Embracing the reality of climate change:

Implications for “future wise” investors in Europe

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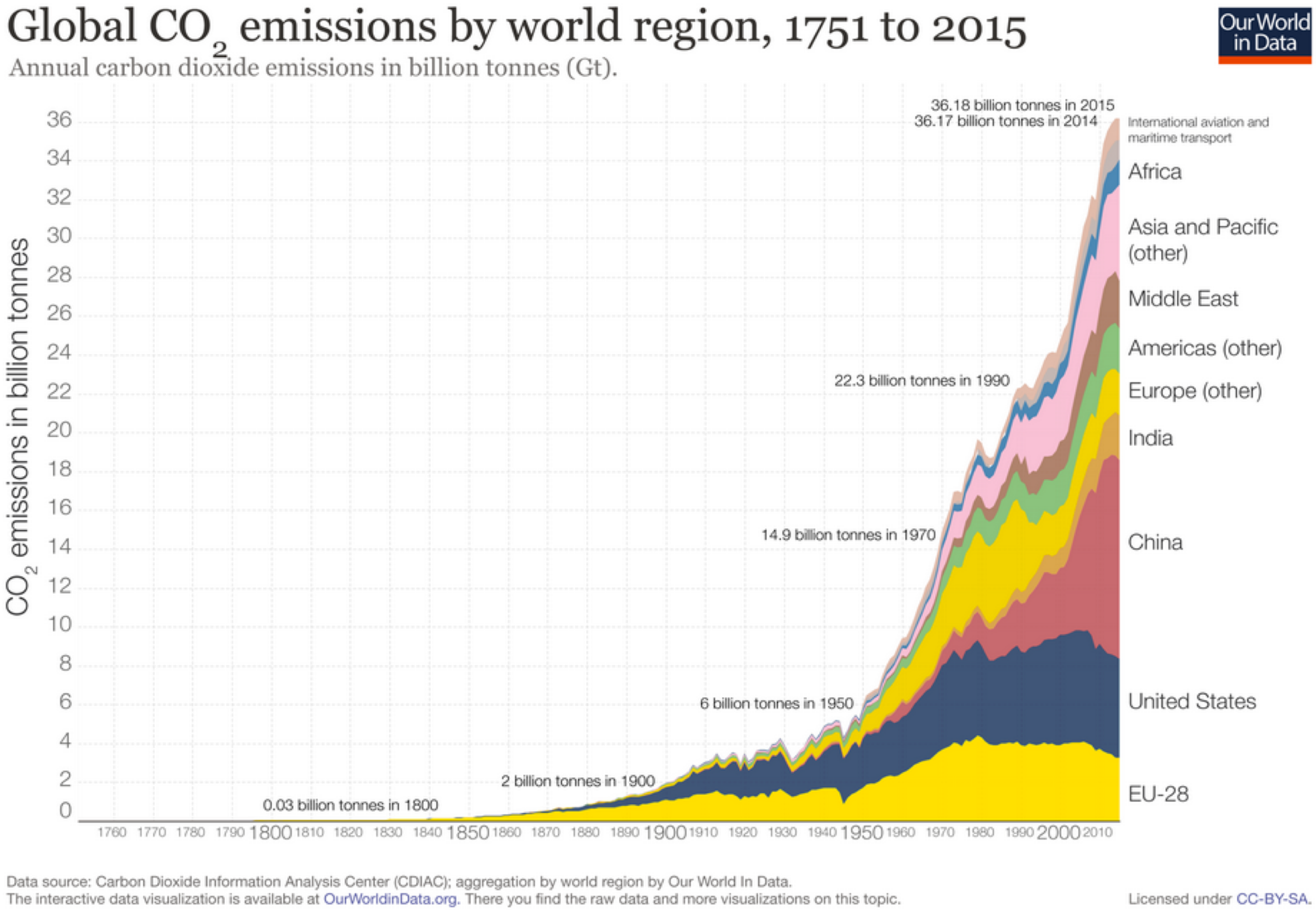
A reminder of the challenge…

Atmospheric CO_2 concentrations are the highest levels
since the humans species came into existence.

CO_2 concentrations are still going up year on year.

