Decarbonisation research and implementation

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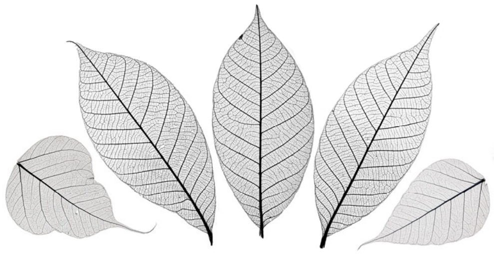

Decarbonisation for New Zealand investors

The recent government declaration of a climate change emergency and the announcement that the public sector would aim for carbon neutrality by 2025 is a step towards transitioning to a green economy. By phasing out public sector use of coal boilers, mandating the purchase of electric vehicles and adopting green building standards, the government is signaling intent to put NZ on the path to full net carbon neutrality by 2050, as pledged under the Zero Carbon Bill.

A number of local investors have already adopted policies and procedures in response to the climate challenge. Some, such as the NZ Super Fund, have tilted their portfolios away from companies with large carbon emissions due to the belief that future related costs are underestimated by the market (and thus, high carbon stocks, in the aggregate, 'overpriced'). Others, such as the ACC, have made a commitment to meet TCFD requirements (see box) and to reducing their portfolio's carbon footprint to align themselves with the Zero Carbon Bill.

Climate change, as an investment theme, does not lend itself to simple implementation policies. Unlike tobacco or nuclear armaments, where a company's involvement is usually binary (i.e. involved or not involved), most companies sit on a spectrum encompassing scope 1, 2 and 3 level emissions.[1] This complicates the application of any climate change investment strategy, particularly at a multi-asset total portfolio level

Building portfolios that make a real, positive impact on the climate is a complicated and challenging process. For example, the recent mandate changes for default KiwiSaver schemes will restrict investment in companies with fossil fuels assets. However if the goal is to make default KiwiSaver investors contribute to the low carbon transition, we believe there may be greater value in adopting engagement policies and positive screens that contribute to the funding of renewables and green energy development.[2] Divestment in secondary markets (where issued securities are traded between investors) may have limited impact on the company's operations and also prevent concerned shareholders from voting for improvement.

Despite implementation challenges, climate change is a tidal wave that has far-reaching and varied implications for most investors. We believe that Kiwi investors, institutional and retail, should be thinking about the climate issue and creating an investment strategy around their beliefs on the topic. Recognising the sometimes-conflicting aims of fund sponsors and their beneficiaries, the formation and

Task Force on Climate-related Financial Disclosures (TCFD)

The TCFD recommends disclosure by investors and organisations on various climate-related risks and metrics. These include:

1. **Governance**: How the organisation is managing internal climate-related risks and opportunities.
2. **Strategy**: How climate risks might impact the business over the short, medium and long term.
3. **Risk management**: How the organisation identifies and assesses climate risks within a risk management framework.
4. **Metrics and targets**: Identifies the relevant climate-risk metrics for the firm.

[1] Scope 1 refers to direct emissions generated as a result of the industrial activity. Scope 2 emissions are those which are released indirectly through the consumption of a resource which itself generated emissions during its production. Scope 3 refers to both upstream and downstream emissions and includes emissions produced by the inputs to the product or to get that product in the hands of consumers (i.e., packaging).

[2] Some companies in the energy sector are now making large investments in renewables, the adoption of which may make a real difference in reducing emissions. Including additional variables, such as renewable energy ratios, allow for better informed investment decisions.

implementation of climate-related investment strategies should be backed by rigorous research and sound governance, something that we have increasingly been focused on in recent years.

Working with investors

Since 2015 we have worked closely with investors around the world to develop robust policies and procedures to solve some of the challenges associated with climate change within investment markets. Our work has been wide-ranging, from working with large government entities in NZ as they began to reduce the carbon footprint of their portfolios, to building customised, decarbonised multi-manager portfolios for large scale UK pension schemes using our innovative Enhanced Portfolio Implementation (EPI) process.

The Russell Investments fund solutions include:

> *Russell Investments Low Carbon Global Shares Fund.* Built to reduce the relative carbon footprint of investors, we leverage our quantitative investment capabilities to construct a global equity portfolio with 50% reduction in carbon emissions and fossil fuels, whilst minimising any impact on performance. In addition to divestment, this fund incorporates positive tilts towards securities associated with renewable energy and superior material ESG scores. This strategy is appropriate for investors looking to both divest from carbon-related assets and increase exposure to firms that support the low carbon transition.

> *Russell Investments Sustainable Global Shares ex Fossil Fuels Fund.* Similar to the Low Carbon Global Shares Fund, the Global Shares ex Fossil Fuels Fund aims to generate benchmark like performance while reducing carbon emissions by 60% and completely excluding fossil fuel assets for investors with ex-fossil fuel mandates. This fund also tilts exposures towards renewable energy and securities with greater material ESG scores.

> *Russell Investments Climate Transition Private Markets Fund*. This private markets fund, available to institutional investors, manages investments in unlisted assets that support the energy revolution, decarbonisation and incremental electrification.

Research on climate change and decarbonisation

We have an extensive research library addressing climate concerns. A selection of articles, all of which can be found on our website, include:

> *Decarbonisation 2.0 – A sustainable investing solution for the energy transition* (Emily Steinbarth)

> *Why the climate transition means renewables are here to stay* (Leigh Hazelton)

> *How climate change can impact investments* (Mihir Tirodkar)

> *Materiality matters* (Emily Steinbarth)

We will be releasing two pieces of research for local investors in the first quarter of 2021; the first will evaluate carbon metrics and other climate exposure considerations, while the second will detail our thoughts and experience-to-date in implementing an effective decarbonisation strategy.

We believe this research and analysis will help our clients in their understanding of this complex issue.

For those that wish to investigate decarbonisation strategies, we can help develop a roadmap of considerations and carbon management options.

Please reach out to the team if you have any questions or would like to learn more about our research on climate change and asset management.

For more information call: 09 357 6633

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IMPORTANT INFORMATION