September 2017

Investor action on climate change

A PRI-Novethic assessment of global investor practices: where we are and what needs to happen next

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PRI Principles for Responsible Investment

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Why this report?

For long-term investors, safeguarding investments requires mitigation of climate change.

In 2017, nearly 400 investors representing US$22 trillion in assets under management stood by the Paris Agreement for this purpose. They asked governments to implement the Paris Agreement, drive investment into the low carbon transition and support climate-reporting frameworks such as the recommendations of the Financial Stability Board Task Force on Climate-related Financial Disclosures[1].

Countries and states are pressing ahead despite the US decision to withdraw from the Paris Agreement: France, through *Article 173 of the Energy Transition Act* covering companies and investors, China through its rise "from zero to hero" in green bonds and US states such as California through *America's Pledge*[2].

Looking ahead, bending the emissions curve by 2020 is the only way to limit global warming. This requires investment of at least US$800 billion private resources in climate action each year[3].

Global investors need to know where they are today to inform action towards 2020.

The Principles for Responsible Investment, a global investor initiative with 1,800 signatories representing nearly US$70 trillion in assets under management, has therefore commissioned Novethic[4] to assess:

- The extent to which global investors see climate change as a long-term factor for investment;
- Progress and leadership practices, including tools and activities underway;
- Where greater attention is needed by investors and PRI in future.

France

PRI signatories from around the world have expressed interest in the impact of Article 173. This review therefore includes a special focus on the practices of investors from France, with the aim of sharing of good practice globally.

[1] http://investorsonclimatechange.org/news/
[2] https://www.americaspledgeonclimate.com/
[3] http://www.mission2020.global/
[4] http://www.novethic.com/mission.html

Where we are - **key findings**

Overall, global investors are moving forwards in action on climate change in 2017. This is evident in higher asset owner awareness of relevance of climate change to investments, investor engagement with companies and strong leadership from France following on from Article 173 of the Energy Transition Act.

Nevertheless, more attention is needed to incorporate climate change within investment strategies and products. While portfolio footprinting is popular and helping investors in measuring emissions, scenario analysis may offer investors a more forward-looking tool for assessing climate-related risks and opportunities.

Positive findings from this PRI-Novethic review include:

- In 2017, 74% of asset owners state they are acting on climate change and see it as one of the most important long-term trends for investments. This is a +8% increase from 2016. In France, 83% of asset owners report that they are acting on climate change.
- 59% of asset owners that are taking action on climate change are engaging with companies to address on the topic, with North-American investors particularly favouring engagement with companies (78%).
- 100% of French asset owners taking action on climate change use portfolio carbon footprinting, with 60% having objectives to reduce emissions and 40% using scenario testing.

Areas for further improvement include:

- 54% of reporting asset owners encourage portfolio managers to monitor emissions, but only 8% have aligned manager contracts with climate change factors.
- Only 17% of asset owners incorporate climate change into asset allocation, with new investment in clean energy standing at US$287.5 billion in 2016 .

The PRI's observation is that the PRI's Reporting Framework could be enhanced further to promote investor good practice in climate change:

- Indicators for governance, investment strategy and products, and risk management could be aligned with the TCFD recommendations.
- The PRI's indicators could be modified in time to encourage investors to consider the impact of their activities in contribution to a transition to a low carbon economy.

[5] This is not from PRI Reporting Framework data - the source is Bloomberg New Energy Finance: https://about.bnef.com/clean-energy-investment/
[6] https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf

What needs to happen next: the PRI's response

The PRI plans to support investors in accelerating action on climate change. The PRI's key focus areas will include:

- Enabling collaborative investor engagement with companies to adopt the FSB Task Force recommendations, manage transition risk and use scenario analysis;
- Advancing investment practices in assessment and management of climate-related risks and opportunities including sharing of good practice;
- Bringing the global investor voice to policymakers, including promotion of green finance, disclosure and carbon pricing, as well as collaboration and policymaker capacity-building; and
- Supporting investor disclosure by aligning the PRI Reporting Framework with the TCFD guidance for asset owners and managers in 2018.

PRI will collaborate closely on investor action on climate change including the areas above with UNEPFI, UNGC, the Portfolio Decarbonization Coalition and investor groups such as CDP, Ceres, IGCC and IIGCC.

Novethic Research Methodology

Novethic's analysis examines responses provided by signatory asset owners and asset managers to the 2017 PRI Reporting Framework[7], which signatories are required by PRI to complete each year. This research covers 1,248 respondents, divided into geographic regions.

A distinction is made between investment managers (IM) and asset owners (AO). The size of the group of signatories researched varies widely from indicator to indicator as presently, signatories complete questions on a voluntary basis and are not required to answer every reporting indicator. In order to normalise the data, Novethic has examined responses to each indicator based on the percentage of respondents. In general, the charts in this study indicate the size of the sub-groups researched.