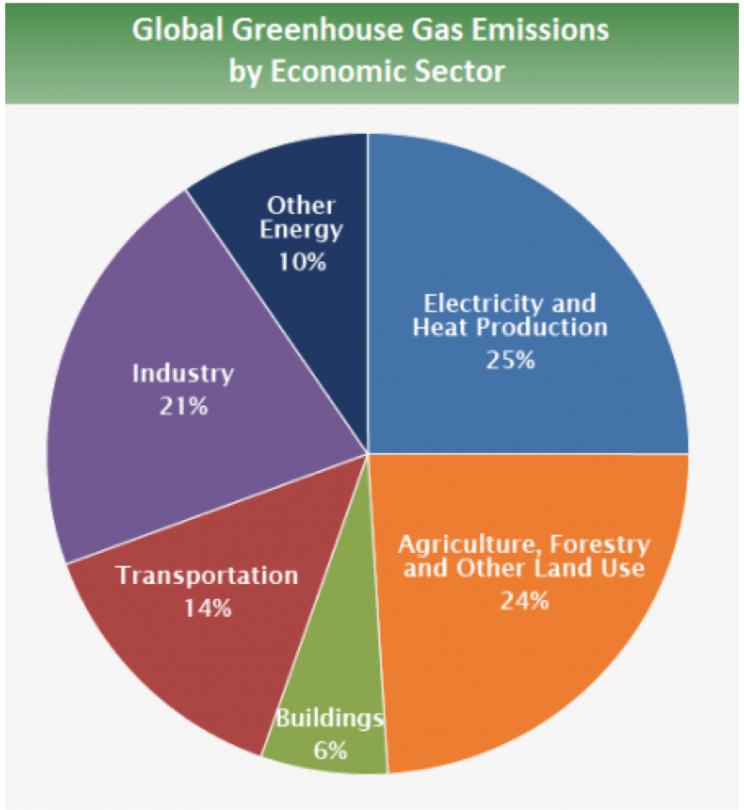


The strategic context

- Action on climate change is urgent
- It poses an existential risk to civilisation
- Easy optimism is unfounded
- This is a time of radical uncertainity
- Climate change is a blessing, not a curse - a system feedback signal that creates the opportunity for meaningful & full employment.

Energy utilities = a major emitter

- A big contributor to GHGs – comparable with agriculture (**25%**)
- Key to other sectors' **ability to decarbonize** electricity.
- Need **time** to decarbonise aviation, agriculture, global shipping & manufacturing.
- **Utilities must go first!**
- Urgent that we use **renewables to make as much electricity as possible.**
- **The low hanging fruit** for reducing GHGs.
- CDP research: EU laggard companies are **RWE, CEZ, Endesa and EnBW:** estimated to exceed their 2^0C carbon budget by 14% or 1.3 billion tonnes CO2e between 2015 and 2050.



Source: IPCC (2014)

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The Trump Administration won’t like what I’m going to tell you

Amy Harder May 22

SAVE

Former Trump energy aide to head new investor campaign

A former top energy advisor to President Trump, George David Banks, will lead a new multi-million dollar campaign aimed at limiting the way large investment firms, like BlackRock, influence shareholder resolutions on hot-button issues like climate change.

Not all investor strategies are equally good at triggering rapid decarbonisation

Portfolio decarbonisation/integration, impact investing, divestment etc all have value these won't bend the curve of GHG by 2020

Only forceful stewardship done collectively & using resolutions calling for transition plans is fit for managing systemic risk and triggering a rapid decarbonisation

	Exclusion	Best in Class	ESG Integration	Active Ownership	Thematic Funds	Impact Investing
Alpha						
Risk Management						
Value Alignment						
Impact						

"The Impact of Sustainable Investing", Julian Kölbel, Florian Heeb, Univ of Zurich (2018)

Muscular engagement is needed

- **Forceful stewardship** puts pressure on company boards to take action & re-allocate capital.

- Ask business leaders how their transition plans will **mitigate climate risk**, how they will take advantage of **opportunities**, and how it will **align compensation** and **lobbying** activities with a **<2^{0}C pathway**.

- If investors don’t want to/cant use **AGM resolutions**, they need to develop other ways to **trigger change that's fast enough** and which puts pressure on **free riders/fence sitters.**

- Our Flip the Switch guide sets out eight questions that should guide engagement with energy companies.

Innovators or Laggards?

