# Integrating Climate Change Whitepaper

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## Welcome to CAMRADATA's Integrating Climate Change Whitepaper

Prior to 15 years ago, climate risk attracted little discussion at the annual World Economic Forum held annually in Davos. But now it is central to dialogue. Senior executives describe how a focus on climate investment now feeds into almost every discussion with institutional investors and with policy makers who define the investment landscape.

The ambitious agenda spelt out in the 1992 Rio Summit and 1997 Kyoto Protocol has taken time to translate into practical action. But climate change is now moving to the forefront of the regulatory and policy agenda in Europe. In the UK, this will be prominent as the UK government hosts the COP26 UN Climate Change Summit in Glasgow– and may be used by UK policymakers to reinforce the appeal of the UK as an investment destination after Brexit.

In line with this agenda, asset owners require tools to measure the climate impact of their investment strategies. A recent survey finds that 46% of investors now evaluate the carbon emissions associated with their investment portfolios, a rise of 13% from three years ago. 36% of pension funds now map their portfolio impact against UN Sustainable Development Goals, while a further 38% are 'actively considering' this step (bfinance ESG Asset Owner Survey, Feb 2020).

While this illustrates positive momentum, it infers that a sizeable cohort of institutional investors are still not measuring the carbon-impact of their investment on an active basis.

Beyond this, climate investing implies more than applying environmental screening to asset and collateral portfolios. This requires actively investing in companies and projects that deliver positive climate outcomes, whether through reducing CO2 emissions, improving access to clean water, or promoting renewable energy and resource use.

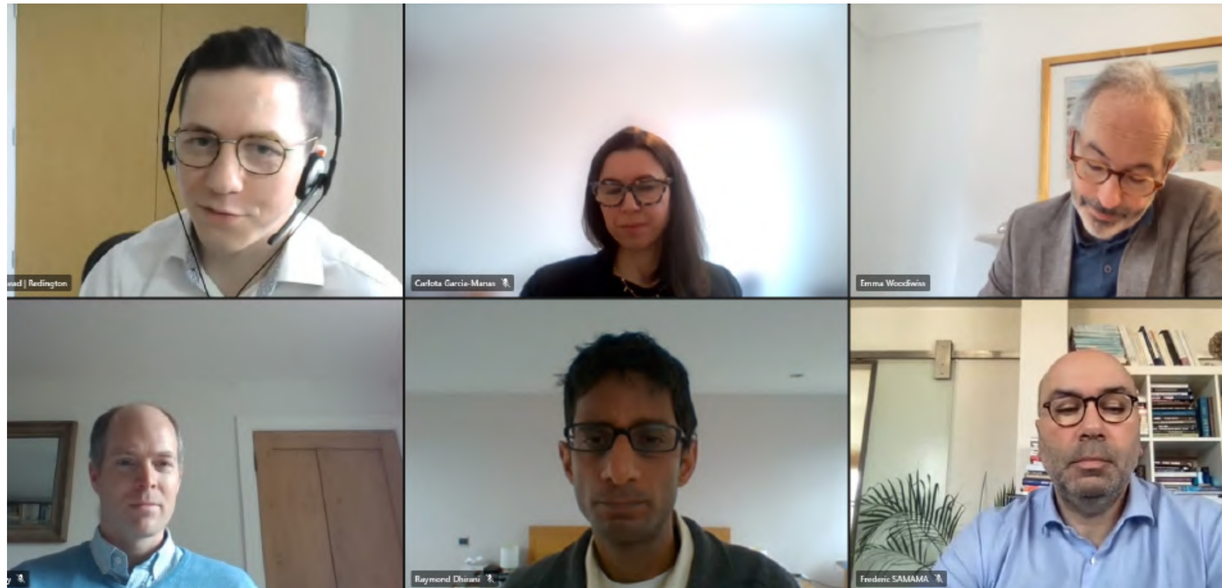
But what are the requirements to deliver these climate objectives? What challenges do investors face in gathering consistent data to measure climate impact? What steps is the industry taking to support data standardisation and data integrity ?

And what impact has Covid-19 had on the industry's commitment to climate goals?

These are some of the areas we will focus on in this CAMRADATA whitepaper.

# *Integrating Climate Change Roundtable*

***The CAMRADATA Integrating Climate Change roundtable took place virtually in London on 3 March 2021.***



The CAMRADATA roundtable on Integrating Climate Change began by asking panellists which policy they would implement if they were president or prime minister for a day.

***" WWF looks to turn aspirations into real policy by campaigning this year for all financial institutions in the UK to develop and implement strategies that align with the Paris Agreement "***

Carlota Garcia-Manas, senior responsible investment analyst at Royal London Asset Management, said that a just transition had to include a social dimension. So her dream policy would be a carbon tax and carbon dividend that remove/ reduce the  social friction from the energy transition.

Frédéric Samama, chief responsible investment officer at CPR Asset Management, said Climate Change was an opportunity for humanity to realise "we are all on the planet together, and not to be selfish. It is a call for responsibility and it matters as responsibility is required to keep societies functioning but it tends to disappear."

