INVESTORS & CLIMATE CHANGE: What's Really Going On?

Investors are increasingly noisy on climate change, but is there a gap between words and actions? Brunswick's **CHRISTOPHE GUIBELEGUIET** and **JESSICA ATKINS** investigate.

Citing a record number of shareholder resolutions being filed on climate change, the think-tank The Center for American Progress concluded investors were finally "paying more attention to climate change when choosing their portfolios." In August, that report will be a decade old. Its findings have aged well in one respect: They could be cut-and-paste into reports today. But they've also held up poorly: We're reaching the same predictive conclusions a decade later.

Yet there's a sense that 2019 marks an inflection point for the investment community on climate change. McKinsey estimates nearly a quarter of global assets under management are invested according to ESG principles, while the investment

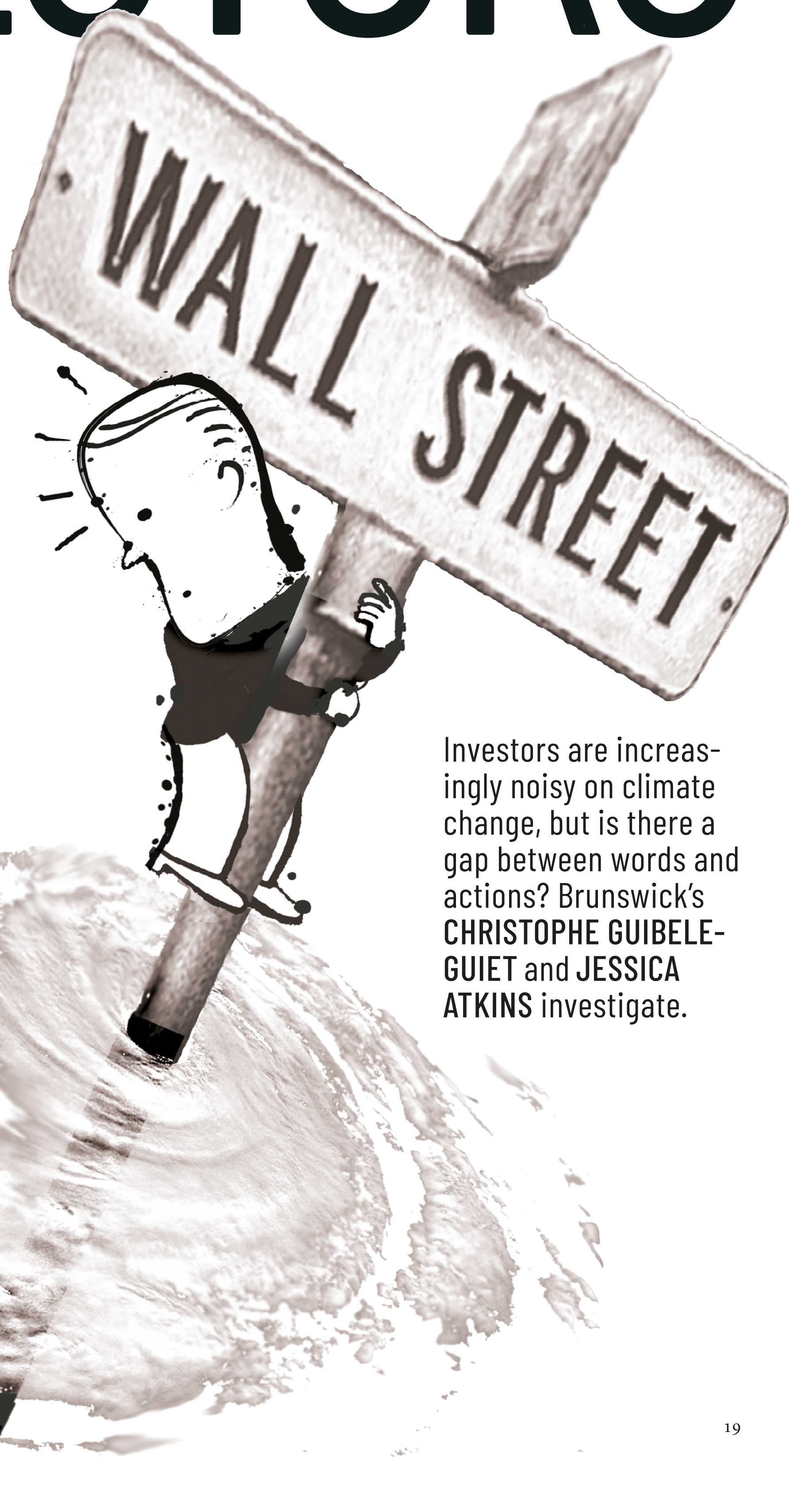


ILLUSTRATION: MIGUEL DAVILLA

research firm Morningstar says climate is the largest investment topic within ESG. More than $200 billion in green bonds were issued in the first 10 months of 2019—smashing a single-year record with a quarter still to go. The largest asset managers are creating new teams to engage with companies on climate change, while smaller firms focused solely on the issue are emerging. Still, there's evidence to suggest that, just as in 2010, a gap remains between words and actions:

