SUSTAINABLE TRENDS

Sustainable Insight
CAPITAL MANAGEMENT

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WHAT'S TRENDING?	SO WHAT?
1 COMING CLEAN *Companies are having to become more open about climate risk*	*More transparency should improve the quality and power of ESG analysis*
2 STEPPING ON THE GAS *A key outcome of the Paris Agreement could be to speed up existing sustainability trends*	*Assumptions about the pace of the shift to a lower carbon economy need to be monitored*
3 ESG FOR ALL *Sustainable investing is moving even more to the mainstream*	*There could be big changes in retail fund flows*
4 BUGGED OUT *Antibiotics are becoming increasingly ineffective*	*Investors need to figure out how companies and sectors will be impacted*
5 PAYING FOR CHEAP LABOR *Businesses' social and governance practices remain under scrutiny*	*Recent developments highlight the need to pay close attention to social factors*

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INVESTORS ASSERT RIGHTS TO KNOW ABOUT CLIMATE RISK

Companies are under mounting pressure to come clean about the potential impact of climate change.

There were further demands last quarter for companies to be more transparent about how climate change and other environmental factors may affect their businesses.

Several of the largest US corporations – including Boeing, General Electric and Procter & Gamble – were accused of failing to adequately disclose the threat to their businesses from rising global temperatures (*subscription required*).

It's a widespread issue. Research firm Influence Map, which analyzed public disclosures by the 20 largest US businesses, claimed current and prospective shareholders of many of them were not being told enough about climate risks to make informed decisions.

Congressman Raúl Grijalva said: "Not including [climate risk] information on SEC filings could provide the public with a skewed vision of the viability of their business."

Many companies are thought to under-represent climate risk

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Bank of England Governor Mark Carney added his voice to the debate, saying that "companies must be more open about their climate change footprint to avoid abrupt changes in asset prices that could destabilize markets."

EXXONMOBIL PROBED

Meanwhile, the New York attorney general is investigating whether ExxonMobil misled shareholders and the public on climate risk, in a case that could set a precedent for action against other companies. At issue is an alleged gap between the oil company's public statements on climate change and its internal research and planning.

As The New Yorker noted, "Exxon had no duty to share with the public the information it gathered about climate change, but it was forbidden to deceive shareholders and potential buyers of its shares." The company says it has always been open about its research.

The litigation may have similarities to that brought against 'Big Tobacco', which eventually resulted in multi-billion-dollar settlements but dragged on for decades.

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> *-The New Yorker*

COAL FIRM TO OPEN UP

Days after launching its ExxonMobil investigation, the New York attorney general settled a similar matter with Peabody Energy, after ruling that the coal company had not been sufficiently transparent with shareholders and regulators about climate-related risks. Peabody has agreed to "make more robust disclosures" about environmental issues. There is no monetary aspect to the settlement.

As reported in Insights 117, the Sustainability Accounting Standards Board (SASB), is close to completing its goal of developing standards across all industries. The final set will be released for public comment early this year. The aim is to develop a standardized way of articulating the material, non-financial risks and opportunities facing companies today. The overarching goal is to give investors 'decision-useful' information.

SUSTAINABLE INSIGHT: MORE POWER TO ESG

An investment process that incorporates robust ESG analysis already reveals much about how environmental factors may impact a company's financial performance.

Nevertheless, corporate disclosures are an important input into ESG ratings and analysis. Greater transparency on climate risks should therefore contribute to ESG data becoming an ever more powerful analytical tool. It should also make it easier for investors to hold management teams to account for what they're doing – or failing to do – in response to climate change.

CLIMATE PACT: WHAT'S NEW?

The main impact of the Paris Agreement may be to accelerate trends that were already in place

Screeds have been written already about what was – and wasn't – included in the final text of the Paris Climate Pact (see box; you can read key point summaries, here, here, and here). President Obama hailed the agreement a potential "turning point for the world". Is it?

AS YOU WERE

It's not a turning point in the near term, according to oil industry executives: they told the Financial Times the deal would not affect their immediate investment choices, which have already been shaped by environmental legislation. In fact, said the Washington Post, the agreement pushes the energy industry in a direction it is already heading – less coal, more natural gas.

And it's more or less as-you-were for now for other industries too, said PwC, arguing the immediate implications for business have not changed. The "sharp end" of the deal will be in the national implementation plans.

SAME ROUTE, BUT FASTER

Though Paris has not set business on a different course, it may have substantially altered the speed of travel. "Analysts have generally expected the clean energy transition to be gradual rather than radical," says the Post - an assumption it thinks can now be called into question.