- The largest investors in the world (mainly US) remain mostly conspicuous in their absence when it comes to climate action.
- Late to support TCFD (signed after CEO commitment removed).
- Of the 10 biggest investors, only 1 has joined CA100.
- As some of the largest shareholders of European utilities are global investors, climate action in one world region <u>could</u> lead to a positive shift in other markets too.
- Only 13 energy utility cos in the list of the hundred target companies for CA100.

How asset managers are using their influence to secure a supportive governance/regulatory context

	Asset Manager	Supporting TCFD	Ceres G20 Letter	Climate Action 100+ member	HQ
1	BlackRock	✓	✗	✗	US
2	Vanguard AM	✓	✗	✗	US
3	State Street Global Advisors	✓	✗	✗	US
4	Fidelity Investments	✓	✗	✗	US
5	BNY Mellon IM	✗	✗	✗	US
6	J.P.Morgan AM	✓	✗	✗	US
7	PIMCO	✗	✗	✓	US
8	Capital Group	✗	✗	✗	US
9	Prudential Financial	✗	✗	✗	US
10	Goldman Sachs AM	✗	✗	✗	US
11	Amundi	✓	✓	✓	France
12	Legal & General IM	✓	✓	✓	UK
13	Wellington Management	✓	✗	✗	US
14	Northern Trust AM	✗	✗	✓	US
15	Nuveen	✓	✗	✗	US

✓ signed Jun 2017, CEO named signatory

✓ signed Dec 2017, CEO not named signatory

✗ not signed

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sustainix

source: TCFD, Preventable Surprises

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Utilities need to *implement* transition plans now

- Investors are still asking for scenario analysis disclosure and **this isn't sufficient** or fit for purpose today.
- **Many scenarios assume the economy/society function at 3-4^{0}C as it does today.**
- Scenarios encourage **one way thinking** – 'how will the external world affect us?'
- The big challenge is to **ensure corporations realise they affect the external world**.
- A transition plan is the **basis of action**. It's a **normative** approach to strategizing, sets **in motion a series of holistic changes** to a business in terms of operations, investments, governance, policy influence and remuneration, setting out clear targets and plans for change.

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"Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders."

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Additional slides

	Indirect Investment Impacts			Direct Investment Impacts		
				Direct (Firm) Capital Allocation Effect	Indirect Capital Allocation Effect	
SI Strategy	**Exclusion**	**Best-in-Class**	**ESG Integration/Portfolio Decarbonisation**	**Active Ownership / *Forceful stewardship***	**Thematic Investment**	**Impact Investing**
Mechanism	Signal to society that excluded industry is illegitimate	Brand value of industry leaders leads to reputational incentives	Increase demand for ESG data leads to better mgmt. systems	**Communicate shareholder demands directly to management** ***(AGM resolutions)***	Support transition of sustainable businesses to more liquid markets	Provide capital to capital restricted sustainable businesses
Potential Investment Impact	Political reform restricting the excluded industry	Industry wide improvement of ESG performance	Industry wide improvement of ESG performance	**Targeted improvements in ESG performance of companies invested in**	Accelerated growth of sustainable businesses	Growth of sustainable businesses
Only if investor…	Makes exclusion decisions public	Investment increases credibility of fund / index	Insists on high quality corporate disclosure	**Pursues realistic change at the right targets** **Removes first mover disadvantage by sector wide focus**	Focuses on investments where additional capital makes a difference	Focuses on investments where additional capital makes a difference
Critical Catalyst	Political movement or societal shift resulting in tangible impact	Companies actively improve ESG performance to become ESG leader	Company managers act on the reported data and pursue improvement targets	**Client (asset owner) demand**		
Uncertainty of Impact	**High**			**Low**	**Medium**	**Low**