He wanted polluting companies to be taxed in accordance with their impacts on climate change. And he proposed a mission as mighty as the moon landing of 1969, but this time mobilising the best brains for green Research & Development.

Ray Dhirani, head of sustainable finance at WWF-UK said he would introduce regulation to align financial markets with the commitments of the Paris Agreement. "This is where science meets financial targets," he said. "We have to fully recognise the risks not just to financial institutions themselves but the planet as a whole."

WWF looks to turn aspirations into real policy by campaigning this year for all financial institutions in the UK to develop and implement strategies that align with the Paris Agreement. WWF UK hopes to build momentum ahead of November's meeting in Glasgow of world leaders on the environment

Edwin Whitehead, responsible investment adviser at Investment consultancy, Redington, restricted his powers to being UK Minister for Pensions for the day. He told the CAMRADATA panel he wanted more regulation that recognised the double materiality of investments, i.e. to both increase wealth and benefit wider society and the world at large. "I want to engender appreciation that we don't live in a limitless world," he said.

He noted an amendment to the UK's Pensions Bill of 2020, defeated last winter in Parliament, which proposed that pension schemes in the UK must align their investment strategies with the goals of the Paris Agreement. Whitehead qualified, however, that he supported the Bill in spirit but not in detail. "The government's rationale is that transition will happen and would prefer the more gradual route

of engagement and divestment by institutional investors rather than heavy divestment of fossil energy infrastructure and its consequences," he said.

***" Stable economies can take advantage of the transition if the roadmap is known "***

Mark Jeavons , head of climate change insights at consultancy, Aon, said he wants the British government, as well as other governments to outline the steps that will be taken to deliver a net-zero economy by 2050 and the timetable for action enshrined in law. "Putting that promise into law and building milestones towards it diminishes the threat of roll-back," he said. "Stable economies can take advantage of the transition if the roadmap is known."

Adam Gregory, head of responsible investment at pension fund consultancy, Cartwright, also chose to focus on pensions. He agreed that a net-zero target in law would raise the profile of the issue. "In its current form the regulations only require Trustees to consider the implications of climate change with no compulsion to align investments to a low carbon world. The difficulty is that trustees have so much else to do, they might not prioritize this," said Gregory. "I would make DC default funds net-zero aligned. Members of pension schemes will overwhelmingly say yes to this. Others can always opt out."

Gregory added that he was a fan of the Net-Zero Asset Owner Alliance. "This does help to push change forward for end-investors like smaller pension schemes. There is a snowball effect and we need asset managers to be seizing the initiative."

**Jargon soup**

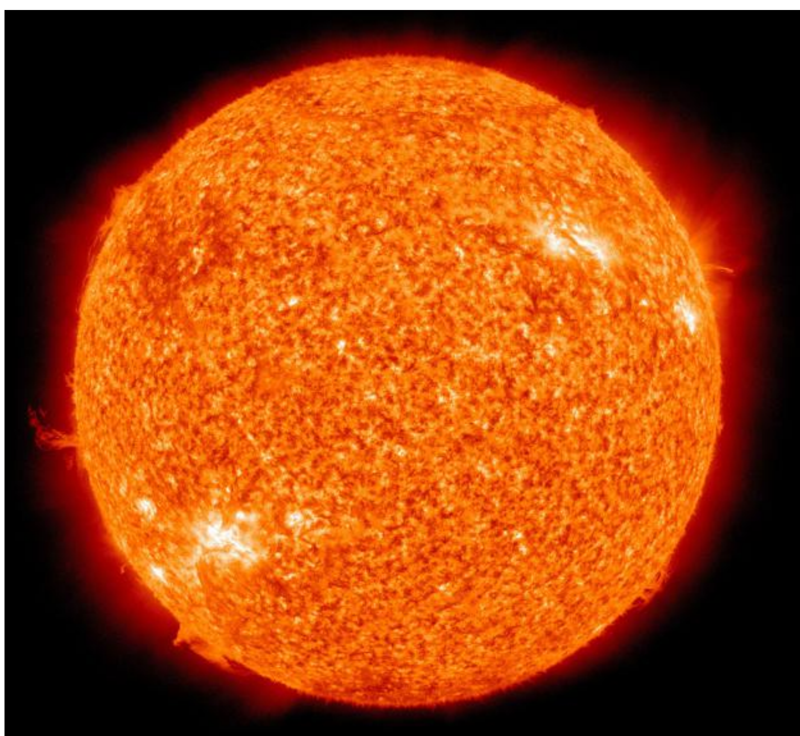
The discussion then turned from wishes to reality in 2021. The CAMRADATA panel were asked what pension fund trustees had to do legally to integrate Climate Change into their duties. A distinction was made between obligations under law and mere initiatives, which may have a tremendously beneficial value – Gregory picked out the UN PRI as an example – which has no regulatory status.

For UK pension schemes, Garcia-Manas began with the modelling of carbon emissions to discover the weighted average carbon intensity of investment portfolios. She qualified that these requirements must be fit-for-purpose, holistic and proportionate.