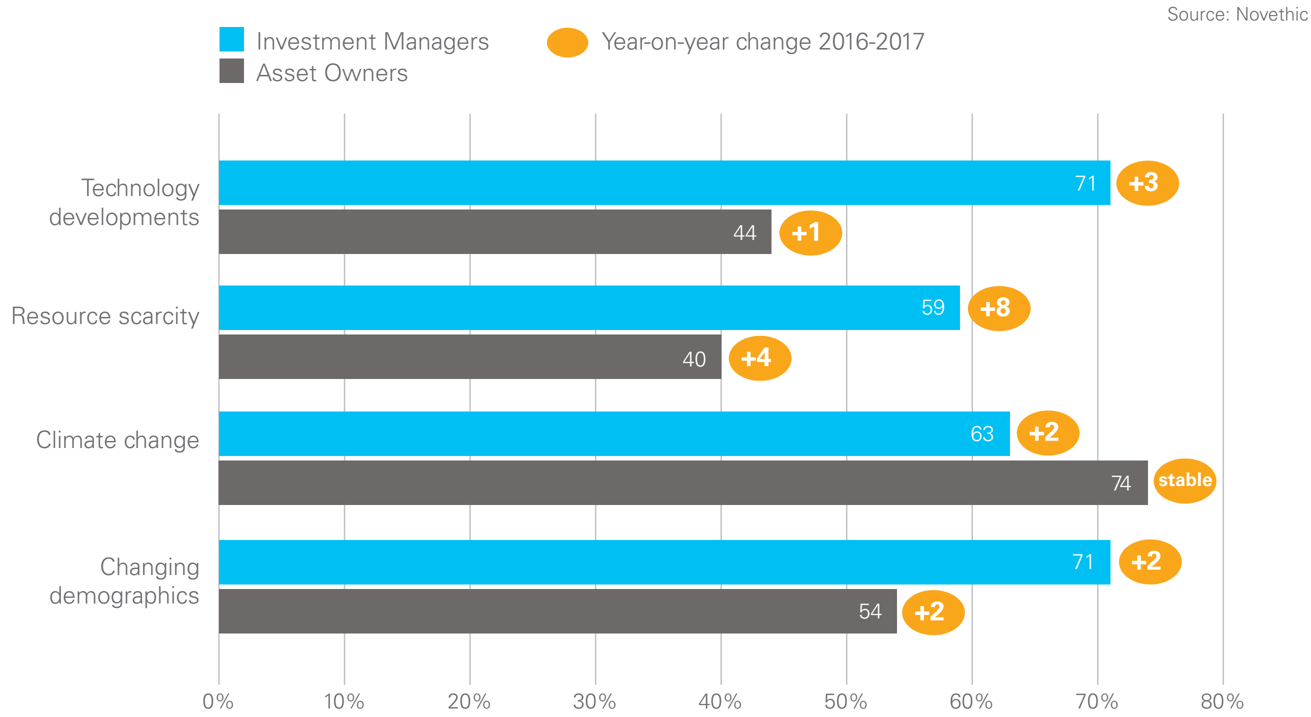
Thus analysis includes a special focus on French-speaking PRI signatories to understand leadership trends and feed into the PRI's Francophone investor network collaboration. The French-speaking group researched comprises signatories from France and signatories reporting regulatory information in French on their websites from Belgium, Canada, Luxembourg and Switzerland. The group of signatories researched has been divided into four quartiles on the basis of their assets under management.

For more information: contact Novethic www.novethic.com/contact.html

[7] https://www.unpri.org/report

Asset owners see climate change as one of the most important long-term trends for investment and report that they are taking action on this

Figure 1: Which long-term trends are you taking action on? (Global sample of 302 AO & 935 IM)



Asset owners: 74% of asset owners responding to the PRI's indicators on key long-term trends state that they are taking action on climate change, followed by changing demographics (54%), technology developments (44%) and resource scarcity (40%). Investment managers also see climate change as an important long-term trend (63%), but see technology developments (71%) and changing demographics (71%) as more important long-term trends.

Growth in year-on-year interest: Overall in 2017, more PRI signatories see climate change as a long-term trend for their investments, but there are nuances in the responses of asset owners and managers. In 2017, more asset owners are acting on climate change, with a year-on-year net increase of + 8%. There is a year-on-year increase in managers acting on climate change, but only + 4%. These findings highlight a discrepancy in asset owners and investment manager views, and potentially the need for asset owner-manager dialogue and alignment.

