Spotlight on climate action

Actively investing in the low-carbon transition

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November 2020

M&G Investments

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

Whether it's the rising number and intensity of hurricanes or floods, forest fires or droughts, it's increasingly untenable to ignore the causes and consequences of climate change.

Much as the coronavirus pandemic has highlighted how interconnected our economic prospects are with the health of society, the effects of rising global temperatures demonstrate our dependence too on the health of the planet.

As policymakers grapple with how to ensure society becomes more resilient to challenges like the pandemic, we believe investors should consider how companies can play a part. We believe those that provide solutions to the most pressing global challenges stand to not only deliver a positive impact, but also be financially successful.

Are we at a turning point?

The effects of global temperatures rising to 1.5 degrees Celsius[1] above pre-industrial levels, as projected by the International Panel on Climate Change[2], are severe. At two degrees, the impact looks grave.

The pandemic-induced shutdown of the global economy in early 2020 arguably offers hope that we are not on an irreversible trajectory towards breaching the goals of the international Paris Agreement on climate change.

[1]The Paris Pledge for Action. For more information: http://www.parispledgeforaction.org

[2]IPCC, "Summary for Policymakers".

Although restrictions on economic activity have curtailed growth in global demand for energy, electricity generation from renewable sources, such as wind and solar, is expected to rise by nearly 5% in 2020. This is because of low operating costs, preferential access to the grid, and the addition of capacity. A recent report by research service, BloombergNEF, found that two-thirds of the world's population lives in regions where wind and solar power represent the cheapest option for new electricity generation.

While there is a long way to go, it reflects an encouraging direction of travel that is reinforced by the growing number of companies aligning their strategies with the Paris Agreement.

Around 1,000 companies have pledged to reduce their emissions in line with the Science Based Targets initiative (SBTi)[3], which encourages companies to specify how much and how quickly they will reduce their greenhouse gas emissions. More than 400 have approved science-based targets that then have two years to be approved and published by the SBTi.

The shift away from a carbon-intensive economy, however incremental, is being encouraged by policy. As we start to emerge from the pandemic, it looks likely that there will be pressure from governments – and perhaps from voters – that we rebuild a cleaner, greener economy. For the first time since the global financial crisis, we are seeing a strong boost to government spending around the developed world.

Given the global imperative to address climate change, it is hard to believe that the government stimulus will not have some focus on encouraging sustainability, especially in Europe.

[3]SBTi, "Meet the companies already setting their emissions reduction targets in line with climate science".

The European Union's Green Deal and Green Recovery programmes aim to catalyse the transition to a low-carbon economy by advocating substantial public investment in clean energy, green infrastructure, low-carbon transportation, sustainable agriculture and biodiversity protection[4]. It is hoped that large-scale public sector investment, combined with regulatory changes, will galvanise private sector investment that helps the EU reach its goal of being climate neutral by 2050.

Targeting climate change

By investing in listed equities with the potential to deliver a positive impact, alongside the pursuit of financial returns, we can invest in companies that offer solutions to the world's most pressing challenges. To identify impactful stocks, fund managers may look to assess the extent to which companies explicitly aim to address societal and environmental issues. Their impact must be intentional, not accidental.

Impact investors can look to gauge the positive impact that a company delivers against the United Nations Sustainable Development Goals (SDGs). These are a universally recognised articulation of the most pressing challenges facing people and the planet.

We can map a company's activities to a primary SDG – in this case combatting climate change – and quantify their contribution towards achieving it. Seven of the 17 SDGs directly relate to climate change.

By establishing key performance indicators that are pertinent to that company delivering an impact against that SDG – for instance, carbon emissions per gigawatt-hour (GWh) of electricity generated by an energy company – we can assess whether we are making a positive contribution through our investment.

How investors can keep up the pressure

Active investors like M&G have long held company management to account on corporate strategy and governance. In the same way, we can hold feet to the fire on climate change.

[4]European Commission. For more information: https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

Companies need to properly understand the risks, and we believe it is the role of investors to persuade company management to make positive changes. Frank discussion about the material risks that climate change poses to a company – for instance, if rising sea levels might inundate its coastal assets – can shape opinions and strategy.

When it comes to lending enough weight to the management of climate risks, an important step is disclosure. The Taskforce for Climate-related Financial Disclosures (TCFD) has developed a framework for consistent climate-related financial risk disclosures, upgrading the importance of climate reporting by requiring its integration within financial accounts.

We also want to see ambitious targets and metrics to ensure companies make tangible progress towards mitigating risks.

Another vital step is linking executive remuneration to climate-related goals. Rewarding progress and aligning incentives makes them more likely to be achieved.

Investors are right to support companies that take steps towards combatting climate change, but it is also right to expect material progress. If companies fail to act, investors have a responsibility to use all tools at their disposal.

The threat of divestment can be effective, but it is no panacea. Actively using ownership and stewardship as instruments – exerting pressure alongside other shareholders on companies to decarbonise or even make radical changes to their business model – can be more powerful and effective over the longer term.