How to Make Change Happen…

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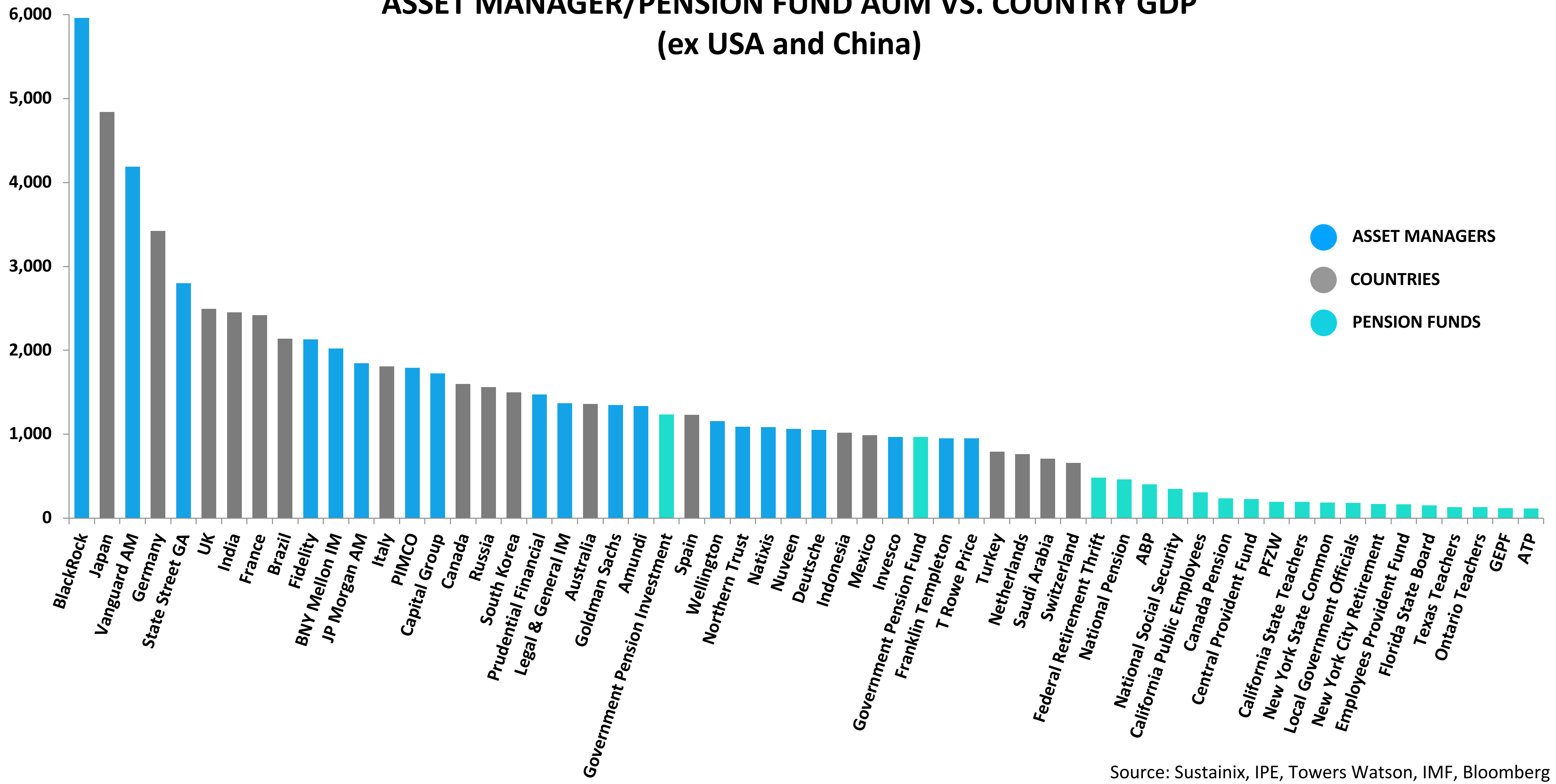
ASSET MANAGER/PENSION FUND AUM VS. COUNTRY GDP
(ex USA and China)



Source: Sustainix, IPE, Towers Watson, IMF, Bloomberg

The investor stool needs a 3rd leg!

Leg 1
Divest/Invest movement
(SAA, carbon bonds/green funds)

Leg 2
Portfolio Decarbonisation

Leg 3
Forceful Stewardship
- Companies
- Govts/Regulators

Divest/Invest

DIVEST

Pros

1. Stigmatises fossil fuel industry
2. Mobilises concerned public
3. In principle, divestment is easy to monitor
4. Address sector risk if done completely/quickly

Cons

1. Divestment challenges core investment beliefs & threatens performance
2. New owners of fossil fuels may be unconcerned or worse
3. In practice, divestment is hard to monitor

INVEST

Pros

1. SAA with asset class to low carbon could have a significant impact
2. Green bonds is a positive story
3. Green real estate is happening
4. Together, divest/invest could shift capital

Cons

4. SAA at best addresses 50% of systemic risk
5. Green investments in many asset classes have been slow (eg private equity, infrastructure, hedge funds, passive/ETFs)
6. What actual impact do green bonds have on GHG emissions?