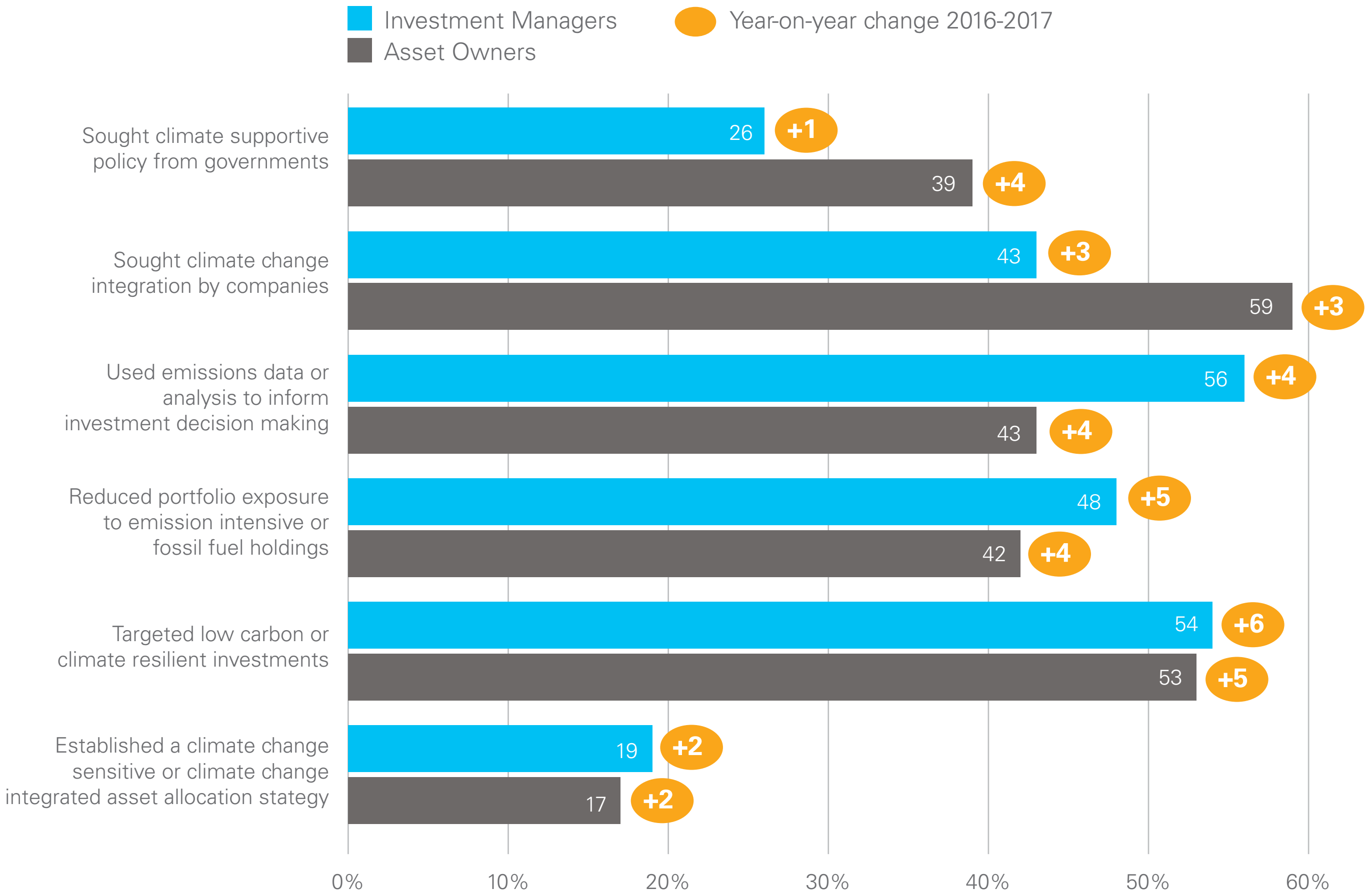
Geographic differences exist: At a regional level, Oceanian asset owners are way ahead with 88% of them acting on climate change. Europeans come second at 79%. There are significant variations however among European asset owners, with Nordic and French asset owners being more active on the topic. A high proportion of asset owners from France (83%) report that they see climate change as a long-term trend for investments, are acting on climate change and regard it as a risk or opportunity. Strong asset owner engagement in France can be attributed to the dynamic created by the adoption of **Article 173 of the 2015 Energy Transition Act in France**. This regulation requires investors to publish a detailed ESG report, beginning with the 2016 business year. Investors with assets over €500m are required to give climate change attention.

Investors have a range of activities underway to assess and manage climate-related risks and opportunities

Investors activities underway include: factoring climate change into the asset mix, active ownership, portfolio carbon footprinting, scenario testing, and manager engagement and contracts.