Investors with more than US$40 trillion in assets under management have signed up to Climate Action 100+, an investor initiative to ensure the world's largest corporate greenhouse gas emitters act on climate change. By October 2019, two years into the initiative, 70% of the companies targeted had made some sort of commitment to tackle emissions[5].

Net zero commitments from the likes of Maersk and Nestlé have followed engagement by Climate Action 100+[6]. In 2018, Royal Dutch Shell linked executives' long-term incentive plans to meeting new carbon emissions targets[7].

Playing a part in the solution

The environmental risks of climate inaction are evident. Where companies do not act, they will not only expose themselves – and their investors – to financial losses, but they will miss opportunities for success that lie in tackling this challenge.

Transitioning existing investment portfolios will play a critical role, but investment in climate solutions will also be necessary if we are to effectively curb climate change.

With growing recognition of the urgency of the challenge, from governments and investors alike, there are obvious opportunities for companies that can offer solutions to tackle climate change.

Where companies can tap into trends like rising demand for green electricity, their shareholders can aspire to achieve sustainable financial returns and contribute to a demonstrably positive impact for the planet and its people.

The power of leadership

We believe there are opportunities for investors to channel more capital to companies that are having a direct positive impact in the fight against climate change and are actively accelerating the shift to a low-carbon economy.

This includes those involved in the production of renewable electricity, as well as those whose solutions increase energy efficiency and promote circular models. These companies might be 'pioneers' – whose products or services have a transformational effect on combatting climate change – 'enablers' – which provide the tools for others to deliver climate solutions – or 'leaders'.

Leading companies which spearhead and mainstream sustainability in their sectors can deliver considerable positive impact given their clout and the power of influence.

Take Ørsted, for example, which is at the forefront of society's transformation towards renewables. Having been one of Europe's most fossil fuel-intensive energy companies just a decade ago, the Danish company has transformed itself to a leader in green energy and was rated "the world's most sustainable company" for 2020 in Corporate Knights' Global 100 Index[8].

In 2006, Ørsted produced 80% of its electricity from coal. Today, Ørsted has built more offshore wind farms than any company worldwide and has committed to being coal-free by 2023, when it will have reduced its carbon emissions by 96% compared to a decade ago[9]. The company wants to be carbon neutral by 2025[10], and states that it will work towards achieving carbon neutrality in its total carbon footprint, both direct and indirect, by 2040.

We believe the world's leading owner and developer of offshore wind power is making a demonstrable positive impact towards its stated purpose, as "a renewable energy company that takes tangible action to create a world that runs entirely on green energy".

Ørsted – Global leader in offshore wind power

Intention

- To make a direct contribution to create a world that runs on green energy
- Coal-free by 2023
- Carbon neutral by 2025.

Impact

- Generated 15.5 terawatt hours (TWh) of renewable energy in 2019
- Equates to saving of 11.3 million tonnes of CO_2 emissions (a 40% year-on-year increase), equivalent to powering the lives of roughly 18 million people
- Green share of its overall energy generation rose from 75% to 86% in 2019.

[5]Financial Times, "Corporate eco-warriors driving change from Shell to Qantas", 8 August 2020.

[6]Climate Action 100+. For more information: http://www.climateaction100.org/

[7]Shell, "Joint statement between institutional investors on behalf of Climate Action 100+ and Royal Dutch Shell plc (Shell)", 3 December 2018.

[8]Corporate Knights, "2020 Global 100 ranking", 21 January 2020.

[9]Ørsted. For more information: https://orsted.co.uk/about-us/our-company/about-orsted

[10]Ørsted ESG performance report 2019.

Net Zero Investment Framework

The Net Zero Investment Framework provides a practical blueprint for investors to maximise the contribution they make in tackling climate change and achieving net zero carbon emissions globally by 2050.

The framework was launched for consultation in August 2020 by the Institutional Investors Group on Climate Change (IIGCC), an investor body with a mission to mobilise capital for the low-carbon transition and to ensure resilience to the impacts of a changing climate through collaboration. The IIGCC has over 240 members, including M&G, with more than €33 trillion in combined assets under management.

The framework is the first major output of the IIGCC's Paris Aligned Investment Initiative (PAII). The PAII looks at how investors can align their portfolios to the goal of limiting global warming to no more than 1.5°C. In practice, this means investors should look to ensure their portfolios contribute net zero emissions by 2050 at the latest.

The framework is intended to help asset owners and asset managers achieve this target by providing a step-by-step guide to aligning portfolios with the Paris Agreement. Its primary objective is to ensure investors can decarbonise investment portfolios and increase investment in climate solutions. Four different asset classes – sovereign bonds, listed equities, corporate fixed income and real estate – are covered by the framework, with others to follow.

M&G Investments has been part of the PAII since the start of the initiative in 2019. We believe it is a powerful example of investors collaborating to find solutions to the global challenge of climate change.

We have committed to reach net zero carbon emissions on our total book of assets under management and administration by 2050, in line with the Paris Agreement and the UK Government's target.

Read our Approach to Climate Change.

www.mandg.com/institutional

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