

# Climate action

Expectations continue to rise, **what is next?**

**Featuring:**

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The bar for credible action on climate change is set higher and higher. At the recent UBS Sustainable Finance Conference a UBS-AM expert panel explored how corporates, investors and governments can prepare to face evolving expectations. And asked: what does successful collaboration look like?

**Lucy**

The science of climate change is evolving rapidly and the expectations and benchmarks are continuously being reset in terms of what good climate action looks like for corporates, for governments and for investors.

All are facing these different pressures, different expectations, both within their organizations and outside their organizations. Today, we want to focus on how the expectation for investors has shifted on climate action and where are the leaders going and how can we be prepared.

Where can investors have the maximum impact and how do you measure that impact? Investors are clearly being held to this higher standard on climate action and this expectation is coming from many corners, policymakers, clients, employees and actors like ShareAction, who are holding investors to account.

From the perspective of an asset manager, how do you use the feedback from interactions with stakeholders to inform your own strategy on climate action, and where do you anticipate climate action leadership to move in the future? How can investors drive the right policy-making environment when it comes to climate?

**Stewardship, engagement and voting**

**Karlijn**

Investors are being held to a higher standard on climate action. In order to realize the Paris Agreement goals, the world needs to move toward halving our carbon footprint by 2030 and net zero emissions in 2050. As investors, we need take responsibility and walk the talk, we need to mitigate the climate risk in our portfolios and bring them in line with the Paris Agreement goals. All actors, all sectors, all companies need to move and so do investors.

We need to focus on the effectiveness of sustainable investing policies to make real economy impact, and that is why engagement is such a powerful tool. Using the influence you have as a shareholder and the way you vote can be really powerful to push companies in the right direction, toward a 1.5° pathway.

At BMO we have a very robust net zero engagement program in place. We know exactly what we expect from the companies we invest in, such as utilities, oil and gas or automotive. We have clear asks for each sector, for how they perform against apparent alliance sector paths. We compare companies. We know which ones are the laggards and the ones that are best in class.

We look at things like short-term and long-term goals, how capital expenditure is aligned with climate strategies, and what their lobbying activities look like. Is there relaxed or strong board oversight? Their climate risk accounting and issues like transition. The social component is also very important. I think these metrics and the way we have the conversation with the companies we invest in enable us to have impact.

### **Lucy**

What I hear is a real emphasis on specific asks and objectives and metrics used in corporate engagement to advance the agenda: moving beyond just commitments and moving more towards the action and the progress on that action.

For context, of collective climate initiatives, Climate Action 100+ is the largest I'm aware of that's out there, launched in 2017, with the goal of influencing some of the highest Greenhouse Gas (GHG) emitters and making progress towards climate action. Isobel recently authored a report looking at the progress of investors.

In some ways, you're assessing the assessors, and you found that climate engagement strategies and reporting are often, in your words, inadequately articulated, inconsistent and vague.

We'd love to hear your biggest takeaways from the analysis, your sense of what investors should and need to be doing in terms of focusing their energies, and what that means for how corporates might interpret that.

### **Isobel**

We assessed 60 of the largest CA 100+ invested participants on their climate engagement and reporting. My takeaway was there is very little evidence that suggests these largest participants in CA 100+ are meeting the challenge of climate change through engagements and taking the necessary action to reduce emissions from investee companies across their portfolio.

To go through a few stats to give some color to this, we found that over 80% did not specify objectives for climate engagements. Over 80%-82% did not specify escalation steps for unsuccessful engagements. And 83% did not report on the progress of engagements that they're undertaking. Finally, over 90% did not clearly identify the CA 100+ focus companies that they were responsible for leading and driving engagement.

Having said that, we definitely did see a pockets of good or leading practice in our assessments.

When you talk about what investors need to be doing, we see the leaders setting smart objectives for climate change engagements. That is, objectives that are specific, measurable, actionable, relevant and time-bound.

And crucially, they're developing escalation strategies to really back up these expectations, so that they can take action when companies aren't meeting them. When we talk about escalating to trustees, that includes extraordinary meetings and letters to the boards of companies, voting against management at AGMs, filing shareholder resolutions and, ultimately, public divestments.

In terms of what companies can expect, we'd love to see more investors taking the CA 100+ net zero company benchmark, and feeding that into their engagements with companies in a very systematic and collaborative way, pushing those expectations forward with other investors.

### **Escalation and transparency**

#### **Lucy**

I'm interested in what some of those escalation strategies could look like. Some in the industry are believe that voting in favor of all climate resolutions isn't necessarily moving the dial or taking things forward, because some of the resolutions are worded in a way that are asking for action that either companies already have in place, or aren't specific, or aren't practically achievable.