Figure 2: Activities undertaken to respond to climate change (Global subgroup of 223 AO and 587 IM)

Source: Novethic



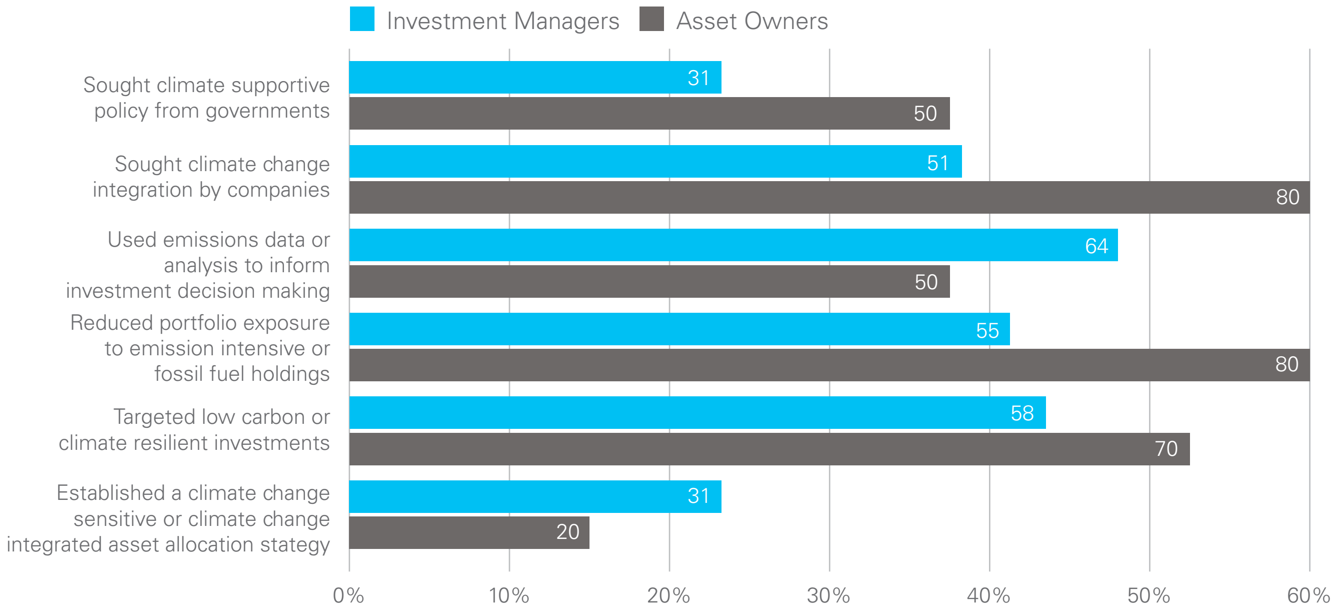
Asset allocation: Out of the 74% of all asset owners taking action on climate change, 53% focus on low-carbon or climate resilient investments of reporting asset owners focus on low-carbon or climate-neutral investments. 42% of asset owners report that they are reducing the exposure of their portfolio to high emitting sectors. Nevertheless, these activities do not translate into a significant amount of assets under management shifting to low carbon investments. New investment in clean energy stood at US$287.5 billion in 2016[8]. Mission2020[9] estimate that investment of at least US$800 billion private resources in climate action each year. As an indicator of the scale of the challenge ahead, only 17% of reporting asset owners incorporate climate change within asset allocation decisions. The PRI's previous research has highlighted some of the reasons for this, including the need for closer investor-policymaker collaboration to scale-up green finance[10].

France: 20% of asset owners and 31% of asset managers from France have established a climate change sensitive or climate change integrated asset allocation strategy.

[8] This is not from PRI Reporting Framework data - the source is Bloomberg New Energy Finance: https://about.bnef.com/clean-energy-investment/
[9] http://www.mission2020.global/
[10] Greening Institutional Investment: https://www.unpri.org/download_report/22444

Figure 3: Activities undertaken to respond to climate change (French subgroup of 10 AO and 67 IM)

