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INSIGHT

Fuelling the fight against climate change

There are positive signs of change and evidence of a groundswell of support for more action on climate change. Chris Newton examines how the investment management industry are in a unique position to join the fight against climate change by exerting pressure on companies to lower their emissions.

by Chris Newton

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INFRASTRUCTURE

The challenge of solving climate change begins with disclosing and tracking emissions in order to identify ways to reduce them.

Several financial institutions are now working to address this challenge by pressuring companies to open up about the impact of their businesses on climate change, and vice versa.

For example, in May 2017, CalPERS (California Public Employees' Retirement System) and other big institutional investors like the Church of England and the New York State Common Retirement Fund succeeded in passing a shareholder proposal that would require Exxon Mobil Corp. to report on how climate change could impact its business. The eventual report, published

in February 2018, included an analysis of 2 degree Celsius (3.6 degree Fahrenheit) scenarios and information on how changing energy needs will impact Exxon's bottom line.

In January 2018, in his annual letter to CEOs, BlackRock CEO Larry Fink called for executives to "understand the societal impact of your business as well as the ways that broad, structural trends—from slow wage growth to rising automation to climate change—affect your potential for growth."

These powerful public statements are backed by a larger trend in capital flows, with an ongoing surge in global assets that follow ESG (environmental, social and governance) or responsible investment principles. According to the 2016 Global Sustainable Investment Alliance (GSIA)



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report, there were \$22.89 trillion in global assets being professionally managed via responsible investment strategies at the end of 2016, representing 26 percent of all global AUM (assets under management) and an increase of 25 percent in assets since 2014.

This growth is only expected to continue, with multiple studies showing growing demand for responsible investment-focused investment strategies, particularly among women and younger generations.

These are positive signs of change and evidence of a groundswell of support for more action on climate change. But often lost in the discussion of disclosures is the investment management industry. With few exceptions, the majority of the fund management industry does not publicly report how climate change could impact its investments or measure how many emissions its assets generate. This needs to change.

Investment managers are in a unique position to join the fight against climate change by demanding transparency into the emissions of every company or financial asset in their portfolio, and thereby exert pressure on companies to lower their emissions. But this is only possible if managers have a mechanism for tracking and reporting the amount and source of emissions in their portfolio. Once armed with this information, asset managers can help influence policy discussions and ensure that assets held in responsible investment strategies are actually managed responsibly.

We at IFM Investors—with an investment portfolio that largely consists of infrastructure assets such as airport, roads, bridges and ports—have been among the leading proponents of behaving and investing responsibly. As part of our commitment to responsible investment, we have developed a methodology for tracking emissions in our portfolio, allowing us to simultaneously position our investments for the long term while also mitigating climate risk. While every methodology will have its

strengths and weaknesses, we hope our approach can serve as a useful model for other investment managers.

Measuring Emissions in an Investment Portfolio

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We laid out this commitment in our Responsible Investment Charter, which states that “long term sustainable returns will be generated if we integrate Environmental, Social and Governance factors in how we invest, and how we manage our investments ... As a long term investor and active manager, it is imperative that we assess our portfolio’s exposure to carbon emissions and climate change risk on a regular basis to inform our asset management strategy.”

In thinking about the impact of climate change on our infrastructure portfolio, we have adopted a two-phased approach to climate risk management. In the first phase, we calculate our portfolio’s net emissions by reviewing all existing data and information available across all assets. In the second phase, we use this data to inform our investment strategy and to identify investment opportunities presented by climate change.

PHASE 1

Measurement & Reporting

One way for asset managers to assess an investment portfolio’s impact on the climate is through the GHG (Greenhouse Gas) Protocol Corporate Value Chain Accounting and Reporting Standard, an internationally accepted standard for calculating and reporting emissions that is already used by many listed companies. This standard defines emissions across three buckets:

- **Scope 1 emissions:** Direct emissions from fuel combustion, company vehicles, and fugitive emissions
- **Scope 2 emissions:** Indirect emissions from the purchase of electricity, heat, and steam
- **Scope 3 emissions:** Indirect emissions from purchased goods and services, business travel, employee commuting, waste disposal, use of sold products, transportation and distribution, investments, leased assets, and franchises

Building on this framework, we came up with an additional category we call “financed emissions,” which we define as the “proportion of scope 1 and 2 emissions

from each asset that represents an investor's ownership percentage.”

Based on this metric, we estimate our total financed emissions are 3,019,803 tCO₂e (tons of carbon dioxide emissions), with the bulk of emissions coming from two sectors—District Heating (54 percent) and Electricity Transmission & Distribution (21 percent).

Although the GHG Standard is a useful starting point to measure emissions, we also understand that many smaller and private companies still don't disclose or even measure emissions in a meaningful way. To solve for this challenge, we have also developed additional proprietary metrics such as “emission per \$1 million invested” to evaluate our emissions on both an overall portfolio and investment level. Based on this, we calculated that the emissions intensity across our overall infrastructure portfolio is 159.8 tons of carbon per million dollars invested.