- In November 2019, an estimate by Cerulli Associates, a research and consulting firm based in Boston, found that nearly 90 percent of public market assets in the US are held by signatories of the UN Principles for Responsible Investment, a coalition that views climate change as "the highest priority ESG issue facing investors"—and yet less than 5 percent of those signatories "formally use ESG considerations in their investment decisions," according to Cerulli.
- From June 2018 to June 2019, only 13 shareholder proposals on climate issues reached a vote among the 1,500 largest companies in the US, according to research by Georgeson, a shareholder engagement consultancy.
- Asset managers (and CEOs) are still often judged on shorter-term results. "From the financial results side, people are not cutting you a lot of slack," Nestlé CEO Mark Schneider told the New York Times in 2019, in an article titled "Nestlé Says It Can Be Virtuous and Profitable. Is That Even Possible?"

SO WHAT'S GOING ON?

Are investors really paying more attention to climate change—and if so, how much more, and where? What are they doing differently in 2019 than 2018—or 2010? Is climate change really changing investment? We set out to answer those questions, and the methodology for our investigation had three levels:

- Primary data analysis, looking at eight years' worth of earnings calls, quarterly reports and annual reports from almost half (228) of the 500 largest global companies.
- Secondary research, synthesizing the findings of more than 100 reports and articles on climate change and the investment landscape since 2017.
- Interviews with investors from the US, Europe and Asia, as well as heads of Investor Relations working in industries ranging from consumer goods to energy and mining.

FINDINGS FROM OUR INVESTIGATION

Brunswick's deep dive into the reality of investor engagement on climate delivered some interesting observations in the following five areas:

1. INCREASED ENGAGEMENT FROM INVESTORS ON CLIMATE CHANGE.

In a new study of roughly half of the world's 500 largest companies, research by Brunswick found that, more than ever before, these businesses are talking to investors about climate change, and investors are asking more climate-related questions.

Mentions of climate change in quarterly reports are up by a third since 2015, while mentions in annual reports are up nearly 30 percent. Mentions of low-carbon strategy on earnings calls have more than quadrupled since 2014. The issue has become a fixture of investor-investee engagement.

But there are a number of caveats. In earnings calls where climate change was mentioned, only 28 percent of the mentions came during the Q&A section, suggesting either analysts weren't interested in the topic or, more optimistically, that questions on climate change were already being addressed through other channels, in particular private conversations with the CEO and the board. "Climate risk" was mentioned only five times in all 2018 earnings calls with nearly half of the largest US-listed companies, and only four times as of November 2019.

> 2019 marks an inflection point for the investment community on climate change.

2. INVESTOR ALLIANCES ARE PROLIFERATING—AND DOMINATING THE CONVERSATION.

"Investors concerned about climate change have never been better organized," The Economist reported in May of 2019. They were pointing to the fact that a number of muscular, new investor alliances have formed to force companies to both enhance quality of climate reporting and to set aggressive carbon reduction targets that align the business with the Paris Climate Agreement's goal of keeping a global warming increase below 2°C.

Our investigation found a number of different types of alliances. For example, there are regional alliances: such as the Asia Investor Group on Climate Change and the Australia-New Zealand-based Investor Group on Climate Change; or the Institutional Investors Group on Climate Change, which has a largely European membership. Some

are asset-owner-led alliances, such as the Transition Pathway Initiative (TPI). However, the most significant collectives on climate change are broad-based global alliances, including Ceres and the UN's Principles for Responsible Investment (PRI)—global networks of both asset owners and asset managers, as well as businesses and NGOs. Almost 450 companies are UN PRI signatories.

Investor alliances are focused on governments as well as businesses. Some have done the seemingly unthinkable: ask for more regulation. A group called The Investor Agenda—a sort of coalition of coalitions—organized a statement urging governments worldwide to take more action. It was signed by 515 institutional investors managing $35 trillion in assets. Most are directing their attention at companies: for example, 200 institutional investors, with a combined $6.5 trillion in assets under management, recently signed a joint letter calling on US publicly traded corporations to align their climate lobbying with the Paris goals.