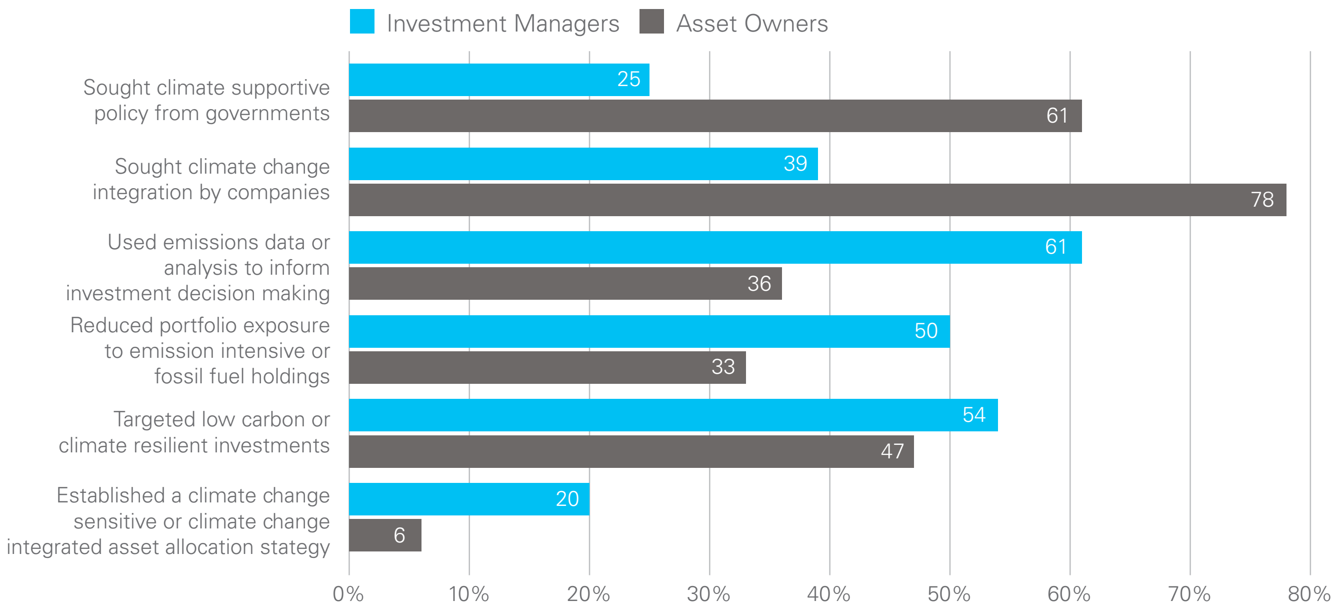
Source: Novethic



Active ownership: Of asset owners taking action on climate change, 59% of asset owners worldwide and 74% from French-speaking regions are engaging with companies on the topic. North American investors taking action on climate change are also particularly active owners, with 73% and 83% of Canadian and US investors respectively seeking climate change integration by companies. The PRI Reporting Framework does not capture voting on specific shareholder resolutions, but the 2017 Annual General Meetings of Occidental Petroleum Corp and ExxonMobil highlighted overwhelming global investor support for climate shareholder resolutions from investors around the world.

Figure 4: Activities undertaken to respond to climate change (North American subgroup of 36 AO and 158 IM)

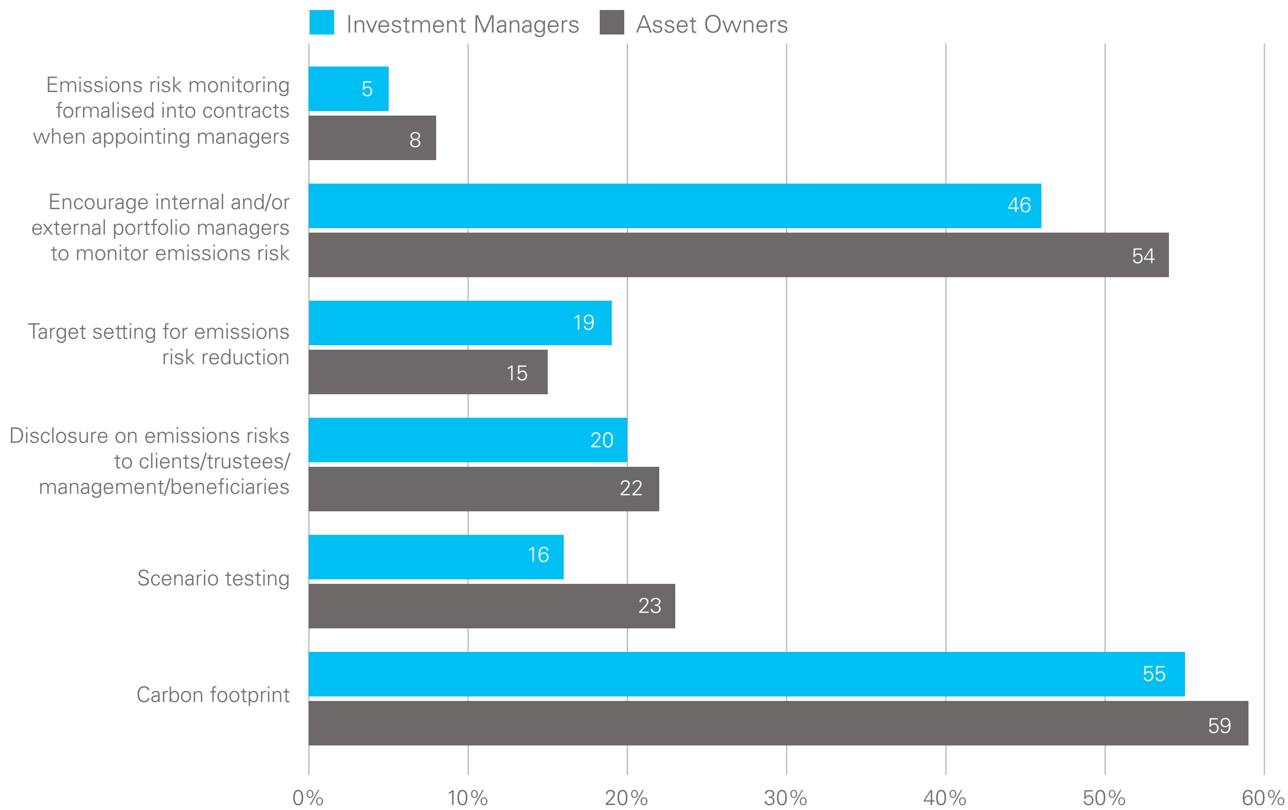
Source: Novethic



Practical tools used by investors

Figure 5: Practical tools used by investors to assess and manage climate-related risk and opportunities
(Subgroup of 223 AO and 587 IM)

Source: Novethic



Portfolio carbon footprinting remains a popular tool among investors acting on climate change, used by 59% of asset owners and 55% of asset managers.