Now, there are plenty of resolutions that are very worthy of supporting. I'm curious on your take on how important supporting all resolutions is vs. finding the right balance between a sensible, well-worded resolution and ask to a company in a timely and practical manner that can really be actionable from the corporate perspective?

#### **Isobel**

What we advocate is for investors to explain their approach to voting on shareholder proposals. They should have a default position to support shareholder proposals that advance initiative objectives.

But as you say, there are some resolutions out there that investors, for whatever reason, might feel they're not able to support. Maybe it's a specific part of the wording. Maybe they don't think it's practical for the company to implement. In that case, you can vote against it, but you should be explaining the rationale for why you have voted against.

There are also many other things that investors can do to signal disapproval with the company. If you're not voting for a specific shareholder resolution on climate action, but you still think the company has areas to improve in, you can take other actions, such as voting against management proposals or pre-declaring, but with the caveat that you'd like to see the company improve on XYZ in the next year, or otherwise revisit voting against the next year.

#### **Lucy**

You describe the whole gamut of what's available to an investor in its ownership rights and stewardship, rather than necessarily just a blunt vote. Transparency in the decisions taken, and reporting on those decisions and other escalation methods, should they be required?

I'm curious whether and how you shared the findings of the report with CA 100+ and what was the response? Where are they sitting on understanding progress and moving forward?

#### **Isobel**

I think it's important to note that there is no single entity that is CA 100+, but we have, of course, shared the report with the coordinating networks and the steering committee for CA 100+. And so far, we've only had positive reactions and constructive dialogue with them.

I have a lot of sympathy for the fact that the coordinating networks are just that. They are not themselves investors. They don't have shareholder influence over the focus companies, only the investor signatories do.

To that extent, CA 100+ can only move as fast as its investor participants move. Having said that, in the report, we do highlight some recommendations that we hope CA 100+ could consider adopting that we think could really bolster engagements undertaken through the initiative as it ends its first five-year phase and looks forward towards the second phase of the initiative, which we think is a really exciting and a very key opportunity to drive up standards of engagements from its investor signatories.

#### **Karlijn**

Maybe I can share some light from the asset management perspective. I think this is such an essential point, to have an escalation roadmap in place when we think that climate progress of the company is not sufficient.

In 2022, we did that for 2,268 management proposals, where we voted against an appointment or board member to really give power to the vision we have, the perspective that we have on the climate performance of a company.

The final stop in that escalation road map is to consider to divest. But before you'd do that, you'd really try to use all influence that you have to have another conversation, to vote against, to explain why you voted against. And that often opens the conversation again, so divestment is the last resort.

But of course, when you're no longer a shareholder, you know that you'll have no influence going forward.

#### **Lucy**

This understanding is that there are multiple levers in a in a stewardship toolbox and, and divestment is one of those, but often, as the last resort, when all other strategies have been exhausted. Because a seat at the table does continue to give a degree of influence and hopefully more constructive dialogue for change.

Maybe we could turn to the topic of reporting and the inconsistency in reporting, whether that's from corporates or from investors, around climate. In particular, we're seeing more regulation being introduced, which may standardize reporting to some extent.

We have EU Taxonomy. We have the US's SEC proposed rules on climate. We have the ISSB (International Sustainability Standards Board) under the IFRS (International Financial Reporting Standards) umbrella, with the climate guidance and consultation that's been put out over the last few months.

Is there any flip side to this regulation? Could this scrutiny reduce our ambition, or stall the pace of change at all in your view? And how might that play out?

#### **Karlijn**

I don't think it will stop the innovation that we have in the sector. Investors take a lot of initiative, are intrinsically motivated. I think it's important that the approach the investor chooses is granular and is based on deep knowledge.

The point of transparency is very important. It has always been. Yes, the legislation is going to take a lot of capacity in a way. It is complex. It is challenging to comply with. But I think it's a good thing that there will be more clarity on the type of investments there are, the types of portfolios that exist, and whether its an Article-8 or an Article-9. I think it is important for asset owners to distinguish and to really be aware of what kind of portfolio they are looking at? And does it suit their investment beliefs and mirror the sustainability values that are important to them.

I don't think the innovation, the dedication we see in the industry, will be slowed down by these kinds of initiatives.

### **Isobel**

Increased transparency is generally a good thing. It helps clients and other stakeholders to assess how well an investor is living up to their expectations on climate action. More transparency means more accountability, but increased transparency does also mean more capacity is necessary to fulfil those obligations.

ShareAction has just released a best practice engagement reporting template, which we hope helps demonstrate leading practice to investors, and can help inform their reporting.

Where investors might be concerned that regulation would be regressive, they also have influence they can put out there. We like to see investors engaging with policymakers where they think sustainable finance regulation might be hampering efforts on ESG and responsible investment.

