INVESTOR CLIMATE ACTION

As director of ethics and engagement for the Church of England Pensions Board and Co-Chair of the Transition Pathway Initiative (TPI), Adam Matthews leads groups of major shareholders in efforts to shift the practices of corporations, fossil fuel extractors and others on the issue of climate change. TPI is supported by investors with over $13 trillion of assets under management.

"We have a belief that business is a force for good," Mr. Matthews says. "Done well it can be an extremely positive force in society. And in the context of climate change, business has a responsibility to disclose how they're going to deal with this very challenging issue. We believe that they can."

The international Paris Agreement two years ago set a target of keeping global warming "well below" a 2°C increase over pre-industrial levels. Since then, there has been a dramatic increase of pressure on companies to be accountable to investors for their greenhouse gas emissions.

Recently, the Church of England investing bodies co-led successful investor engagement with Shell and Glencore as part of the Climate Action 100+ investor initiative, a group that collectively represents $33 trillion in assets. As a result, Shell set a binding target for emissions that stem from the use of its oil and gas products, and miner Glencore set a cap in thermal coal production capacity.

A key component of investor discussions surrounds what are called Scope 3 emissions. Under the Greenhouse Gas Protocol, a widely used international accounting tool, emissions are categorized into three groups or "scopes." Scope 1 and 2 cover emissions sources from fuel used in company operations or purchased electricity, for instance. Scope 3 covers all other indirect emissions—in the case of oil and gas companies, that's considerable, as it covers the emissions caused by users of their products.

Investors managing a collective $33 trillion are pushing companies to improve their resilience to climate change. **ADAM MATTHEWS** of The Church of England Pensions Board tells Brunswick's **PHIL DREW** and **WILLIAM MEDVEI** where this is heading next.

Investors are also addressing companies' government lobbying efforts, which can be at odds with their stated climate goals. Corporations are being asked to review relationships with the trade associations and lobbying organizations that work with regulators on their behalf, to ensure consistency with the companies' public commitments.

In an interview that took place as thousands of young people crowded Parliament Square in London demanding action on climate change, Mr. Matthews described his positive outlook for corporate leadership on climate change, increasing the chance for success in meeting the Paris climate goal.

Norway recently recommended that its sovereign wealth fund partially divest from oil and gas. What is your rationale for engagement versus divestment?

Ultimately, you want the market to properly weight the risk. If the market fully embeds carbon-related risk into investment decisions, then it should be re-allocating capital to companies that have plans consistent with the transition to a low-carbon economy. Then you would see that shift on a company by company and sector by sector basis. That isn't yet happening, but it is starting to happen with the move away from coal.

Divestment can be a bit of a blunt instrument, but the Church of England recognizes the value of divestment—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.