PARIS AGREEMENT AT A GLANCE

- Sets a limit on global average temperature rise to below 2 °C, with a stretch target of 1.5°C
- Aims for emissions to peak as soon as possible, with a rapid reduction thereafter
- Requires countries to detail their plans to cut emissions further every five years, as well as to monitor and report on their emissions
- Establishes that wealthy countries will provide finances to help poorer ones adapt to climate change and switch to renewables

> ***[The agreement] pushes the energy industry in a direction it is already heading – less coal, more natural gas.***
>
> *-The Washington Post*

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CAPITAL FLOWS TO LOW-CARBON

There is widespread conjecture that the biggest near- to medium-term impact could be to spur capital flows to low-carbon technologies, because of growing confidence in the outlook for these sectors. "Investors can accelerate capital market responses that address carbon risks at levels not seen before," said giant US pension fund CalSTRS.

But as other developments last quarter highlight, investors should be careful in assuming that any industry represents a one-way bet. For one thing, state backing for low-carbon schemes can never be taken for granted: the UK government has cancelled a £1 billion competition for carbon capture storage and slashed its subsidies on domestic solar panels by over 60%.

SUSTAINABLE INSIGHT: BEWARE THE UNKNOWNS

Getting nearly 200 nations to agree to a deal was a remarkable achievement, but COP21 was only ever going to be one step in a long journey. There are many known unknowns (to say nothing of the unknown unknowns): Will governments stick to non-binding targets? How will plans be implemented nationally? Will they be effective? In investing, there's no such thing as a sure thing.

Nevertheless, the Paris Pact confirms what sustainable investors already knew: that one way or another climate change will increasingly force all of us to do things differently, including investment analysis.

PARIS IN FIVE TEMPERATURES

5: Projected rise in global average temperature if no action is taken

2: Targeted limit above pre-industrial times for global average temperature

1.5: Aspirational target set by Paris Climate Pact

2.7: Lower end of range of projected global warming based on current national plans

1: Degree Fahreneit rise in global average temperature expected this year, the highest ever

ESG GAINS FURTHER MOMENTUM

The move toward incorporating ESG factors in investment processes continues to strengthen

There was further confirmation this quarter that ESG is moving to the mainstream – driven, among other factors, by retail investor demand for better insights into funds' sustainability characteristics.

Morningstar is to launch the world's first ESG scores for global mutual and exchange-traded funds. Investors will be able to compare global funds' ESG ratings relative to benchmarks and over time. They'll also be able to see individual scores for each of the three pillars (E, S and G). The rankings will enable "investors to put their money to work in ways that are meaningful to them," Morningstar says.

Meanwhile, French public authorities are backing a new SRI quality label for investment funds. The idea is to give investors and the general public better insights into the way funds integrate environmental, social and governance factors into their investment processes.

It isn't only retail investors that are pushing ESG to the fore. As we reported in Insights 112, Japan's $1.2 trillion Government Pension Investment Fund (GPIF) has signed up to the United Nations-supported Principles for Responsible Investment (PRI), which require signatories to consider ESG factors. GPIF is expected to ask its external managers whether they are also signed up. Other Japanese institutional investors are likely to follow suit.

There are now 1,440 signatories to the PRI, representing USD 59 trillion of assets under management.

SUSTAINABLE INSIGHT: DEVIL IN THE DETAILS

A fund-level ranking is likely to be of only limited use to an investor. As our paper on VW showed, it's necessary to drill down to the details to obtain investable insights from ESG scores. Nevertheless, it's encouraging to see further efforts to address growing demand from the general investing public for better insights into the environmental, social and governance characteristics of investment products. As ESG analysis grows more sophisticated, it'll be crucial to make sure that ESG data is communicated to non-specialists in a simple, clear and useful way.

MEDICINE, BUT NOT AS WE KNOW IT

Recent evidence suggests the post-antibiotic era may be closer than thought, bringing with it profound economic and social consequences

The post-antibiotic era may already have dawned. It emerged this quarter that scientists have discovered bacteria that are resistant to colistin, the so-called 'antibiotic of last resort'. Antimicrobial-resistance is already killing more than 40,000 people a year in the US and Europe. Some estimates put the number higher.

Recognizing the threat to global growth, the G-20 committed at its November meeting to put the issue on the agenda at its next get-together. Left unchecked, by 2050 antimicrobial resistance is forecast to rack up a cumulative cost of $100 trillion, more than 1.5 times current annual world GDP, and could be taking the lives of an additional 10 million people a year.

Antibiotics are central to so many aspects of modern healthcare that if they become ineffective "medicine as we currently practise it will not be practised," an academic for Antibiotic Research UK told the BBC. And as a senior health officer at the Natural Resources Defense Council (NRDC) said in December, that would mean that "more than a few billion-dollar health companies may have to rethink their business models."