A number of other investor alliances are pressuring companies to act:

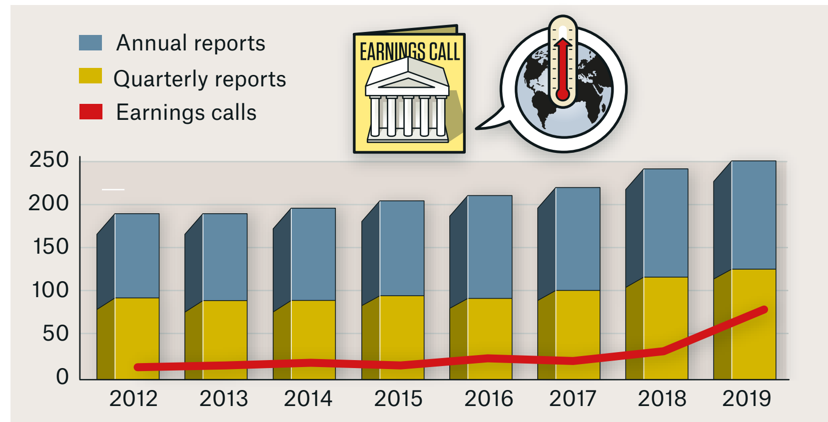
- Last September a group of the world's largest pension funds announced a commitment to make their combined $2.2 trillion portfolio zero-carbon within the next 30 years as part of the UN Net Zero Asset Owners Alliance.
- The Carbon Disclosure Project (CDP), a nonprofit that works with some of the world's largest companies to disclose their environmental impact, reports that more than 7,000 companies are disclosing information at the request of 525 institutional investors with $96 trillion in assets.
- Climate Action 100+, a $35 trillion alliance, led efforts to publicly pressure cement producers, an industry responsible for 7 percent of man-made emissions, to be carbon neutral by 2050.
- Ceres, an investor network whose members have more than $26 trillion in combined assets, pressed fast-food companies in 2019 to set tougher greenhouse gas emissions targets.

3. ASSET MANAGERS FACE PRESSURE FROM ASSET OWNERS.

As asset managers press companies for better disclosure and governance, asset owners are making similar demands of investors. One asset manager we spoke with said they take calls from their asset-owner clients to discuss climate change "almost every day." In their internal monthly fund manager calls, "half of the time is spent on discussing carbon pricing," reveals another. Another told us, "There

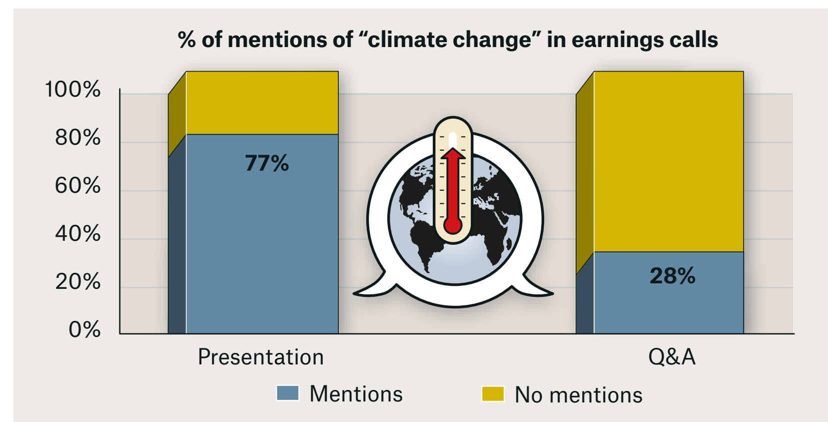
CLIMATE CHANGE IN REPORTS & EARNINGS CALLS

Earnings call mentions of climate change have increased sharply. Just 8 mentions on earnings calls occurred in 2012, with 28 mentions by 2018—versus 74 mentions in the first 10 months of 2019.



