SUSTAINABLE PERSPECTIVE

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# Will Catholics become the new guardians of the environment?

## The Pope Prepares the Ground

Pope Francis, as the leader of the 1.2 billion worldwide Catholic Church, attracts considerable media attention. His statements carry great weight in many global communities. Pope Francis has made a number of references about the importance of the environment and climate change since his election in March 2013. On his recent visit to the Philippines he urged listeners to show *'concern for the environment'*.[1] Lately, he has commented at a press conference, *'We have, in a sense, lorded it over nature… over Mother Earth…I think man has gone too far'*.[2] He has left listeners in no doubt about his determination to do his best to encourage the signing of a climate change treaty which he views as *'a grave ethical and moral responsibility'.* [3]

More detailed insights into the Pope's thinking on the environment will emerge, although the exact timing is not public. What is understood is that an encyclical (circular) on climate change will be released in time to influence 'crucial decisions' of this topic.[4] Mid-year is viewed as the most likely timing. There are three headline conferences on this topic planned this year. In late June, the UN General Assembly is convening a climate change summit in New York. In September, the UN intends to agree an agenda for the Sustainable Development Goals in the 21st Century (SD21).

Later, in December, the United Nations Framework Convention on Climate Change (UNFCC) meets in Paris (see Sustainable Insights 2015 Predictions[5]). Furthermore, the Pope intends to convene a meeting with the world's main faiths to discuss ecology and climate change. It is clear that the Pope feels strongly about this issue and is prepared to stand front stage, recently evidenced by the revelation of discussions between the US Environmental Protection Agency and Vatican officials.[6]

## Financial Considerations for Catholic Institutions

As Catholic institutions reflect on the Pope's messages, what are the main issues they may wish to consider when examining their investments? In this paper, we will examine the issue of the environment and climate change only. We have identified three main considerations:

**1** - Clearly define the terms of the investment mandate.
**2** - Determine how the investment process will be run.
**3** - Demand the delivery of transparent reporting.

## 1 Define the Investment Mandate

One of the most persistent environmental issues is that of climate change. The first UN Climate Change Conference took place in Berlin in 1995. The latest one, held in Lima[7] last December, was the 21st such meeting. Closely linked to climate change is the role that fossil fuels play in influencing global temperatures. This has led to a growing number of anti-fossil fuel campaigns, which encourage either the sale of fossil fuels stocks (divestment) or discussions with the management of fossil fuel companies to change their practices (engagement).

Creating an investment portfolio without fossil fuels is a fairly simple request once the definition of 'ex-fossil fuel' is fixed. As a minimum it appears that the Asset Owner will require the exclusion of oil & gas companies as well as coal stocks. As of 31 December 2014, this would have resulted in the exclusion of 9% of the S&P 500 Index by market cap weighting. However, another asset owner may wish to exclude users of fossil fuels as well, such as coal-fired power stations, fertilizer companies or automakers.

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This would cause exclusions to have risen to nearly 17% of the S&P 500 Index, by weighting. However, some Asset Owners may not wish to adopt an exclusionary approach and opt for a theme-based approach instead. For example, an environmental fund could opt to invest in renewable energy investments only. It may invest in only pollution prevention technologies or green real estate opportunities. The bewildering choice of environmental products available will quickly narrow once the Asset Owner has clearly defined the requirements. (A more detailed analysis of fossil fuel free investing is available – 'The Risks and Returns of Fossil Fuel Free Investing'.[8])

## 2 Understand the Investment Process

When the mandate has been defined, the Asset Owner needs to understand the investment process used by the Asset Manager. The negative screen is simply the exclusion of various stocks or sectors or countries or a combination of these. This process is often criticized for its simplicity, but the attraction is its clarity. The Asset Owner is reassured that certain stocks will never be owned.

More complex is a 'best-in-class' approach whereby those fossil fuel companies which are attempting to change – for example, by investing in renewable energy – may be purchased. However, such approaches afford the Asset Manager a higher level of discretion. For example, is a best-in-class renewable company one which has started investing in this activity or one which is showing the most rapid growth? In both of these instances the company may hold sizeable fossil fuel interests. Or should it simply target the largest renewable corporations? Similar diligence is required when investing in thematic funds, as there are often no firm exclusions in place. Peter Lynch provides valuable guidance here, *'You have to know what you own and why you own it'*.

## 3 Demand Transparent Reporting

Before awarding an Asset Manager any mandate, the Asset Owner should request and carefully scrutinize the investment reports they are likely to receive in the future. It may appear strange to be demanding reports prior to the awarding of a mandate, but this is important.

Transparent investment reporting should provide a valuable insight into the measures the investment firm has in place and hence provide a guide as to what the investment manager focuses on in terms of product delivery. For example, are agreed exclusions always in place? Does the report provide evidence that the investment process, agreed to during the manager selection process, is being consistently followed? Are the risk and return outcomes in line with expectations? Is performance hidden away and/or inadequately explained? Both underperformance and outperformance against expectations warrant a clear analysis.

A recent report released by sixteen of the UK's largest pension funds provides a guide to assist Asset Managers on delivering on responsible investment assurances.[9] The Lead Editor, Daniel Ingram, stated, '*What asset managers tell us they are going to do in terms of responsible investment when they pitch for our business and what they actually deliver can be very differen*t'.[10]

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