We believe these figures serve as a useful benchmark by which to track the performance of our portfolio and to evaluate individual assets against each other over time. Although we understand that each asset will have a unique operational footprint and climate change profile, and that every metric comes with its limitations, we believe it is important to continue to measure the environmental performance of each asset to the greatest extent possible. This data will only become more valuable as data collection and analysis improves across the investment management industry.

PHASE 2

Engagement & Risk Management

In the second phase, we focus on using data on emissions and energy usage to find ways to optimize the performance of our overall investment portfolio and of each individual asset. This approach allows us to both “protect” assets that may be negatively affected by climate change—for instance, by improving energy efficiency—

as well as identify assets that may be positively impacted by climate change such as renewable energy sources. The more data we have, the better we can perform our due diligence on existing or potential investments, and therefore the more value we are able to deliver to our investors.

For example, one of the infrastructure investments in our portfolio is the Colonial Pipeline, which connects the US refinery region of the Gulf Coast with customers serving communities and businesses throughout the South and Eastern US. Every day, Colonial delivers more than 100 million gallons of gasoline, home heating oil, aviation fuel, and other refined petroleum products, collectively accounting for over 50 percent of all refined products transported on the East Coast. Determined to proactively manage the pipeline's energy consumption and reduce its emissions footprint, we worked with management to:

- Add coatings and other additives to the refined product to reduce drag, therefore reducing the power required to move the product,
- Install solar panels at pump stations to reduce reliance on grid electricity,
- Build solar farms along the pipeline's physical footprint to power booster pump stations.

These types of stories are common across our infrastructure investments. By understanding where the emissions in our portfolio come from, we are able to go in and identify ways to reduce emissions or improve energy efficiency.

While understanding the impact our assets have on climate change is important, it is also necessary to understand the risks that exist to our portfolio from the threat of climate change. In assessing these risks, we have adopted the International Energy Agency's 450 Scenario, which describes how energy demand would change in a world where global warming is limited to 2 degrees by 2100. The specific changes are what you would expect—demand for fossil fuels will decline while demand for renewables and nuclear will increase. This shift is already well under way, but more work is still needed to understand the investment-related risks, both physical and transitional, of moving to a carbon-constrained future.

To evaluate these risks, we have developed a framework similar to the Task Force on Climate-Related Financial Disclosures (TCFD) to proactively identify those assets that may be positively or negatively impacted by climate change. This framework allows



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us to decide when and to what extent we need to engage with management to reduce a company's reliance on fossil fuels or to improve energy efficiency.

Our investment portfolio includes multiple toll roads that are actively thinking about the future impact of climate change and integrating that thinking into the design and execution of projects. For example, one road has adjusted the way its tunnel ventilation system works during less congested periods, thereby reducing emissions and its energy bill. Another road is installing electric vehicle charging stations to ensure that the changing nature of automotive transportation—shifting from gasoline-powered cars to electric-powered autonomous vehicles—does not impact traffic on the road. Both of these projects were supported by qualitative and quantitative data about each toll road's energy needs and impact, allowing us to work with management to identify a potential solution.

This is a start, but more data on emissions is still needed. To get an even more holistic view of our financed emissions, we would also need to find a way to reliably calculate supply chain and scope 3 emissions. The bulk of carbon emissions are in the supply chain of each asset—not at the asset itself. By working with management teams and our investment partners, we can influence the emission profiles of our assets' customers by continually improving how our assets operate. This is particularly important, for while we take full responsibility for managing our scope 1 and scope 2 emissions, even the smallest reduction we can help achieve across the rest of the supply chain can dwarf our directly financed emissions.

Transparency = Accountability, Data = Power

Solving a challenge of this scale requires the participation of everyone. Institutional investors thus far have led the fight in

pushing more companies to publish emissions data and environmental impact studies, but there is still a long way to go. Investment managers, particularly those with a stated commitment to responsible investing, have a duty to measure and report on the emissions generated by their investments. While this moral duty is not yet held up to the standard of fiduciary duty, there is a growing acceptance of the idea that asset managers have a responsibility to publish emissions data. It may only be a matter of time before governments turn this into a legal requirement, with any laggards expected to have difficulty maintaining their competitive position.

Transparency helps keep everyone, including the heaviest polluters, accountable for the environmental impact of their business. For investment managers, transparency may be the key to continuing to attract assets, particularly under a responsible investment mandate.

And while no metric is perfect, every piece of information is valuable. The more data that regulators and policymakers have about the source and scale of emissions in the global economy, the better they can make recommendations about how to fight climate change.

The investment management industry is currently sitting on a treasure trove of data that could forever change the conversation around climate change. It's time they dug up that treasure and shared it with the world. ■

The above was first published on 17 May 2018 by Bloomberg Environment under the headline 'Practitioner Insights: How Asset Managers Can Help Fuel the Fight Against Climate Change' - <https://news.bloombergenvironment.com/environment-and-energy/practitioner-insights-how-asset-managers-can-help-fuel-the-fight-against-climate-change>



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