### **Lucy**

This is a really important point: the role investors have in shaping the system in which we all operate. Our financial system, our economic system, and indeed, our societal system: how we think about engagement and stewardship running into the policy advocacy space and some of these convened networks and initiatives that we have on climate, and how we use those most effectively.

### **Impact, frameworks and measurement**

#### **Lucy**

Nalini, we haven't had a chance to hear from your side. And one of the things that I find exciting at the moment is how we have seen the investment industry move up the spectrum toward sustainable investing and impact investing, and how within the philanthropic space there are more creative solutions being thought about, from a financial perspective, on how to achieve that impact, on how to scale impact.

When it comes to defining impact in the climate arena, specifically, does it go beyond emissions reduction? What do you think about, sitting on the philanthropic side, and given the types of donors you deal with, when it comes to measuring impact?

#### **Nalini**

Impact, obviously, is a very hot topic. And it was the topic of the white paper published by the UBS Sustainability and Impact Institute, where you had a framework called the "Define. Align. Refine." that combined the best principles of both impact investing and strategic philanthropy.

But when it comes to impact measurement, the principles, which I call universal principles, are applicable for climate change measurement, just as well as it would apply for health, education or any other sector. These boil down to five things.

The first is having a clear vision of what that impact is or what the change that you want to achieve is. When it comes to climate change, within the work of the foundation, we go well beyond carbon emissions or reduction in carbon emissions or sequestration of carbon to including biodiversity outcomes.

This includes protection of native species of plants and animals, avoiding their extinction, and also, most importantly, community-based outcomes.

Often we are working to protect, restore and conserve forests which are on land belonging to indigenous communities. So seeing the benefits to communities in the form of livelihoods, improvements in health and nutrition, and so on, is critical.

The second principle is how you are going to achieve the change is just as important. And in the development sector we call this theory of change.

This is the link between your activities to outputs, to outcomes, to impact. And that is very important, alongside the risks and assumptions you're making in order to realize that impact. So having that chain mapped out right from the very beginning is key.

The third is mapping your data system against that theory of change, and these are some of the indicators we call a smart indicators. But you've got to be very careful, and very specific from the beginning.

You need to know who's going to collect that data? How often are you going to report on that data? So that you're asking the right questions at the right time. For instance, sometimes when we have investments our clients want to know within six months of the program how much carbon has been sequestered. That's the wrong question, because these things take a lot of time. You have to ask the right questions and have proper baselines, and so on. That system is fundamental and crucial.

The fourth principle is, particularly with climate programs, independent verification and evaluation of the outcomes. This is key. There are a few auditors, a few agencies, that do this. But engaging them from the very beginning is critical, so that you have the proper baselines.

There are three things that are critical that need to be established when you're doing independent verifications.

- One is you want to ensure what we call this causality or attribution. You want to have a reasonable way, a strong hypothesis that's linking the activities that you are engaged in to the outcome.
- The second is the additionality. Would this change have happened anyway? That's crucial. Because often, you can document change. But is this better, or how different is it from business as usual?
- And the last are the externalities. Are there unanticipated consequences that have resulted because of the project? There has been a lot of criticism, particularly in the carbon offsetting and the carbon market field. If you are conserving and protecting forests in one area, has it actually been displaced to another region or location. You want to make sure you are tracking these externalities, as well.

The fifth principle is feedback and feedforward. The feedback is about using that data. What are the consequences of the data? You may have really good data, but that good data needs to be acted upon. For instance, if you're not realizing the impact, if you're not really seeing some of the changes, what are the course corrections that need to be made? That feedback is really important.

The correct stakeholders, the communities, the beneficiaries, they all need to be involved in that process in order to feed forward. How are you going to use this data to then predict going forward. Often the risk is partners, often our grantees, have lots of data, but they don't know what to do with the data. I always say it's better to be roughly right than precisely wrong.

The Optimus Foundation is particularly well known for what's called social finance, the blended finance approach. And we've done some of this in other spheres, like health and education. The basic principle is actually there is upfront investment, what we call risk capital, that is put forth by philanthropists, then based on the achievement of outcomes, there are outcome funders who repay this capital back.

It's judged on the basis of outcomes that are achieved. And the financial returns might be very minimal. But it's really the social returns that are privileged. And here, some of the benchmarks, in terms of measurement, really come into play.

Let me give you an example of what this might look like. We are, exploring an opportunity in the Gola Rainforest in West Africa, that borders Liberia and Sierra Leone. And in Sierra Leone, over the past 10 years, there has been the first REDD+ project. For REDD, it's reducing emissions from forests, degradation of forests and deforestation.

The plus element is about sustainably managing these forests and enhancing the carbon stocks in these forests. Over the past seven years, there has been a lot of investment in the Gola Rainforest in the Sierra Leone region. And you have Verra carbon standard that has been verified, that it has actually benefited the communities, in terms of a number of SDGs. It has also restored the sequestered carbon reduced emissions. And it provides a great pilot for us to bring in philanthropic investment.