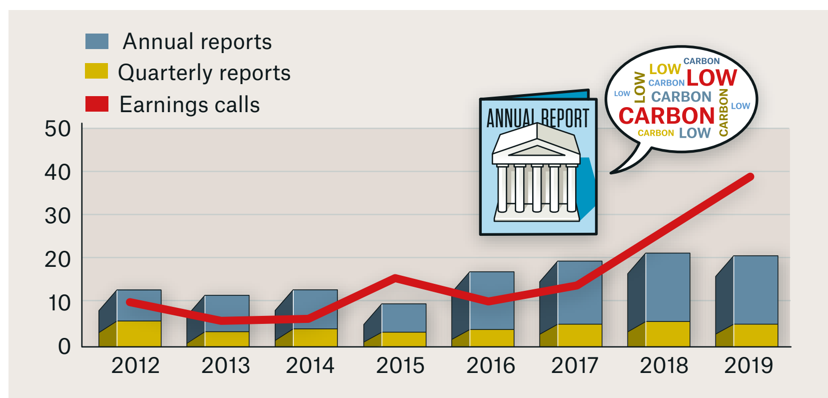
COMPANIES ARE TALKING ABOUT THE ISSUE

In 77 percent of the earnings calls mentioning climate change, the mentions occur only during the company's presentation.



"LOW-CARBON STRATEGY" IS ON THE RISE

In recent years, the focus on low-carbon strategy has broadened beyond annual and quarterly reports to earnings calls.



CHARTS:PETER HOEY

is no conversation possible today with asset owners and pension funds without a clear policy on climate change."

Part of the pressure is demographic: Younger generations form an increasing percentage of asset owners (and asset managers) and are now "ready to invest as sustainably as they shop," according to Bloomberg. They are pressing investors to disclose and measure the climate impact of their own portfolios. Another is regulatory: Accounting for climate-related risks is being increasingly considered as part of a company's fiduciary duties, Mercer reported in 2019.

Combined, these have made climate risk an issue that leaders of investment firms have to take ownership of. More than half of the investors polled by the European Corporate Governance Institute in 2019 said the issue had "C-level responsibility." As one corporate Investor Relations expert noted, "This is all quite new to the investors as well, so investors are trying to work with the companies that they hold to understand it better themselves."

4. GEOGRAPHICAL DIFFERENCES.

Beneath the umbrella term "investor" lie important regional differences. Of the 373 signatories on Climate Action 100+, an alliance that represents nearly half the world's invested capital, only 20 came from Asia, South America and Africa combined.

Regional representation, however, doesn't necessarily correlate with meaningful action. Sharestudy looked at investors with the highest percentage of voting in favor of climate-friendly proposals, and those with the lowest. The 10 "worst" investors on climate were all from the US, while the 10 "best" were based across Europe, Canada and Japan. A study by the CFA institute found that 66 percent of investors in the UAE factored the environment into their investment decision-making—58 percent in the APAC region, and less than half in the Americas.

5. THE DIVESTMENT DEBATE IS LARGELY SETTLED—AMONG INVESTORS.

"If you care about climate change, this is a dereliction of duty," Oliver Shah, Business Editor of the Times, wrote in November. Mr. Shah was arguing against a course of action proposed by activists: cut ties with high-carbon-emitting companies. "As a shareholder, you have an ability to influence a board that you don't have on the outside," Mr. Shah countered.

The investors we spoke with broadly shared Mr. Shah's sentiment: Engagement is often a better option to help companies become more sustainable.

"We take calls from our asset-owner clients to discuss climate change almost every day," an asset manager told us.

"Divestment can be a bit of a blunt instrument," Adam Matthews told the Brunswick Review earlier this year. Mr. Matthews is Director of Ethics and Engagement for the Church of England Pensions Board and Co-Chair of the Transition Pathway Initiative, which leads groups of major shareholders, collectively worth $13 trillion, in efforts to shift the practices of corporations, fossil fuel extractors and others on the issue of climate change.

"But the Church of England recognizes the value of divestment," Mr. Matthews said, "particularly where companies produce more than 10 percent of their revenue from thermal coal and tar sands. We've taken a view that those companies are simply not part of the transition—they are at the wrong end of the spectrum. We don't believe they will survive in a world consistent with the Paris targets.

"On the larger question, it is completely legitimate to engage with companies on this, because it allows the owners of companies to really drive positive change. When you divest, you can't do that so effectively from outside. But we're also clear engagement has to have a deadline."

The Church of England investing bodies look for good faith efforts to meet established climate-goal timelines. "If we can't demonstrate that you're on a credible path to below 2°C—then you are a candidate for us to divest," Mr. Matthews said.

What Should BUSINESSES EXPECT?

1. A POLICY RESPONSE INVESTORS HAVEN'T PRICED IN.

Since 1997, there has been a 20-fold increase in climate change laws globally, according to Carbon Brief, totaling more than 1,400 climate change laws worldwide today. Everyone we spoke with expects more and expects it to be more forceful (as Anthony Gardner writes in "The Inevitable Policy Response," on Page 15). Public demand is finding its way to the ballot box: The Green Party doubled its number of seats in European Parliament in 2019 and public climate-change concern is growing in many countries.