Whitehead added that scenario analysis had to occur at least every three years and cover not only the invested assets but also the liability profile and sponsor covenant, which increasingly includes contingent claims on assets such as sponsor-owned real estate. Whitehead said it made sense to undertake this analysis in harmony with the customary triennial valuation for defined benefit schemes but this was not essential. He explained that scenario analysis was "as far as trustees are able"; it could be qualitative and/or quantitative.

Samama turned to France, where section 173 of the Energy Transition Law requires risks related to Climate Change to be reported by all French financial institutions of a certain size. He said that the philosophy of section 173 is aligned with the Taskforce on Climate-Related Financial Disclosures: "It does not say what should be measured but is there to get people thinking," said Samama. Disclosure is currently on a comply-or-explain basis. "The idea was that when and if there is a consensus [on reporting metrics], then the analytical framework would be stabilized," added Samama. France is developing a new law, A29, on environmental reporting, which is currently open for consultation.

Bringing the conversation back to the UK, Gregory noted that the regulations mentioned by Whitehead and Garcia-Manas



currently applied to bigger UK pension schemes, with more than £1bn in assets. For smaller schemes, the same rules won't bite until 2024-5. "There is a big danger that trustees see this as freedom to delay 'until The Pensions Regulator tells us to do it'" warned Gregory. He appealed to trustees of smaller schemes to undertake their fiduciary duty and take account of climate risk now: its impact (both threats and opportunities) won't wait for regulations to arrive.

Bolstering Gregory's point, Jeavons noted that all UK pension schemes already have to report financially material risks. "Climate Change is a material risk," he argued.

In terms of regulation, Jeavons noted this might even appear in the new Statement of Intent, which obliges sponsors to report any major intended change on their part that affects the pension scheme; or the existing Statement of Investment Principles, which comes from the trustees themselves.

Jeavons continued that DC and DB schemes have to work to engage with their asset managers and ensure they are transparent about how they are managing material risks, including climate change. "Aon encourages clients to think about Climate Change risks and have a climate policy," he said.

*" He appealed to trustees of smaller schemes to undertake their fiduciary duty and take account of climate risk now: its impact (both threats and opportunities) won't wait for regulations to arrive "*

Dhirani had a different take on legal pressure. He suggested that pension scheme trustees could be more susceptible to litigation on an individual basis if they do not act on climate change. He clarified that this was not a route WWF would take but noted that already there have been some forays into such litigation. He understood the frustration behind such actions: "New policies are gradualist but we don't have time. A green bond here and a green bond there is not enough," he told the CAMRADATA panel. "We have to halve emissions by 2030; that requires meaningful action."

Dhirani noted that hosting COP-21 in Paris five years ago had really galvanised France's finance institutions – Article 173 (mandatory climate disclosure) was passed into law ahead of the landmark gathering. Reiterating his "dream policy", Dhirani hoped similar levels of achievement could be attained this year by UK financial institutions ahead of COP-26 in Glasgow.

"As a territory, the UK is responsible for about 1% of global emissions. But in terms of financing emissions, the UK is responsible for about 10-15%," he said.

Dhirani claimed that if the institutions responsible were to pledge to align their investment policy and practice with the Paris Accord – essentially limiting temperature rises to 1.5C - such disclosure and the actions would benefit UK finance (as well as other countries should they adopt the same pledge). "The finance sector would become more resilient," he said.

"I agree 100% with Ray," said Samama. "We know we are facing coming shocks. How do we prepare for that? What sort of capital structures are needed for sectors at risk? After the Global Financial Crisis, we had contingent capital for banks to absorb shock."

Samama suggested similar shock absorbers for sectors at transition risk such as autos and airlines so that national balance sheets don't take the hit. "We need patient investors but short-termism is everywhere in modern markets," said Samama. "Companies need help to navigate Climate Change."

He warned that too much weight can rest on disclosure. "It is only one part of the solution; policymakers place too much reliance on disclosure making things better," he said.

He gave the example of insurance for extreme weather events. Samama claimed, based on MunichRe figures, that there is an insurance gap up 97% of Africa and 92% Asia. States and public agencies need to be bolder because there are some major gaps in the current system.

Jeavons agreed that, while progress on carbon reductions is important, other stakeholder considerations, such as working conditions or environmental degradation, also need more attention. He reminded the panel that only half of the investable universe are disclosing carbon emissions and Scope 3 emissions reporting was scant, even though it could be much larger and meaningful than 1 and 2 for some companies. Improving disclosures is therefore still an important part of the solution.

Garcia-Manas followed that the wrong type of disclosure is a major blind spot in the investment industry. Her remedy was for ESG reporting to be standardised at the corporate or asset level. She expected the Bank of England's biennial exploratory scenario on climate change in June to provide some standardisation in the form of comparability of macroeconomic factors. She also urged that qualifications for the likes of actuaries incorporated Climate Change as a risk: at the moment, many professionals are not trained or required to evaluate Climate Change as part of risk management.

Meanwhile, investors are confused not merely by the number of regulations and initiatives, but by the different approaches of regulators. Garcia-Manas noted that in the UK the FCA has a comply-or-explain philosophy while the DWP asks for mandatory disclosure.