Fund manager engagement: 54% of asset owners and 46% of asset managers encourage external/ internal portfolio managers to monitor emissions. However, only 8% of asset owners formalise emissions risk monitoring and reporting into contracts when appointing managers. This highlights the need for industry collaboration on reporting frameworks, methodologies, metrics and aligned incentives to encourage portfolio managers to factor climate-related risks and opportunities into investment decisions.

France: 100% of reporting assets owners from France use tools to assess their carbon footprint, while 60% have set objectives for reducing their emissions, and 40% of asset owners are using scenario testing.

Socially and environmentally themed investing

Socially and environmentally themed fund areas primarily include clean technology (including renewable energy, green buildings, sustainable forestry and sustainable agriculture). The actual amounts (assets under management) invested are not available through the PRI Reporting Framework; however the analysis below highlights overall trends in thematic investments.

Across all investors reporting that they are acting on climate change, 57% allocate assets to or manage funds based on environmental and social considerations. This included large investors, allocating a modest portion of their assets, as well as smaller investors who are particularly engaged or specialist in climate change.

Figure 6: Share of responding signatories acting on climate change AND allocating assets or managing thematic funds
(Panel size: 1245)

Source: Novethic

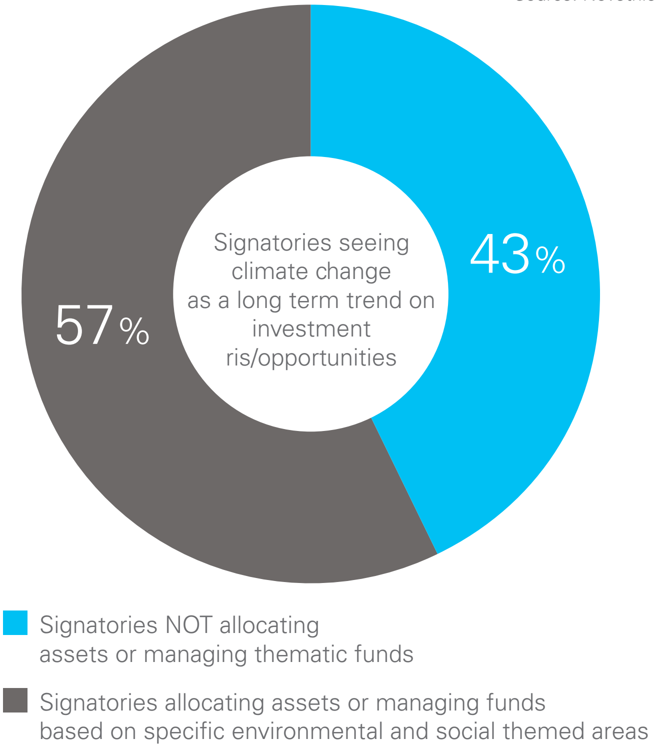
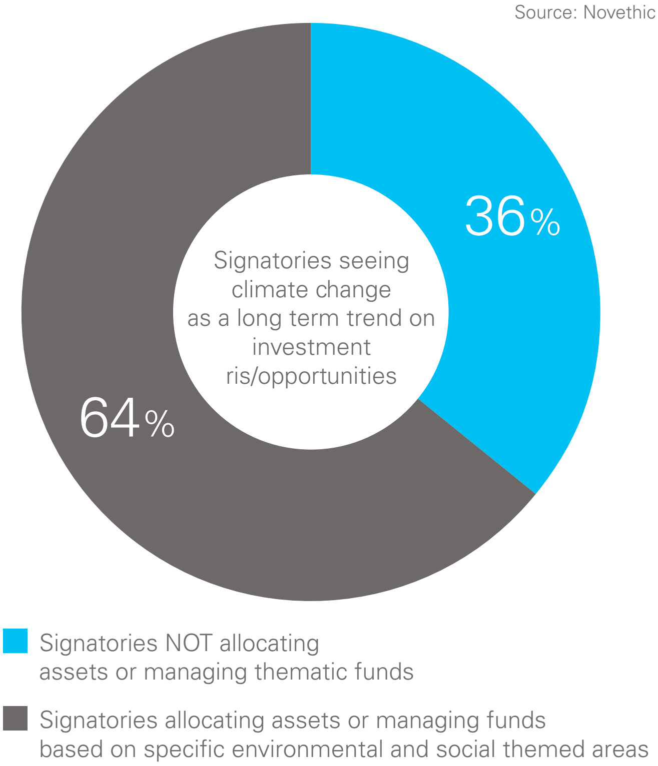


Figure 7: Share of responding signatories acting on climate change AND allocating assets or managing thematic funds
(French speaking subgroup of 27 AO and 164 IM)

Source: Novethic



For French-speaking investors reporting that they are acting on climate change, 64% allocate assets to or manage funds based on environmental and social considerations. 75% of larger investors (with above the average size of assets under management) allocate assets to or manage funds based on environmental and social considerations.