Modern farming will also likely have to change, as the widespread use of antibiotics in intensive animal rearing is a primary cause of accelerating antimicrobial resistance. The US Food and Drug Administration reported last month that the volume of medically important antibiotics given to livestock continues to rise. Some 96% of the drugs administered to farm animals in 2014 were used in feed and water – i.e. for preventative reasons, rather than to treat sick animals.

Amid all the concern, at least one optimistic note was sounded last quarter. Economist Jim O'Neill, Chairman of the Review on Antimicrobial Resistance, said superbugs "can be beaten with political leadership, some global coordination, and without breaking the bank." O'Neill said a two-pronged approach is needed: put a stop to the overuse and misuse of antibiotics; and create better financial incentives to develop new drugs. The latter would cost the world a fairly modest USD 2 billion, far less than the current cost of dealing with the problems caused by growing antibiotic resistance.

SUSTAINABLE INSIGHT: BEWARE THE UNKNOWNS

Antimicrobial resistance has been likened to climate change. It's an appropriate comparison, because it is likely to have profound economic and social implications. A world where a scratch can kill will be very different to the one we live in today. For investors, this is not just a healthcare issue. From the insurance industry to the travel sector, a wide range of businesses would be significantly impacted.

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EXTRA: THE HIDDEN COSTS OF CHEAP LABOR

Developments this quarter again highlight the need to pay close attention to how well companies are addressing social and governance issues

In Insights 120 we noted the potential for poor labor relations to affect company performance, reporting that the garment industry in Asia has been shaken by unrest over working conditions and low wages.

Last quarter, Sweden-based fashion retailer H&M – which sources most of its clothes from suppliers based in Asia – took action to address the problem. The company has been criticized previously for staff conditions at the businesses that make its garments.

In partnership with IndustriALL Global Union, H&M is setting up a program to train its suppliers and their workers in issues such as negotiating wages and working conditions. The idea is to "achieve functioning labour market relations in these countries," the company said.

Labor relations are not only an issue of concern in the developing world. Shares in UK clothes retailer SportsDirect fell more than 10% in a day in December, following newspaper revelations about pay and working conditions at its north of England factory. "If you're not looking after your staff it will hit the share price in the end," said a disgruntled major shareholder in the company, which has since launched a review of its labor policies and practices.

The SportsDirect case comes as UK regulators seek to put more pressure on asset managers to engage with companies on governance issues, such as pay, succession and audit quality. From next June, the Financial Reporting Council will name and shame fund management companies that fail to live up to the spirit of the UK's stewardship code.

As Reuters reported, "some 300 asset managers have already signed up [to the code] but the degree of improvement in fund manager engagement in companies has been variable and not always evident to investors."

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THIS QUARTER BY THE NUMBERS...

ENVIRONMENTAL

2019
is the date by which China is to ban any new coal mines, while output of existing operations will be cut.

650
billion US dollars is the forecasted amount of government fossil-fuel subsidies this year.

140
Fahrenheit is the peak summer temperature expected by 2100 in the oil-rich desert kingdoms of the Gulf (creating "intolerable conditions") if action is not taken to combat climate change.

10
billion US dollars of earnings risk to the world's largest mining companies is forecasted by CDP.

3.3
trillion US dollars is the estimated cost to the environment of industrialized farming practices calculated by Trucost.

SOCIAL

70,000
There are this many ways to get sick, hurt or mortally injured in the US.

757
million is the estimated number of illiterate people in the world.

8
million Swedish Krona is the monetary value of the 2015 Nobel Prize for Medicine jointly awarded for the treatment of parasites and malaria.

10
million is the forecast for the number of people who will die from drug-resistant infections by 2050 (*subscription required*).

1.2
billion people could lose food security in India given sea level rise, water security and agricultural impacts.

GOVERNANCE

240
billion US dollars is the upper estimate for global revenue losses from corporates moving profits across borders (USD 100bn is the low estimate).

40
years or more is the estimate for women to reach boardroom parity, says the US Government Accountability Office.

4
out of 5 SEC commissioners could be women, if nominations are confirmed by the Senate.

QUOTE OF THE QUARTER

"It became increasingly uncomfortable to be fighting global warming on the one hand [through our charitable grants] and then investing in businesses that cause global warming."

–Rockefeller Brothers Fund President Stephen Heintz reflecting on the Fund's decision to exit fossil fuels one year ago

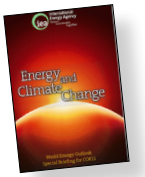
QUARTER 4 READING LIST

EY
Tomorrow's Investment Rules 2.0
(link)

CDP, UNEP Finance Initiative
From Disclosure to Action: The First Annual Portfolio Decarbonisation Report (link)

Merrill Lynch
Impact Investing: The Performance Realities
(link)

Cambridge Associates
Risks and Opportunities From the Changing Climate: Playbook for the Truly Long-Term Investor
(link)



EIA
World Energy Outlook 2015
(link)