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Responsible investment means action and accountability

The initiative between Climate Action 100+ and Royal Dutch Shell has demonstrated the potential power of investors. All asset owners committed to responsible investing must exercise shareholder power in support of the Paris Agreement and the SDGs

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Sustainable Development Goal (SDG) 13 calls on us to take urgent action to combat climate change and its impacts. Investors are responding to this challenge. Over 320 investors, collectively representing $33 trillion in assets, now support the Climate Action 100+ (CA100+) initiative. This is an investor-led engagement to ensure the world's largest corporate emitters of greenhouse gases (GHGs) take necessary action on climate change.

Similarly, investors have also supported stronger policy action by governments. During the most recent Conference of the Parties to the UN Framework Convention on Climate Change (COP24) in Katowice, Poland in December 2018, investors managing similar size of assets

▲ Relatives and friends hold a vigil in Brumadinho, Brazil for the victims of the Vale tailings dam collapse. Following the disaster, investor action coordinated by TPI resulted in the International Council on Mining and Metals agreeing to set up an independent panel to set safety standards for tailings facilities

called on world governments to achieve the Paris Agreement's goals and to accelerate private-sector investment in the low-carbon transition.

Actions as well as words

This unparalleled coordination and mobilisation by investors is beginning to have a credible impact as investors back words with concrete actions. Perhaps the most striking example has been the December 2018 joint statement between the oil and gas major Royal Dutch Shell and institutional investors operating under the banner of CA100+ and the European Institutional Investors Group on Climate Change (IIGCC). The joint statement was the first time that investors had come to a common position with an oil and gas company about the nature of their transition to a Paris-aligned future.

The statement committed Shell to reduce its 'net carbon footprint ambition' by around half by 2050, to lock the ambition into rolling intermediate targets, to link these targets to executive remuneration, and to publish annual reports on progress. Shell also committed to review its membership of industry associations that lobby on climate change-related issues, to check that this lobbying aligns with Shell's stated support for the goals of the Paris Agreement.

These outcomes could not have been achieved without the support of investors in CA100+ and IIGCC. The process and outcomes have also shown that it is possible to align the long-term interests of institutional investors with a company that needs to manage an ambitious multi-decadal transition – in effect turning an oil and gas company into an energy provider.

The role of asset owners

Asset owners such as pension funds have been at the forefront of these efforts. There are various reasons for this. Some relate to the investment risks and opportunities presented by climate change.

The transition to a low-carbon economy may affect company cash flows and profits. Energy-intensive sectors, fossil fuel-based industries and high GHG-emitting sectors may see assets stranded. Delivering emissions reductions of the magnitude envisaged by the Paris Agreement will require considerable capital investment by both the public and private sectors.

The drivers for action are about more than the investment case. Asset owners have responsibilities to their beneficiaries and to wider society. Ultimately, asset owners not only need to provide pensions to retirees but must also ensure that they have not harmed the world these individuals will retire into. Asset owners, therefore, need to take a long-term perspective on climate change, and its implications for their assets and liabilities.

Asset owners also occupy a privileged and influential role in the investment system. Through their commitments and actions on climate change, they can drive change through the system and in corporate practice and performance. It is a uniquely important position that is beginning to demonstrate what can be achieved.

Since the joint statement with Shell, further agreements have been reached by investors with major coal producer Glencore on capping its coal production, and with HeidelbergCement and a range of other German companies to review their corporate climate lobbying. Other corporate commitments are expected in the coming months as investors ramp up their engagement.

However, asset owners have faced challenges in delivering on this leadership role. Corporate disclosures on climate change practice and performance remain inconsistent and incomplete. The consequence is that it is often not clear to investors what the transition to a low-carbon economy looks like for individual companies or for key energy-intensive sectors. This has allowed companies to make bold statements on carbon performance knowing that they are debating on their terms and that investors are unlikely to be able to properly hold them to account.

It has not been straightforward for asset owners to assess whether company strategies sufficiently address the climate risks that are embedded in business models, or whether companies are positioning themselves appropriately for a low-carbon economy and to meet the goals of the Paris Agreement.

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It has also been difficult for asset owners to demonstrate to their own beneficiaries, clients and stakeholders that their interventions are making a meaningful contribution to the goals of the Paris Agreement – or that they are effectively managing the risks and opportunities presented by the transition to a low-carbon economy.