Fiona Reynolds, CEO of UN PRI, recently wrote in the Financial Times that she foresees "an inevitable policy response by 2025 that will be forceful, abrupt and disorderly because of the delay. This will create considerably greater disruption than many investors and businesses are prepared for today. The implications of this mispricing go far beyond the energy sector, rippling throughout the economy…" Investors agree. A 2019 survey by BNY Mellon of

institutional investors found that 93 percent believed climate change still wasn't being priced in.

2. LEGAL TANGLES OVER STRANDED ASSETS AND CLIMATE IMPACTS.

The European Investment Bank in November 2019 announced it would stop funding fossil-fuel companies. The rationale wasn't moral, but financial, according to the company's Vice President for energy, Andrew McDowell. "From both a policy and from a banking perspective, it makes no sense for us to continue to invest in 20-to-25-year assets that are going to be taken over by new technologies and do not deliver on the EU's very ambitious climate and energy targets," Mr. McDowell told Bloomberg.

In other words, the bank expects oil, coal and gas to become stranded assets. As the FT reported, this "might prompt activists to launch suits against other private-sector lenders. After all, if they lend to the gas sector this might be a possible breach of fiduciary duty, given the potential future losses."

In October 2019, Exxon Mobil defended itself against a lawsuit brought by New York State, claiming the company defrauded shareholders by downplaying the risks of climate change to its business. The trial was decided in the company's favor, but the decision may not prevent other such attempts.

Meanwhile, more than a dozen "public nuisance" lawsuits have been filed by cities in the US against energy companies for the costs of climate adaptation, and repairing damage from unprecedented hurricanes, floods and wildfires. These possible legal complications could be among the most concrete forces that shape investment flows and investor behavior.

3. METRICS WILL PROVE CRUCIAL.

Progress on climate change relies on "two important factors," according to Mark Carney, Governor of the Bank of England: The first is consistent, robust disclosure, and the other is that "market and policymakers must continue to work together to determine the most decision-useful metrics for climate-related financial disclosures."

Investors want disclosures to be more granular and consistent, and also tied to financial projections and concrete risk analysis. A recent analysis from ShareAction found that among resolutions filed on climate change in 2019, nearly a third were on disclosure, although the complexity of climate change often renders such figures inexact. The FT's Gillian Tett sees these metrics as crucial. "The new front for green revolution rests on warrior accountants."

The Task Force on Climate-Related Financial Disclosures, considered the standard by which companies measure and disclose climate risks, issued recommendations in 2017. The Sustainability Accounting Standards Board Foundation is looking to establish industry-specific disclosure standards across ESG topics, including climate. Attempting something similar is the Global Reporting Initiative.

"Climate change is where short-term thinking and long-term consequences collide."

HANK PAULSON, former US Treasury Secretary and CEO of Goldman Sachs

4. A FOCUS ON THE LONGER TERM.

"Climate change is where short-term thinking and long-term consequences collide," observed Hank Paulson, former US Treasury Secretary and CEO of Goldman Sachs. Investors are expecting climate to be integrated into longer-term corporate strategy, especially through a company's scenario analysis.

There is also a shift toward assessing company strategy and performance in the context of the system that a company operates in. Many companies in retail and consumer goods have long value chains, and investors will increasingly seek information on climate risks in these chains. As one investor told us, "Taking a systemic approach is becoming common practice when looking at the performance and risk of a company with a large supply chain."

5. INVESTOR ENGAGEMENT WILL ONLY INCREASE.

Hurricane Sandy was an important inflection point for investors when it hit the US East Coast—including downtown Manhattan—in 2012. Wall Street—the actual location and the investment network it represents—was physically threatened by the "superstorm." The New York Stock Exchange had to close. The insurance industry was left with a $25 billion bill. Investors who had ignored climate change before began to take it more seriously.

An increase in extreme weather events and rising sea levels are expected to impact many financial centers, confronting investors with the realities of climate change. At the same time, the world will be increasingly looking to investors to play a role in encouraging the transition to clean energy.

Already, investors are fully in the frame. Brunswick research found the number of publications mentioning both climate change and the top asset management firms nearly doubled in just one year—those include mentions of BlackRock, Vanguard, Fidelity, Legal & General Investment Management (LGIM) and Schroders, among others. As climate impacts accelerate, the activity of investor engagement on climate will only increase. ◆

CHRISTOPHE GUIBELEGUIET, a Partner, and **JESSICA ATKINS,** an Executive, are with Brunswick's Business & Society practice, based in London.