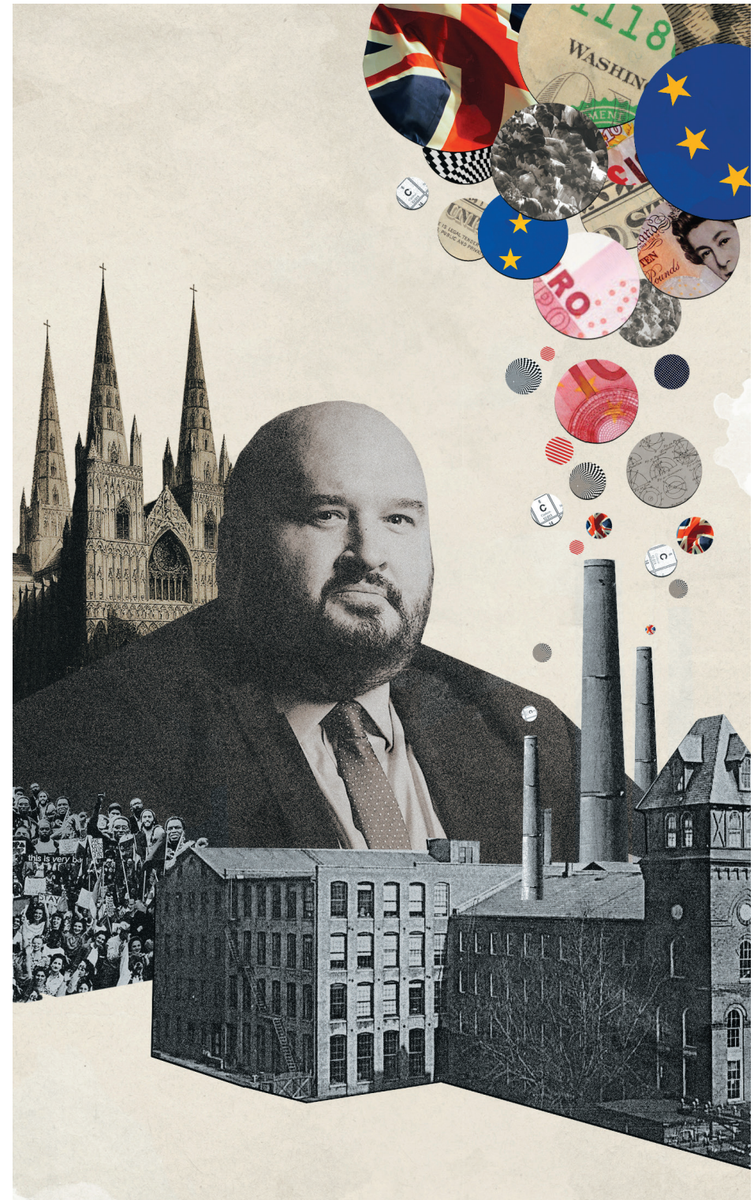

ILLUSTRATION: LINCOLN AGNEW

If done well, engagement has the potential to deliver the change we need, as with the commitments BP, Shell and Glencore have made.

But we're also clear engagement has to have a deadline. For three national investing bodies of the Church of England, 2023 is a key boundary: If you're not aligned with that—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. This timeframe is also in step with Climate Action 100+, which is a five-year initiative.

Does the church's moral and ethical code mean it is naturally well placed to make this case?

Our approach is absolutely rooted in our faith and guided by our ethics, but we act in a way to bring other mainstream investors to particular issues. The issues companies and investors are grappling with are immensely complex—the transition to a low-carbon economy, concerns around tailings dams at mining operations, agriculture's impact on deforestation. And there is a lot of gray space in there.

We have focused on trying to understand the connection between the teachings of the church and practical reality. You could take a very easy position of, "OK, the extractive sector, well, we just divest as it's not ethically right." But it's probably more correct for us to be in that messy space with our eyes open.

The moment companies break ground and start to extract oil, metals, resources, that's when the responsibility starts to flow. You have to track responsibility, from the person breaking the ground to the shareholders.

The other big reflection for us is a preferential option for the poor. The poor are very disadvantaged in many circumstances in the extractive sector. But equally, the industry can be a force for development and good.

That implies a tension between reducing emissions and the right to economic development and prosperity. How do you navigate that?

The poorest are at the forefront of our minds. And when you look at who is going to be the most impacted by climate change, it's going to be the poor who are least equipped to manage the transition to a low-carbon economy. So, you need to say, "How can we enable clean energy development so that the

poorest aren't impacted by climate change, whilst respecting their right to development?" So yes, there can be a tension.

But prices on renewables now are much more competitive. In India it's cheaper to go for solar panels than pursue some of the more traditional alternatives. That path is the one that we obviously want to support. There's not yet the follow-through to produce the sorts of international funding commitments required to manage the transition under the Paris Agreement. There needs to be a lot more effort put into enabling countries to pursue low-carbon paths.

Some argue that a low-carbon economy will lower dividends by turning those companies into something resembling utilities. Should investors choose a path that could undermine their returns?

That goes back to that point earlier about the market properly understanding the transition and pricing the risk. This is a multi-decade transition that is deeply complicated.

Two models are beginning to emerge: one where the companies begin to run down reserves and pay out cash to shareholders as they wind themselves down; the other, which is more apparent in the larger integrated oil companies, is where they diversify further into gas, then into renewables and then ultimately into being a variation of an energy utility. Both paths are equally legitimate as long as there's a consistent way of being able to track those processes. The consequences of that I think we're yet to see.

What disclosures would you like to see companies give you to prove greater confidence in their carbon transition model?

This is very clearly laid out in the TPI. We need to be able to look at future carbon performance according to the company's stated strategy. That means we need to understand Scope 3 trajectories. For oil companies, Scope 3 often accounts for 80 percent of emissions. Whatever your plan is, we want to know: How does that correlate to your Scope 3 emissions?

We're working with the diversified miners at the moment to identify a methodology that can track their performance in a similar way to the oil and gas sector. I'm very conscious that in the multi-decade transition you have some coal, some oil and some gas. And somebody to provide those. There's just less of them. The companies that are going to gain investor confidence are those that can demonstrate to us that they've got a plan and the assets best placed to meet that demand. Plus the transparency to back it up.

> "WE'RE ESTABLISHING COORDINATED INVESTOR GROUPS FOR EACH SECTOR, TO INCREASE THE KIND OF INTERVENTIONS WE'VE HAD IN THESE OIL AND GAS AND MINING COMPANIES IN AVIATION, UTILITIES, CEMENT."

How global is this investor movement?

The Climate Action 100+ engagement initiative has membership from all regions of the world. While we have major investors in Japan, the US and Australia, different regions run on slightly different timescales, with Europe initially moving forward a bit faster and seeing some more successes. You'll see other investors join these initiatives. Ultimately this is the shot that the investment community has to demonstrate that engagement works, and that we're able to shift companies into alignment with the 2°C target.

Where is investor engagement on climate change going?