"There is a major problem integrating Climate Change into reporting," she said, "that ultimately leaves a lot of portfolio managers with fewer choices."

*" There is a major problem integrating Climate Change into reporting that ultimately leaves a lot of portfolio managers with fewer choices "*

"It is very complicated," agreed Samama. "Pension funds are being asked to report before we have all the data from corporates."

His take was that policymakers are passing the buck on responsibility to the financial sector, keeping the political costs low. "They are using investors and analysts to do the dirty job. Instead, they should reinforce rules on polluting companies," he said.

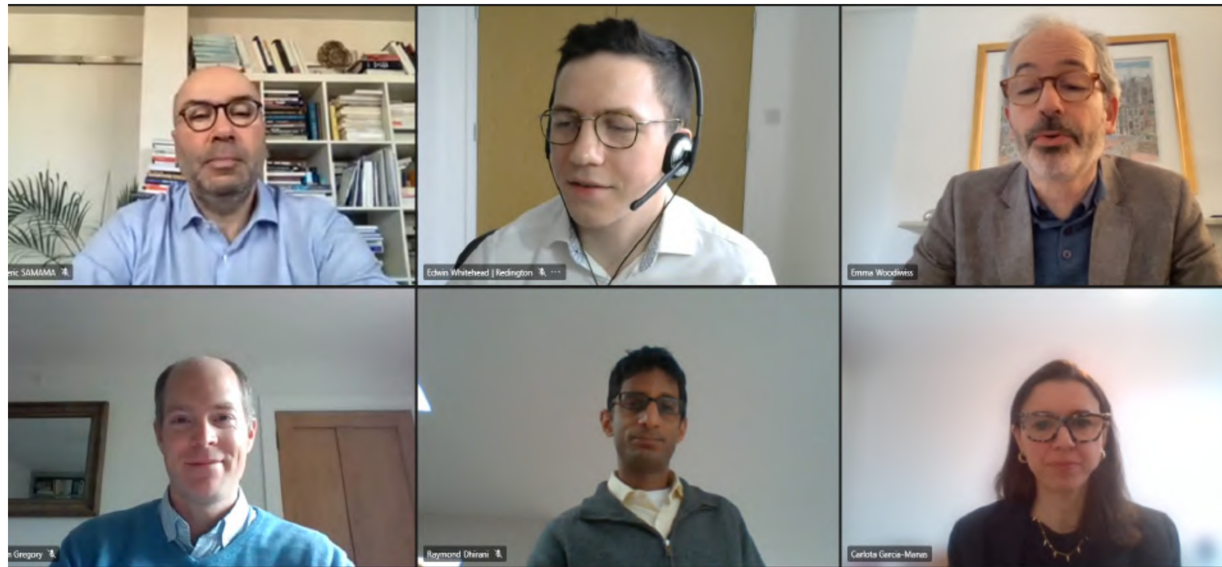
He did add, however, that in contrast to the many market-led approaches, the EU taxonomy experts follow a prescriptive ethos, with firm guidance on what a sustainable European economy should look like.

Gregory echoed Samama's very first point that being prescriptive never works as well with humans as encouraging them to see that transitioning is to their benefit, ie. the carrot rather than the stick.

**Where are clients at?**

The CAMRADATA panel then sought to understand asset owners' appetite for integrating Climate Change into their portfolios. Jeavons said that broadly 90% of Aon's clients in the UK, Europe and Australia understand that they have to do something but the range of investment actions taken will depend on investor beliefs. Of the rest in those regions, many were sponsored by companies whose business model will be challenged by the transition. Jeavons added, however, that even among this 10%, there were those willing to transition. He said that regulation was critical in this regard, noting that of all major markets, the rules around ESG in the US had gone backwards in recent years. However, greater progress is expected to be made in the US under the renewed efforts of the Biden administration.

Redington categorises its clientele differently, using types of persona based on the Bridges spectrum of capital (which goes from financial only to responsible to sustainable;



to impact to impact-only). A survey from late 2020 found that only 20% lay in the financial-only or 'traditional' category. "We hope to get that 20% down to 0% over time by education," said Whitehead, adding that Redington estimate about 55% of their pension fund clients are measuring and managing climate-related risks, with more and more clients seeking to allocate to more sustainable investment opportunities.

Gregory said that smaller UK pension schemes are much further back on this journey. His recommendation for them was to keep it simple, do some high-level analysis but focus on the actions. This could mean passive equity indices with tilts to carbon or ESG. He also argued that climate change was likely to present greater opportunities for active global equity managers.

The topic was then raised of how Climate Change sits within Buy & Maintain credit portfolios, very popular with pension schemes seeking steady income. Whitehead noted that higher rated corporate issuers tend to have a deeper carbon footprint. Sectors such as utilities score worst on Scope 1 and 2 emissions. Given that Buy & Maintain has numerous functions, including some liability matching and yield pick-up, and no benchmark, Whitehead said that it becomes harder to integrate the management of climate-related risks within a mandate that has so many objectives. At the same time, given this weight of emitters (including the financiers of emitters) and the duration of the portfolios, Redington's clients are becoming more and more concerned about how resilient their B&M portfolios are. "If you look at companies like Exxon with debt in issuance out for another 25 years at least, clients' number one question is: 'are we going to get our money back?'" said Whitehead. "The important thing to be analysing is direction of travel: are the companies transitioning and are your managers part of that journey?" To mitigate doubt, he noted that lots of Europe-based credit managers Redington review don't have oil and gas exposure going out longer than 10 years; and he said clients are currently looking to adjust Investment Management Agreements to lock this in.

