ After Paris, investors have an opportunity to push <2°C transition plan resolutions on banks, particularly those with distressed fossil fuel debt portfolios.
- ◆ The banking sector is failing to communicate science based emissions targets and to re-allocate capital in line with the Paris Agreement.
- ◆ Credit risk assessments, loan pricing policies, KPIs/ executives, stress-testing for resilience under different scenarios [and] the positive work banks can do in financing the low-carbon transition ... could fit well into these Guidance notes [for banks.]



“Now it’s time to find someone to fund the drafting of a Guidance Note for the financial sector on Deep Decarbonisation Pathways...”

“We need to explore in more depth the notion of “transformative shifts” and what could get us there... We’ve already conceded that fear-based approaches don’t work - and side-stepping the true risks are simply irresponsible - so we have to design a process that invites deep and difficult dialogue that scares the crap out of people while inspiring hope and instigating action.”

“Fitting an existential/ systemic risk like climate change into decision-making requires a much longer-term outlook, and correspondingly, incentives that encourage (and indeed allow) this type of thinking. This has to go beyond nominal ‘environmental’ metrics.”

Guidance Notes for <2°C Transition Plans



Convener Raj Thamootheram

Codify <2°C Target

- ◆ Companies should now accept the May 2015 UNFCCC SED conclusions, reinforced in Paris, that a limit toward 1.5°C should be the new temperature objective, and adjust their policy accordingly. This would require dramatic change to their business models.
- ◆ The IEA 450 <2°C Scenario, while a valuable benchmark in testing <2°C transition Plans ... is not going to deliver the below <2°C outcomes we need. It may make sense to engage IEA on developing a “well below <2°C” scenario (say net-zero by 2050).

Communications

- ◆ Create a comprehensive “case-for-support” document that has both broad messaging as well as key messages for different stakeholders. This document could then be a resource for the “mavericks.”

Expose & Enforce

- ◆ Leverage existing exposure mechanisms such as the Climate Risk Disclosure tool to identify inadequacies, and campaign for improvement by comparing current practice to benchmarks such as PS guidance notes.
- ◆ Lobby for implementation / enforcement of existing regulations requiring <2°C stress testing (EU) and material climate information disclosure (US).



“We need to make sure we have a reasonable idea of what we will do with the information companies provide to us, assuming we are successful in our asks.”

“Who/what bodies should set the overall decarbonisation caps and minimum floors? - how to incentivise adoption and punish laggards? - what could/should be nationally mandated and what levels of enforcement applied?”

“PS/FS strategies moving forward ought to include a definition of what “leadership” looks like.”

Scrutiny Process: Lessons from the BHP Billiton pilot



Guest Expert Désirée Lucchese

Stakeholder Segments in Scrutiny Process

- ◆ 2D transition plans improve corporate transparency and highlights questionable assumptions.
- ◆ The bodies involved in the scrutiny process should have sufficient authority and independence in order to assess the scientific representativeness and viability of <2°C transition plans (cf Deep Decarbonisation Pathways Project).
- ◆ ShareAction recently produced an analysis of BP's enhanced climate reporting through a 'PostParis' lens. The 'peer review' process called on a range of stakeholders for feedback: including investors, those representing investor groups, industry insiders and NGO experts.
- ◆ Could business schools and students also be an answer? Having students scrutinise <2°C transition plans would not only provide insights into the plans, but would also engage future decision makers on this issue.



"Transition plans are about fundamental business transformation and should therefore demonstrate sufficient and credible ambition. Clarity and rigour of disclosure is necessary, but not sufficient."

Crowdsourced Opinions & Recommendations

Scrutiny Process: Conceptual Considerations



Guest Expert Julie Gorte

Identifying (and Questioning) Assumptions

- ◆ All forecasts/stress tests/strategic plans are based on some assumptions, or inputs, that can have significant impacts on the outcomes that are often unacknowledged, or at times quite covert.
- ◆ It is right to question the underlying assumptions...Taken to an even more fundamental level, the demand forecasts of BP, Shell, IEA apparently assume that it is acceptable to project demand in light of social science (GDP development etc.) independent of the limitations set by natural science the carbon budget.
- ◆ The French in their Article 173 disclosure requirements ... require disclosure not only of Climate Change risks, but the methodologies and assumptions on which they have been calculated.

Culture

- ◆ Culture is a nut as hard as a diamond to crack... But diamond-like business-as-usual cultures have flaws... Strike right and... That's what we have to do with common cause, reason, evidence and market shaping policy frameworks that reward only very, very low carbon investment and energy production, as well as secure methods to strip GHGs from the atmosphere. This means an organised, unified, single, market changing approach wielded like the cutter's blade.
- ◆ It is not possible to effectively engage with any group of like-minded people (and who doesn't predominantly recruit in their own image?) over issues of change without understanding the organisation's prevailing culture and finding mutually acceptable ways to step outside that box.

“There are a few circumstances that allow people to “think outside their own experiential disciplinary boxes...Deep dialogue that allows barriers to collapse and new ideas to spring to life.”

“I really like the emotional intelligence approach - recognise the inherent framing perspective of the person you are engaging with, and sell the message in their terms, not ours.”

Crowdsourced Opinions & Recommendations



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