Portfolio Decarbonisation

Pros

1. Portfolio decarbonisation builds on the traditional investment worldviews & methodologies
2. Enhances accountability provided reporting is public and against objectives
3. In theory, relevant to all asset classes
4. Creates new products/services

Cons

1. Today, decarbonisation is focused on equities ie only half the portfolio:
2. Decarbonisation is about adaptation, not mitigation – it addresses sector risk, not systemic risk.
3. Too technical for the public to get excited about
4. Underlying data & methodologies questionable
5. Normal ESG integration has a weak track record

Forceful Stewardship strengthens the other legs

Forceful Stewardship helps Invest/Divest

- Creates real corporate demand for green growth
- Identifies the worst laggards & some divestment is essential

Forceful Stewardship helps Portfolio Decarbonisation

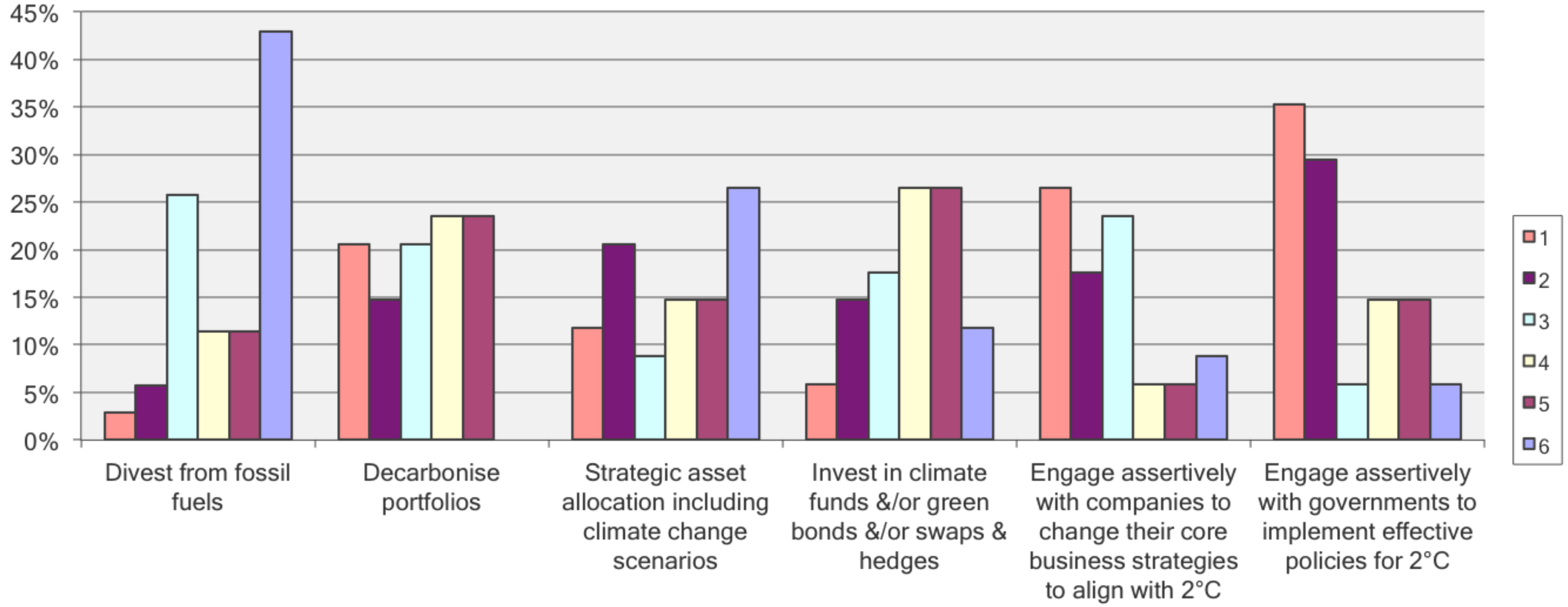
- Promotes more authentic GHG reporting
- Catalyses more informed analysis from information intermediaries

Forceful Stewardship supports policy engagement

- When investors are doing what they can in their own sphere of influence, they have much more credibility with governments – otherwise they can look as if they are playing a 'blame game'

Forceful stewardship turbo charges other strategies!