We're only just getting started and more does need to be done. Different approaches are emerging.

With Shell, the framework of continued engagement has five pillars. At the top level, you've got a clear set of emissions targets. And you've got transparency on Scope 1, 2 and 3 emissions.

Second, there is the connection of that to executive pay.

Third, you've got the disclosure of all the metrics that they are using that enable investors to track progress.

The fourth pillar is having built-in points of review. Technology and regulation change; the company has to be able to reassess those developments and reflect on its ambitions.

And then the last pillar, the fifth pillar, is the commitment to ensure lobbying is consistent with Paris. You're going to see increasing focus on that area from investors.

My sense is that that framework can be extrapolated to any other company. We're talking across Climate Action 100+ about how we can replicate that. Climate Action 100+ covers a raft of sectors. The cement industry is one of the worst for disclosure and performance assessment on emissions. We also just produced our first assessment of the aviation sector, which has had limited engagement and focus on climate issues.

We're establishing coordinated investor groups for each sector, to increase the kind of interventions we've had in these oil and gas and mining companies in aviation, utilities, cement—you'll see that roll out in the coming year.

How can companies demonstrate that their lobbying practices are in line with their commitments on meeting the Paris targets?

As investors we're very clear about what we're looking for. One, good governance and oversight by the Board of its lobbying practices; two, annual review of memberships to trade associations or other lobbying groups to test them for alignment with their own positions on issues; and three, in the event of misalignment, identify clear steps to address that—including ending memberships.

The OPEC Secretary General recently described the oil industry as suffering from a "crisis of perception." What do you think oil companies are getting wrong?

Well, if you look at Parliament Square right now, you've got thousands of school children who are probably thinking, "Oil and gas companies are not ethically aligned with my future." There's a massive challenge there for companies. Does an oil and gas company have a role in the low-carbon transition? Yes, it does. All the scenarios that we base our projections on include oil and gas, but to different degrees.

The oil sector is legitimately challenged right now. For the vast majority of companies, there has not been a collective set of disclosures and strategies that align to 2°C pathways. You're now seeing the first begin to do that. When you can get to the point that you've got that line of sight on all of them, then the sector can have a clearer message. That's critical, not just to explaining oil's role but also to retaining the best talent going into the sector, to enable it to manage that transition well.

> "WE'VE NOW GOT COMPANIES WITH SCOPE 3 EMISSIONS TARGETS, INTEGRATING THEM INTO EXECUTIVE PAY AND CORPORATE REPORTING. THAT'S IN LESS THAN TWO YEARS."

Change is hard and this transition is a fundamental change of the business model. These are not easy things to do. It's often the case that the first response is defensive. But being open to the challenge and finding a pathway to address it enables you to have a more robust response. If your company or your sector has only a defensive reaction, it's hard for people to align with that.

What inspires confidence that society is going to get to where it needs to be?

Partly it's all those children in Parliament Square right now. This is intergenerational and it's clear a movement has been united across schools and children will want to see more action. I'm also encouraged by the pace of change that we've got going. Just in the space of a year, look at the commitments from companies, the kind of territory we're now discussing. Two years ago, we weren't talking about targets or oil and gas companies covering Scope 3 emissions. We've now got companies with Scope 3 emissions targets, integrating them into executive pay and corporate reporting. That's in less than two years.

And now we've got to see all of this move quicker. And I think there's a real possibility of that. ◆

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THE LOW CARBON TOOLBOX

INVESTORS ARE LEVERAGING THEIR COLLECTIVE POWER TO DEVELOP NEW TOOLS AND A PLATFORM FROM WHICH TO ACTIVELY ENGAGE COMPANIES, SEEKING BINDING COMMITMENTS THAT WILL ENSURE COMPANIES' ACTIVITIES ARE ALIGNED WITH PARIS 2˚C GOALS.

Developing a tracking tool. The Transition Pathway Initiative offers a tracking tool for carbon goals, cutting through different corporate reporting methodologies in a way that is public, independent, academically rigorous and free. This allows investors across industry sectors to identify if a company is aligned to the Paris Agreement's 2˚C. TPI is co-led by the Church of England Pensions Board and supported by investors with over $13 billion AUM.

Creating a clear set of targets. These targets are essentially the requests investors are making of companies. These requests can be broken into three parts.

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First, use metrics that can be compared against the Taskforce on Climate-related Financial Disclosure.

Second, make emissions targets binding and link them to executive remuneration.

Third, ensure that lobby activity intended to influence legislation and regulation is consistent with public commitments and with the Paris Agreement targets. Business's lobbying activities should also be reviewed annually to guarantee continued compliance.

Collaboration among investors. Leverage the collective power of investors across regions to maximize global impact by coordinating under the Climate Action 100+ group.

Engage passive money. Looking to the future, there is an ambition to target passive investing through the creation of an index fund that integrates TPI assessments into its investments and ensures that the fund is weighted toward companies that scored positively on that criteria.