*" Ripples in one country can cause upheaval on another continent "*

Garcia-Manas agreed there were tricky areas in Sterling Investment Grade regarding ESG and Climate Change impact. Royal London Asset Management has undertaken its own research into the sector because of its importance to clients. She claimed that the upshot was that the number of instruments properly analysed and acceptable in a RLAM ESG universe increased from 60% to 80% of total Sterling IG issuance.

Focusing on UK utilities, Garcia-Manas said that as a major creditor, RLAM had been able to discuss and influence the industry in its energy transition. Returning to her original wish, she noted that alongside the Friends Provident Foundation, RLAM had worked with most utilities in the UK and so far got one utility, SSE to go further and produce its policy for a just transition. This included the reskilling of SSE's workforce for green energy usage.

For CPR AM, Samama noted its range of Impact Funds, which not only assess risks but also opportunities. The range, with themes such as Green Cities and Education, build on positive externalities. "Companies will position themselves on these trends," he said. "There are ways to capitalise from options on an externality being produced by social forces."

Both Samama and Garcia-Manas agreed that these forces are global: ripples in one country can cause upheaval on another continent. They reiterated the need for all to take responsibility, beginning at the top with governments and policy makers.



# Roundtable Sponsor

## Frédéric Samama, Chief Responsible Investment Officer

*Personal Profile*

Frédéric Samama, Chief Responsible Investment Officer at CPR AM, joined Amundi in 2009, the leading European Asset Manager.

He is the founder of the SWF Research Initiative and co-edited a book on long-term investing alongside Nobel Prize Laureate Joseph Stiglitz and published numerous papers on green finance. Formerly, he oversaw Corporate Equity Derivatives within Credit Agricole Corporate Investment Banking in New York and Paris. During his tenure, he developed and implemented the first international leveraged employee share purchase program, a technology now widely used among French companies. He has advised the French Government in different areas (employee investing mechanisms, market regulation, climate finance, etc.) and has a long track record of innovation at the crossroads of finance and government policy.

Over the past few years, his action has been focused on climate change with a mix of financial innovation, research and policy making recommendations, being an advisor of Central Banks, Sovereign Wealth Funds or policy makers on the topic.

## CPR Asset Management

*Company Profile*

CPR Asset Management is an AMF-approved management company, a wholly-owned subsidiary of the Amundi Group, which is autonomous in its development and management.

CPR AM is exclusively dedicated to the management of third-party assets (institutional, corporate, insurance, private banking, fund managers and asset managers) in France and abroad and covers the main asset classes (equities, convertible, diversified, fixed income and credit). At the end of September 2020, assets under management amounted to more than €51 billion.

Responsible investment is one of its founding pillars and ESG remains an essential commitment. With nearly €9.3 billion under management (June 2020), the company selects investments according to a specific methodology to take into account ESG risk factors and impact measures deployed on a range of dedicated solutions and open products for all asset classes.

# Roundtable Sponsor

## Carlota Garcia-Manas, Senior Responsible Investment Analyst

*Personal Profile*

Carlota joined from the Church of England National Investing Bodies, where she spent three years running high profile corporate engagements focused on climate change, international corporate tax, and board diversity (among others). Before joining the Church of England, she was the Director of Products and Services at a tech start-up (Datamaran, formerly eRevalue) where she led the research team to develop software for sustainability benchmarking.

Prior to that, she spent 10 years and was Head of Research at EIRIS (now Moody's following its merger with Vigeo) where she led global ESG research and product development. Carlota has a deep interest in analytics and the integration of externalities (environmental and social) in corporate assessment. She uses techniques learned during her business development and sales role at eRevalue in her company engagements. Carlota is a Civil Engineer with an MSc in Environmental Economics.

## Royal London Asset Management

*Company Profile*

Royal London Asset Management (RLAM) is one of the UK's leading investment companies, having built a strong reputation as an innovative manager, investing across all major asset classes. RLAM manages over £148 billion of assets (as at 31/12/20), split between equities, fixed interest, multi asset investing, property and cash, with a market leading capability in sustainable investing. Products include funds and segregated accounts investing in government bonds, investment grade, high yield and unrated credit, equity income and equity growth across global developed markets, as well as UK property and cash and short-term money market instruments.

At RLAM, we have embraced responsible investing for many years and continue to expand our offering in line with the evolving world of ESG best practice. We've continued to invest in our responsible investment team, our research and insight in this area, and now integrate this capability across all our asset classes.



# Roundtable Participants

## Mark Jeavons

*Principal Economist and Head of Climate Change Insights*

Mark is a senior economist and principal investment consultant in Aon's asset allocation team, with over 15 years' experience in a variety of investment roles.