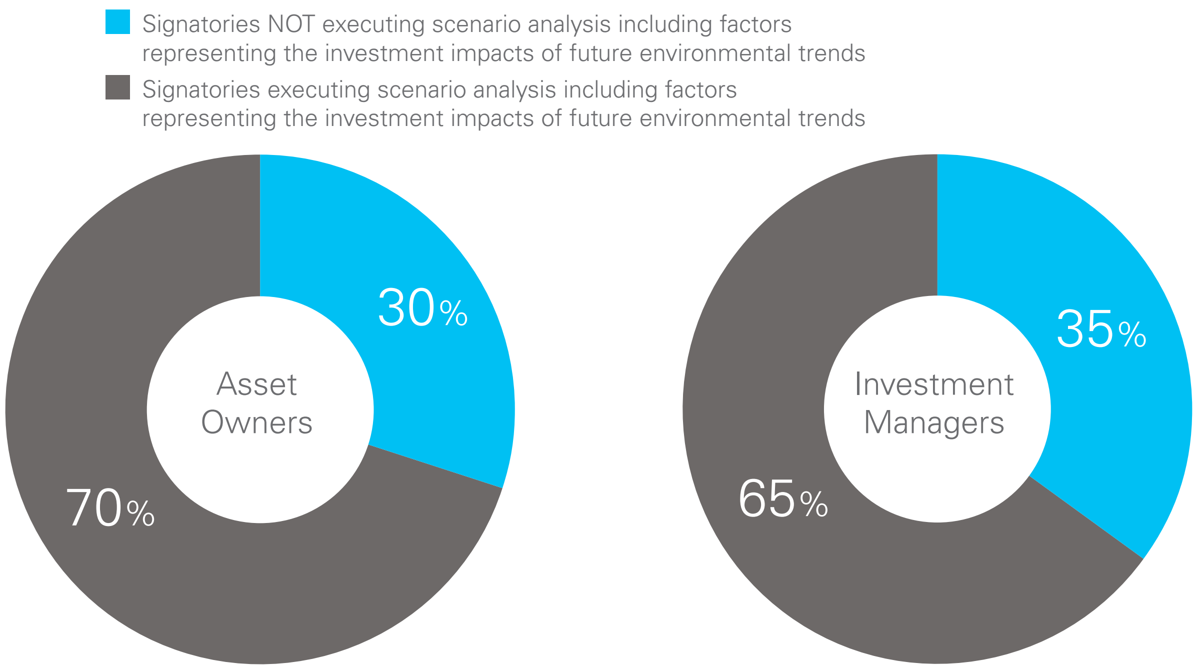
Investors are already using scenario analysis for future environmental trends, with the TCFD guidance providing a useful tool to evolve this for climate change

One third of signatories reporting on ESG issues in asset allocation use scenario analysis and/or modelling to calculate the profile of future ESG trends at a portfolio level. One quarter of all respondents say that they run scenarios including future environmental trends.

Of those investors acting on climate change, 30% of asset owners and 35% of asset managers execute scenario analysis which includes future environmental trends.

Figure 8: Signatories acting on climate change AND executing environment-based scenario analysis
(Global Subgroup of 223 AO and 943 IM)

Source: Novethic



France: 42% of asset owners and 25% of investment managers use scenario analysis and/or modelling for future environmental trends.

With the exception of investors from France, French-speaking investors are slightly lagging other markets; only 24% of French-speaking asset managers use a scenario analysis and/or modelling for future ESG trends. In contrast, Latin American investors stand apart, with over 40% using scenario analysis for future ESG trends.

Investor feedback to the PRI on the recommendations of the FSB Task Force on Climate-related Financial Disclosures (TCFD) indicates that presently, there is low investor use of scenario analysis specifically with respect to climate change, mainly as company disclosures are inadequate. The TCFD has published technical guidance on scenario analysis in relation to climate change; if this is implemented the quality of disclosures and investor use of these will likely improve across geographic markets.