The most effective way for investors to tackle climate related systemic risk

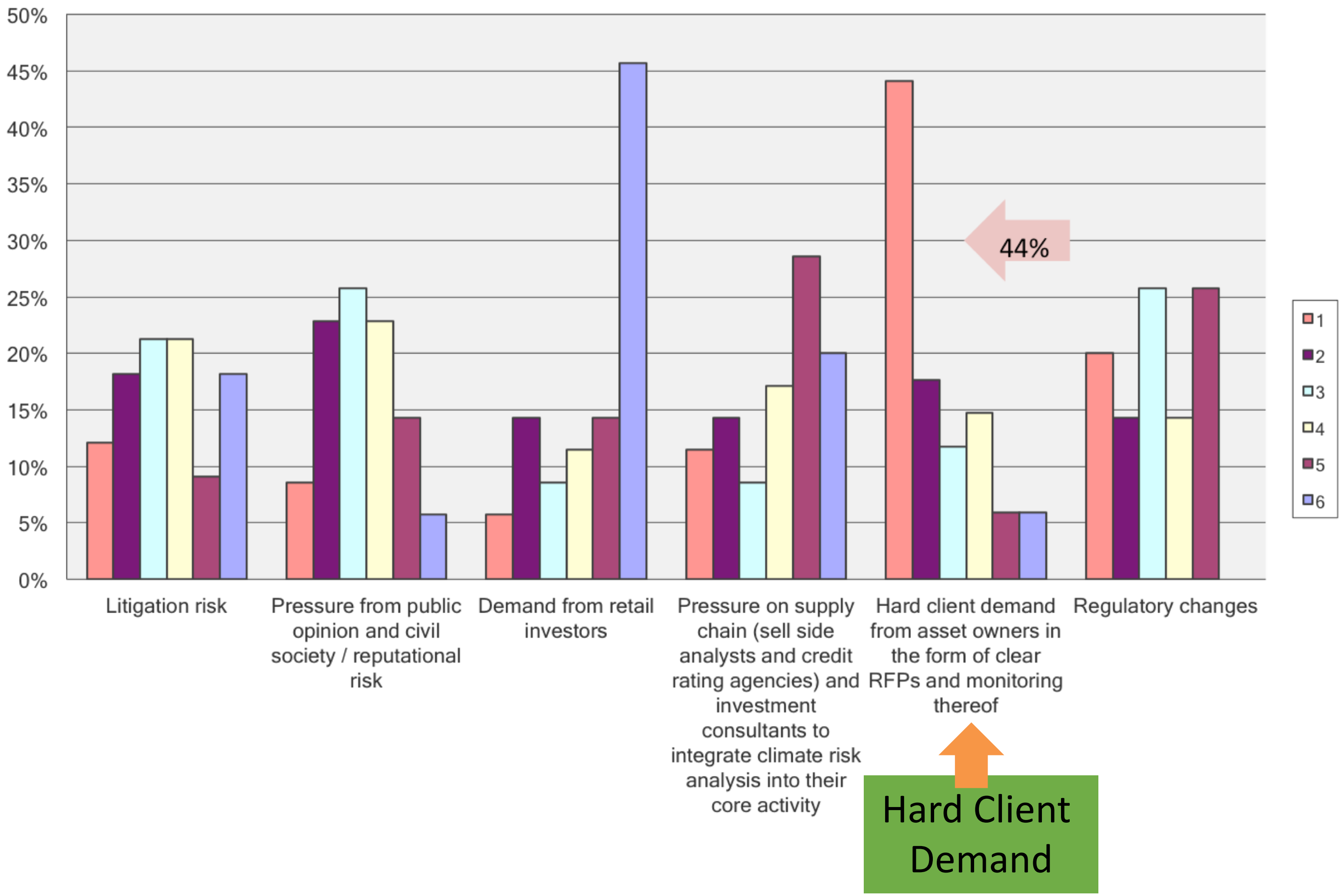


1 = most effective
6 = least effective

Engage with companies

Engage with governments

What will make fund managers be good stewards?



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