Mark led the development of Aon's climate change scenarios, working closely with Aon's academic partner, Cambridge University, to create a market-leading climate change scenarios toolkit that has been used by over 30 of Aon's largest clients.

He has a comprehensive understanding of the workings of a variety of climate change risk models and regularly advises clients on their strengths and weaknesses. He leads on the thought leadership around climate aware investing and responsible investment.

Mark has also contributed to the PCRIG – which produced guidance on the TCFD for UK pension schemes – as well as the All Parliamentary Group on Sustainable Finance.

## Adam Gregory

*Senior Investment Consultant*

Adam is a Senior Investment Consultant at Cartwright acting as the lead consultant for a portfolio of clients, covering all aspects of investment strategy and investment-related consulting. He is also Head of Responsible Investment at Cartwright.

Adam enjoys helping clients make sense of technical concepts and takes great pride in helping plans in achieving their objectives. He believes that it is often too easy to get bogged-down in the detail on investment matters and that more time spent setting and agreeing a high-level plan is time well spent, making future decision-making more straight-forward and cost effective.

Adam is a qualified actuary with 16 years industry experience. He began his career at Mercer learning his trade as a traditional pensions actuary before transferring these skills over to the investment arena.

His pensions background has been particularly useful when considering liability-related assets such as LDI and bulk annuities, the interaction between the different measures of the liabilities, and the potential investment implications of liability management exercises.

His investment experience has spanned investment consultancy, fiduciary management and working in-house for a multi-sectioned £10bn pension scheme. Working across a variety of fields has left him with a wealth of experiences to draw upon, allowing him to bring the best advice to his clients.

# Roundtable Participants

## Edwin Whitehead

*Senior Vice President*

Edwin leads the delivery of Responsible Investment advice to Redington's clients. Edwin is responsible for supporting clients in setting Responsible Investment beliefs and objectives, integrating ESG factors into investment-decision making, and helping to practice better stewardship and engagement.

Edwin is a member of Redington's Responsible Investment Committee. The job of this committee is to ensure all areas of Redington's business, from internal hiring to the client advice process, have sustainable and responsible considerations at the forefront. Edwin also leads Redington's relationships with external industry bodies, including among others the UN PRI, AMNT, Institutional Investor Group on Climate Change (IIGCC) and the Financial Reporting Council (FRC). Edwin also leads the Asset Owners sub-group of the Investment Consultant Sustainability Working Group (ICSWG).

Edwin works with a number of Redington's largest clients who are transitioning their investment approach to one that is aligned with achieving the goals of the Paris Agreement and moving to net zero emissions by 2050.

Edwin has a BSc in Economics from the University of Warwick, holds the Investment Management Certificate (IMC), is a CFA charterholder and was one of the first candidates to pass the new CFA UK Certificate in ESG Investing.

## Ray Dhirani

*Head of Sustainable Finance*

Ray leads the sustainable finance team at WWF-UK. Previously, he worked in the global markets division of Merrill Lynch in New York. He holds a BSc. in Economics from the Wharton School at the University of Pennsylvania and an MSc. in Environment & Development from the London School of Economics. Ray's team focus mainly on spatial finance, policy and regulatory work on climate and environment, thematic areas such as food and finance, as well as broader system change in global finance. Ray is a member of Parmenion's Ethical Oversight Committee as well as WHEB's Advisory Committee.

# Moderator

## Brendan Maton

*Freelance Jounalist*

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.
Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

# Climate Change, hot topic in Euro Credit

***CPR AM expands its range of climate solutions with a credit fund aligned with the Paris agreement. Julien Daire, head of fixed income, and Noémie Hadjadj-Gomes, head of research at CPR Asset Management, explain the main features of this new strategy.***

First, to set the scene, it is clear that large asset owners want to invest in strategies that are Climate-aware and they are asking managers for solutions that are more engaged. But pension funds and insurers do not simply want to mitigate Climate Change. They are responding to evolving regulation and the challenges it brings. Investors today have a clear role to play as financiers of corporations to limit Greenhouse Gas Emissions in a more responsible way. Our clients do not, however, want to sacrifice returns. And so, they are looking for strategies that try to be carbon-neutral while at the same time offering attractive performance, which is key in a very low return environment.

*" The Climate Bonds fund builds on our experience of creating investment products that will help humanity transition to a low-carbon economy "*

### CPR AM, at the forefront in climate change solutions

CPR AM today offers a wide range of solutions for all asset classes. In 2018, we set up an exclusive partnership with Carbon Disclosure Project (CDP) to analyse thousands of companies' climate policies and emissions at all levels, Scopes I, II and III and launched Climate Action, a broad equity fund based on CDP scorings. In 2020 we launched similar solutions on equity and multi-asset with an innovative mechanism of carbon offsetting. And CPR AM accelerates in 2021! We are launching two new products in this beginning of year: a Euro equity version of our popular Climate Action strategy and a Euro Climate Bonds fund. The Climate Bonds fund builds on our experience of creating investment products that will help humanity transition to a low-carbon economy and covers European Investment Grade with an interesting optionality to allocate up to 20% of capital to BB-rated issuers. We believe these will add value as Europe recovers from the pandemic.

