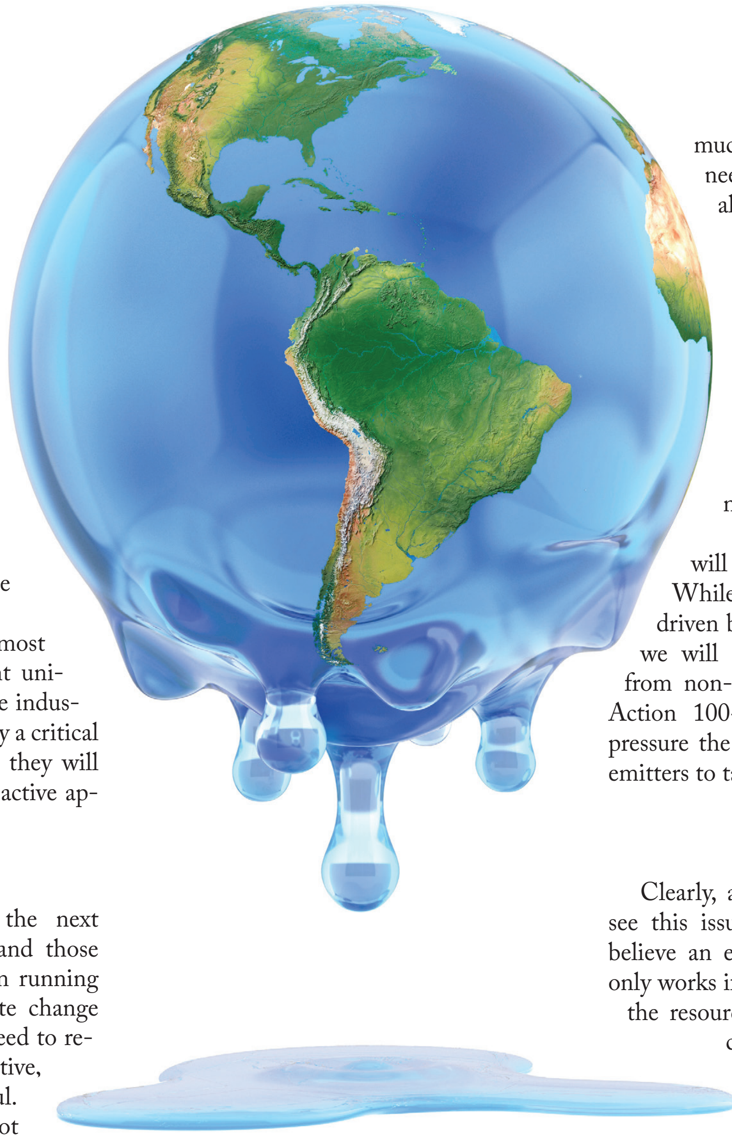
Why Asset Managers Cannot Be Passive On Climate Change



BY: **DAVID CUMMING**

The United Nations warns we are approaching the "point of no return on climate change." Scientists describe it as an "existential threat to humanity." And yet, the lack of urgency by governments and many parts of the private sector – including some of the largest financial institutions belatedly talking up their own credentials – threatens the most catastrophic failure in the history of free-market capitalism.

Climate change is causing the most significant shift in the investment universe I have seen in 35 years in the industry. But if asset managers are to play a critical role in the response to the crisis, they will have to adopt a more radical and active approach.

Next Generation

Our customers, particularly the next generation coming into money, and those that will replace my generation in running money, increasingly regard climate change as the biggest global threat. We need to respond in a manner that is substantive, authentic, informed, and impactful. This means focusing on actions, not excuses; outcomes, not intentions. Failing to do so will hurt firms' reputations, their businesses, and their ability to attract talent.

To create impactful outcomes, we need to understand the problem and agree on objectives. The threat of rising temperatures is well understood – mass extinctions, mass migration, flooding, and environmental destruction. Given the consequences, investors cannot wait for governments to respond. We have to start redeploying capital now to find solutions and address the risks.

The obvious template for solutions is the 2015 Paris Agreement, which seeks to limit the increase in global temperature this century to well below 2°C above pre-industrial levels, and to pursue efforts to limit the increase even further to 1.5°C. Investors should recognize we are nowhere near these levels currently: the FTSE 100, for example, is on course to burn the planet at 3.9 C.

Our focus is to put pressure on companies and governments to enact policies that will deliver these objectives. We need to be direct and visible in representing our views and communicate our position to customers.

In the equity business, combining the climate expertise of responsible investment teams with the financial, sector, and company knowledge of portfolio managers will be critical in driving a positive corporate response. But while we were one of the first managers to integrate sustainability factors, including climate change, into our voting policy in 2001, our engagement needs to change. This will now be led by our equity team, fully supported by our responsible investment colleagues.

Rather than engaging mainly with boards in an effort to get climate change on a company's agenda, discussions with chief executives, chief financial officers and their executive teams need to be prioritize. If we want companies we invest in to take the necessary actions on capital expenditure, innovation and repositioning assets, we must communicate with their senior management and hold them directly accountable.

Climate change needs to be a key agenda item in company engagements. Climate needs to be included in every discussion, built around the need for companies to adopt science-based targets. While many companies are setting emissions reduction targets and other environmental measures, we are long past being satisfied with symbolic gestures.

We need to want to know whether a company's ambitions and targets are sufficiently progressive to create the necessary outcomes to tackle the climate emergency. The use of science-based targets is an independently verifiable approach that specifies by how much and how quickly companies need to reduce carbon emissions to align with the Paris targets.

There will be consequences for those that do not meet expectations. We will vote against directors of companies in high- and medium-impact sectors that are climate laggards and against directors of companies in the Climate Action 100+ that have not committed to science-based targets.

How companies react this year will determine our actions in 2021: While our approach has always been driven by engagement over divestment, we will consider shifting capital away from non-responsive companies. Climate Action 100+ is an investor initiative to pressure the world's largest greenhouse-gas emitters to take action on climate change.

Certain Lens

Clearly, as an active asset manager, we see this issue through a certain lens. We believe an engagement approach like ours only works if you have the climate expertise, the resources, and proven influence with company decision-makers. Passive managers cannot deliver on these pre-conditions. They track indices that are algorithms of the past, supporting existing business models, and ignoring the massive future business impact of climate change.

Passive managers often have tens of thousands of holdings but limited research coverage; their engagement, therefore, takes place at a superficial level. They lack connectivity with the core reality of a business and are not equipped to evaluate the credibility of corporate responses. Passive investors' poor record on voting on climate-related shareholder proposals supports this view. As a result, there is limited incentive for companies to engage with passive managers on this issue.

Climate change has changed everything. Investment objectives now have to include responsible values and actions, in addition to financial returns. We have to respond by engaging in a different way and by taking decisive action when the companies we invest in don't. We cannot be passive in the face of climate change. We have to be active. **BPM**

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