Clear objectives

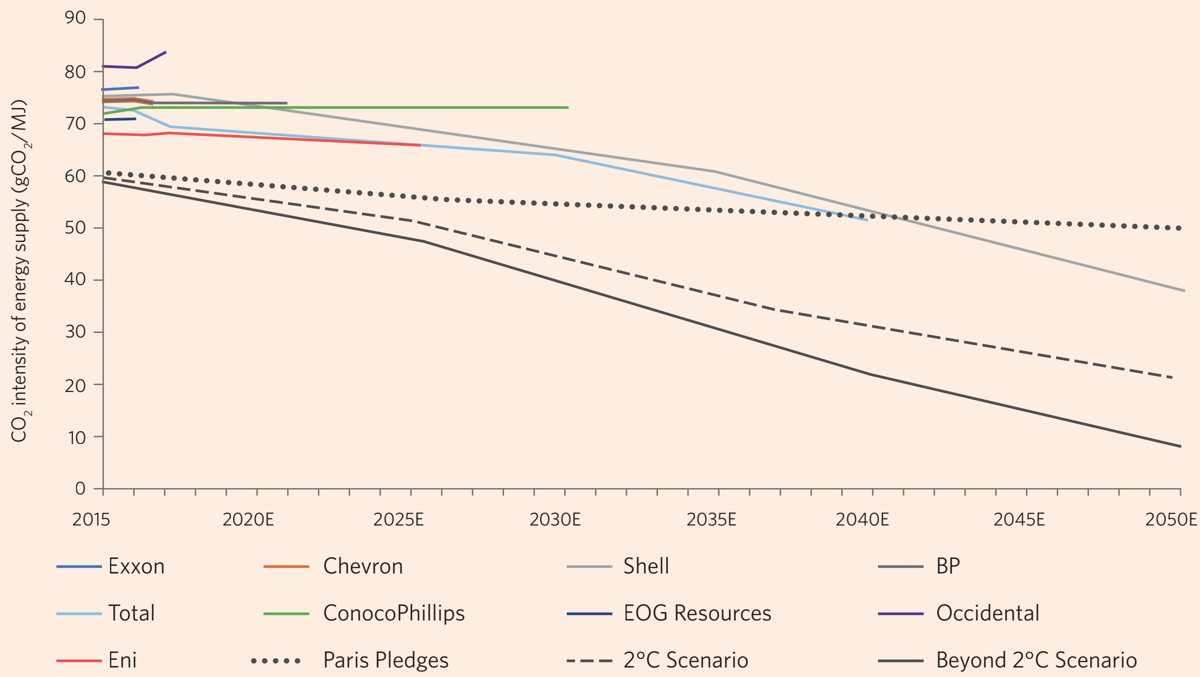
These issues are important. If they are addressed well, they have the potential to unlock far greater capital and support for the Paris Agreement. Investors – both the asset owners at the top of the investment chain and their investment managers – need to recognise that these are, fundamentally, questions of corporate and societal governance.

How do boards ensure that companies are run in the interests of their investors/owners? How do we – investors, governments, stakeholders and so on – ensure that companies are run in a way that aligns with the short and long-term interests of society?

Ultimately, companies should be clear about their:

- purpose (what they are and what they

Figure 1. Carbon intensity pathways (emissions from operations, direct and indirect, plus from use of sold products) for nine of the top ten oil and gas companies, versus low-carbon benchmarks



want to achieve);

- goals (their objectives and targets, and how these are to be measured);
- strategy (how they are going to deliver on their purpose, objectives and targets – both the actions they will take to deliver on their goals and the investments they will make to ensure the goals are delivered);
- main risks to their purpose, goals, strategy – and how these are to be managed; and
- performance against their objectives and targets.

Transition Pathway Initiative

The Transition Pathway Initiative (TPI) is an asset owner-led initiative co-chaired by the Church of England Pensions Board and the Environment Agency Pension Fund. It has been established to enable investors to hold companies to account for the goals that they set themselves and for the actions that companies take to deliver these goals.

For companies in high-impact sectors, TPI evaluates the quality of companies' management of the most significant GHG emissions associated with their business. It also assesses how these companies' planned or expected future carbon performance compares to international targets and national pledges made as part of the Paris Agreement.

This allows investors to clearly and unambiguously identify those companies whose current and expected future emissions align with the Paris Agreement. As TPI data are updated annually, they allow companies to be held accountable for the delivery of the goals they set for themselves.

Figure 1 (above) presents an example from TPI's recent analysis of the oil and gas sector. TPI has prepared similar analysis for many of the other high-emitting sectors such as auto, electricity, steel, aviation and cement.

TPI allows asset owners to hold investment managers to account for the companies held in their portfolios and for the actions being taken by the investment managers to reduce the emissions from these companies. Importantly, TPI also allows beneficiaries and other stakeholders to hold asset owners to account for their investments and for the effectiveness of their engagement with companies.

Ultimately, if asset owners want investment markets to take responsible investment seriously, then asset owners must start by demonstrating their own commitment to responsible investment, and then driving this through the investment chain. Through aligning their investments with the goals of the Paris Agreement, and using their unique position as owners of the companies to drive change in corporate behaviour, asset owners can play a key role in enabling society to meet the challenge of SDG 13. ●