### Include all sectors

CPR AM's firm wide philosophy is to include every sector of the index in our strategies. Unlike some of our competitors, we do not make a priori exclusions. Our reasoning is that the transition to a low-carbon economy requires all actors to play their part. Whatever their sector and actual carbon emissions, issuers making efforts to transition are noticed and rewarded. We use CDP's scoring from A to D, with the most engaged companies – regardless of sector. We are looking for those enterprises making substantial adaptation to new demands, whether it is by energy conservation, a greener transport fleet or electrification of industrial processes. While our climate strategies initially includes only those issuers rated A or B; an issuer rated C by CDP can be accepted into the portfolio if its decarbonisation targets are strong enough according to Science-Based Targets initiative. Our climate universes have two further safeguards. We filter out the worst scorers on ESG ratings (especially those in which the environment part suffers) and also disregard any companies involved in controversies. We believe that these ESG and controversies filters are complementary to our selection on climatic criteria, to manage the extra-financial risks of the universe, which can weigh on performance.



### The path to decabornisation

If low carbon indices were a first answer, they are no longer sufficient. To limit global warming to 1.5° according to the IPCC, it is not enough to reduce emissions relative to the index, it is also necessary to reduce them over time. We are committed not only to significantly reducing emissions relative to the index, but also over time. However, we are aware that the application of this constraint will depend on the behavior of companies. That's why we favor corporates that have validated Science-Based Targets, and we also consider companies temperatures as an interesting indicator of how they contribute to global warming. We will also publish temperature of our portfolios. If index solutions reduce by 7% per year without asking any questions, the advantage of active management is to be able to offer the same reduction over the long-term, while being more flexible, in order to adapt the trajectory according to market opportunities. The last stage of our climate solutions is to use offsets to achieve carbon-neutrality. We plan to invest through our partner, EcoAct, in various projects, including Amazonian diversity in northern Brazil and wind farms in India.

*" Our goal is to find climate-aware opportunities within the whole traditional credit asset class "*

### A wider credit spectrum

The first question that always arises nowadays when an asset manager proposes a climate-aware fixed income solution is: Why not invest only in green bonds? The answer from CPR AM is that our goal is to find climate-aware opportunities within the whole traditional credit asset class, which requires every sector and every issuer contributions and not only the green bonds market. Our multi-sectoral approach enables us to take advantage of all the sources of value of the credit asset class, which is crucial to be able to deliver performance in the current rate environment. Here we come to a major interest of portfolio construction in sustainable credit. There is no statistical relevance today between standard credit ratings and non-financial data (ESG ratings, CDP score, carbon footprint, etc.). This is one of the reasons why we can achieve a reduction in carbon emissions whilst maintaining some similarities to the index. It also explains why we have the possibility to go to BB without violating our risk tolerance and adding a major source of performance. In the medium-term, there is a topical advantage to accessing BB. Covid-19 and the subsequent suppression of the economy has forced approximately €50Bn of Investment Grade debt in Europe has been pushed into High Yield.

Obviously, some may go even lower as companies fail under pressure. We expect a good chunk, however, to rerate and opportunities for spread compression present themselves ahead of the muchneeded bounceback. If you compare sector weightings, geographical breakdown of issuers and even maturity of holdings, Climate Bonds is never far away from the index. But when it comes to helping the planet, our solutions are invested in the best climate performers and have a lighter footprint and ambitious decarbonisation targets.

**Julien Daire**
*Managing Director, Head of Fixed Income*

**Noémie Hadjadj-Gomes**
*Head of Research*

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# IN FOCUS

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*Portfolio Manager, Global Asset Manager*

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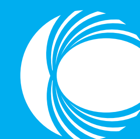
*Business Development Manager, UK Asset Manager*



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*To find out more* - **Natasha Silva** ( Natasha.silva@camradata.com) would be delighted to speak to you.

# Integrating climate risk management

2021 will see climate requirements become more formalised for investors. From March 10th European financial market participants, including insurers and pensions funds, will be required to make disclosures under the Sustainable Finance Disclosure Regulation (SFDR). First round disclosures will be high level, outlining only how sustainability issues are integrated into their investment process (or why they are not). However, European supervisory authorities (ESAs) will provide more prescriptive disclosure metrics that are expected to come into force in 2022. Initial proposals from the ESAs can be found in the February publication of draft regulatory technical standards (RTSs), the detail underpinning the SFDR regime.

At a European level there is further regulatory activity to come linked to climate. EU Taxonomy screening criteria for investments related to climate change adaptation and mitigation were due in December 2020, but have been delayed until 2022. Furthermore, 2021 is likely to be the year that Solvency II, Europe's regulatory framework for insurers, introduces requirements on sustainability.