More innovation is needed to align investment strategy and products with a transition to a low carbon economy

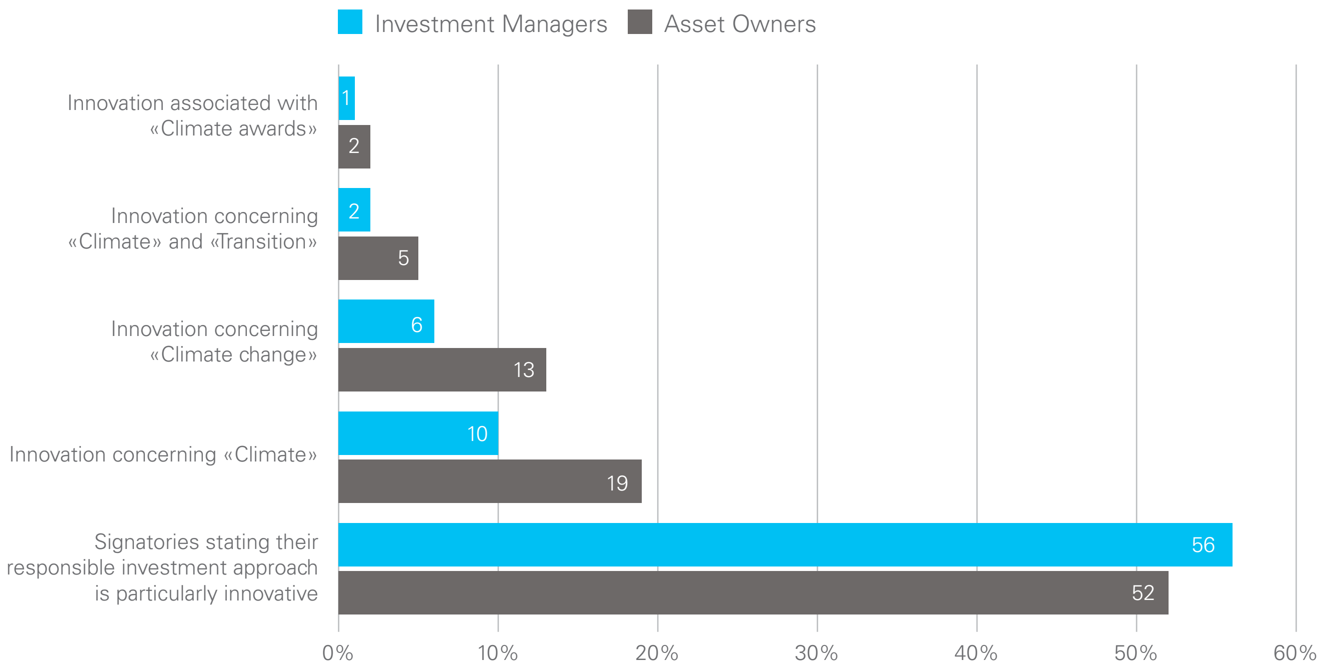
Over half of reporting investors (52% of asset owners and 56% of investment managers) state that they are particularly innovative in the area of responsible investment. The word "climate" appears in the responses on innovation of 19% of reporting asset owners and 10% of reporting asset managers. For French-speaking investors, 31% of reporting asset owners and 17% of asset managers include the word "climate" in responses on innovation.

However, Novethic's lexical analysis has identified few practical examples of innovation to align investment strategy or products with a transition to a low carbon economy. Investor responses focus on processes such as asset allocation procedures, exclusion criteria, awards, working groups to define reporting standards, sector research, scenario testing and shareholder resolutions. Twenty investors cite green bonds as examples of innovation.

These findings highlight that looking ahead, asset owners may need to consider how they can innovate and encourage asset managers to innovate, so that climate-related risks and opportunities and aligned within investment strategy and products.

Figure 9: Signatories perception of innovation correlated with climate change
(Subgroup size: 258 AO and 795 IM)

Source: Novethic



France: The PRI is aware of good practice developments in investment strategy and products by investors who made early commitments towards COP21 and implementation of the Paris Agreement. These include: Amundi, AXA Group, BNP Paribas Asset Management, Caisse des Dépôts, ERAFP, Fonds de Réserve pour les Retraites, Humanis, Ircantec, Mirova and Sycomore Asset Management[11]. France's 2016 International Award on Investor Climate-related Disclosures also highlights good practice[12].

[11] This list is not definitive and is based on PRI's dialogue with signatories participating in the Montreal Carbon Pledge and/or membership of the Portfolio Decarbonization Coalition. Innovation is not limited to France and PRI will undertake further research of global good practice.
[12] http://2degrees-investing.org/#!/page_Award

Conclusion

Novethic's last review of the PRI focused on the Montreal Carbon Pledge in 2016, highlighting the role of the initiative in accelerating investor climate action, and the need for PRI to move beyond this to reach more investors across geographic markets.

Since then, PRI signatories have moved on to undertake a range of activities to assess and manage climate-related risks and opportunities. PRI signatory asset owner engagement is particularly strong and across markets, with high year-on-year growth in 2017.

However, while the PRI's broader reach and activities signatories have underway are encouraging, more attention is needed to meet the 2020 challenge to bend the emissions curve. In particular, greater focus is needed in implementing the FSB Task Force on Climate-related Financial Disclosures' recommendations, including incorporation of climate risk and opportunity into investment strategies and products.

The PRI and Novethic look forward to investors making further headway in active ownership, in scaling up low carbon and climate resilient assets under management, advancing investment practices and enhancing investor disclosure in climate change.

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