*" Issues such as compromising returns, being able to measure and report on climate risks, and defining what a reasonable climate change mitigation objective might be, are obstacles which must be overcome "*

UK regulators have been particularly active on climate. The Department for Work and Pensions (DWP) announced this month that by October this year occupational pension schemes larger than £5bn should have effective governance, strategy, risk management, and metrics and targets for the assessment and management of climate risks. By the end of 2022 they should also produce an annual Taskforce on Climate-related Financial Disclosures (TCFD) report. Schemes of £1bn and more must comply with these same requirements by 2022 and 2023 respectively. For insurers in the UK, the Prudential Regulation Authority (PRA) has stated that insurers "should have fully embedded their approaches to managing climate-related financial risks by the end of 2021".

With disclosure and reporting requirements being widened by regulators, effective climate risk integration is becoming essential. However, it does not come without challenges. Issues such as compromising returns, being able to measure and report on climate risks, and defining what a reasonable climate change mitigation objective might be, are obstacles which must be overcome.

### Determining the climate goals

Developing a climate change objective is essential, whether in respect of the investment portfolio or just the wider enterprise. These objectives tend to be framed in terms of being "carbon neutral" or having "net zero" carbon emissions over a certain timescale – often looking to align this with the Paris Agreement's long-term temperature goal. There are different definitions around carbon neutrality and being net zero, with the devil in the detail around areas such as:

- the time horizon for the peak of emissions;
- how much of the assumed decarbonisation is from energy efficiencies versus production switches (e.g. moves from fossil fuels to renewables) versus the use of carbon offsets.

Offsets have had a dirty past, but the publication of the Oxford Principles (for Net Zero Aligned Carbon Offsetting)[1] is trying to put a framework for classification of "good" or acceptable offsets, which are required to bridge the gap around hard-to-abate emissions. Equally, the Taskforce on Scaling Voluntary Carbon Markets[2], launched by Mark Carney in late 2020, was set up to find consensus on how to grow these markets, identify key challenges and present a proposal for actionable solutions.

We believe 'net zero by 2050' is a stretching target that sensibly balances urgency against cost and an orderly transition, particularly in developed economies.



In addition to setting the overarching climate change goal, it will also be important for investors to have a robust framework for aligning the composition of investment portfolios with this climate change goal. This will require a strong measurement framework considering warming potential (or Implied Temperature Rise) and Value at Risk metrics. There are various challenges in developing such a model including the need to make very long-term assumptions, shortfalls in emissions disclosures and in general the poor quality of data, particularly in certain asset classes such as fixed income. To address these issues, within RLAM we have developed tools with bespoke carbon data to expand the coverage of our portfolios and enhance the quality of the underlying climate information.

### Reducing climate change impact

*" Asset owners will have to decide whether to invest in inherently carbon-producing sectors or companies, or whether to focus only on 'cleaner' sectors "*

Any investment approach around decarbonising investment portfolios must acknowledge that there are two sides to the issue – supply and demand. For example, selling mining or power generation assets will not alone meet the decarbonisation goals without changes on the demand side. At RLAM, we have considered downstream energy impact from electricity and gas transmission networks to the energy efficiency of buildings, engaging with utility infrastructure owners and property companies.

Without the major technological changes, however, there will be practical limitations to carbon reduction – some industries, such as cement and steel production, airlines and shipping, will continue to have considerable carbon footprints for the foreseeable future. The only way to accommodate these 'hard-to-abate' sectors in a decarbonisation pathway is to increase negative emissions in planting trees or forestry management, or to improve carbon capture, utilisation or storage. These are still very expensive, but are expected to become more competitive over time, for example through subsidies until they are commercially viable. To focus minds on efficiencies, governments have at their disposal a number of tools including carbon taxes, regulations, licences to operate and fines for breaches. Without such measures and the changes they can enable, asset owners will have to decide whether to invest in inherently carbon-producing sectors or companies, or whether to focus only on 'cleaner' sectors. This will depend on individual beliefs around corporate responsibilities – in particular how to balance financial against societal considerations.

In considering an effective responsible investment approach, it is crucial to consider not just integrating climate change factors into investment decisions, but also stewardship – namely active engagement and voting. Engagement strongly supports climate risk management: our approach has three key elements:

1. We focus on aligning companies' strategies with the 'net zero by 2050' goals.
2. Transition means gradual change, balancing different factors such as cost and urgency.
3. 'Close, not sale' – avoiding just making these someone else's problem. This is fundamental if we want to test the outcomes of investors' actions not just on their portfolios but on the real economy.

### Demonstrating climate change credentials

**Carlota Garcia-Manas**
*Senior Responsible Investment Analyst*

For most institutional investors there is acceptance that climate change is a highly important factor to consider when setting the investment approach, as well as the wider business strategy. However, there are various challenges in credibly integrating climate change risk within the overall investment approach including goal setting, quantification of risks, efficient alignment within portfolios and meeting the increased disclosure and reporting requirements. These are all areas we have been considering for years, and we have the resources and expertise to help to identify the best solution to help meet various objectives without compromising on returns.

The views expressed are the author's own and do not constitute investment advice.

1. https://www.smithschool.ox.ac.uk/publications/reports/Oxford-Offsetting-Principles-2020.pdf
2. https://www.iif.com/tsvcm

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