We want to now take this and replicate it in a neighboring region in Liberia. The Sierra Leone project has also realized \$6 million in carbon credits over five years of sales. We want to make sure that we can replicate this and invest the philanthropic capital.

There are other financial institutions who are keen to come in and invest possibly as outcome funders. This is the way we take it to scale, meeting all of the standards of impact measurement.

## **Policy and advocacy**

### **Lucy**

Turning to policy. How do you think about fostering the right policy environments? In these real, tangible, on the ground projects that you want to see take shape and have real impact? What kind of efforts do you put in place around policy?

### **Nalini**

We often take what we call a systems approach, meaning working with communities. We also work closely with the

investors, our philanthropists. We often engage them in some of the programs and learning. We also work with the markets, the carbon markets, for instance. There is a future in terms of sustainability, particularly financially, in markets. And an important element of the system is the government. For a government is not a monolithic or a homogeneous entity. You have various levels of government, from community leaders working with communities, to provincial authorities and local authorities and, ultimately, national government.

Involving them right from the very beginning is critical. For them to become active and actually collaborate with us is key, so they see the value for them in the long term. Ultimately, we look to find champions at each of the levels, at the local level or at the national level to advocate for what we're doing, so that ultimately, over time, what you are supporting gets integrated into policies.

In many countries, policies exist. For example, we work in the Mekong region in Vietnam, and 60% of their public land has to be forest cover. But often, it's aspirational, and they need support implementing those policies. So sometimes our partnership is about taking those policies, and seeing how communities can benefit from them, offering advocacy by working very closely with communities and building that capacity. In a nutshell, that's how we engage, particularly when it comes to policymakers.

### **Lucy**

Karlijn, turning to you from a policy perspective, as a fund manager, what do you see as important to create the right policy environment, and how does that impact how you approach things at BMO?

### **Karlijn**

Policy engagement is actually quite important. Investors and governments, each have their own responsibility to act swiftly and boldly. And we've seen more investors than ever before implementing net zero goals and strategies into their investment decisions and portfolios. We have our net zero approach in place.

In that way investors encourage companies to cut their emissions. We also see investors calling on policymakers to really deliver on robust climate action. And I think investors can actually be a key influence on policymakers. Policy engagement by long-term investors is an important element in the toolkit of capabilities and responsibilities.

I think policymakers need to really make sure that a policy framework is about fostering or supporting investment in low carbon assets, but it should also be about investing in adaptation. We should not only focus on climate risk, but also looking at what we need in terms of adaptation and the measures there. So, that should also be something that governments look into to enable investors to help enable a just transition, to protect communities and workers.

We saw this in the run-up to COP 26 in Glasgow. We saw investors asking governments to step up the game. There was an investor letter that was signed by an enormous amount of investors, and it actually called on governments to do at least three things.

One was to strengthen the action plans of governments on the nationally determined contributions (NDCs) and to make them tangible, and to make sure they are aligned with the 1.5° trajectory.

The second was to commit to a domestic 2050 net zero emissions target and to outline a pathway with ambitious interim targets. Because many companies and sectors are looking to their governments and expecting some guidance on what those sector pathways should look like and what the intermediate pathways should be.

And the third was about incentivizing private investments into net zero emissions. I think that it's both fascinating and really important that investors urge governments to step up the collective response to the climate crisis.

### **Lucy**

Having previously sat in a sovereign wealth fund, I understand the power of being on the receiving end of those letters to government-related entities. The collective voice, and the articulation of some very clear asks was quite powerful for mobilizing action in a situation where governments may not have been aware of the connection to their debt issuance programs, and the importance of climate in investors' minds.

Isobel, maybe we could turn to you, because I think advocacy extends beyond policy, and into our own standards as an industry, our own frameworks, and the settings that we use.

Looking across many of the collective bodies that exist, what are the features that stand out to you as good practice when it comes to collective action, and maybe the direction that you see some of these collective initiatives taking in the future?

**Isobel**

I would say that the problem as outlined before is, in particular, CA 100+ can only move as fast as its investor participants move. That's an issue across the board for all big tent collaborative initiatives. And there is no, one, quick, overnight, easy fix. But we think the solutions come from increased transparency, increased accountability, and minimum standards for investor participants.

In that vein, we have made some recommendations in our recent reports for CA 100+. Those include introducing minimum standards for investors signing up to the initiative, as well as minimum expectations for participation in activities.

Transparency and accountability mechanisms should hopefully ensure that investors aren't just signing up and thinking that their job is done, but they're actually actively taking part in these collective initiatives as well, and walking the talk, not just talking it. Not using these collective initiatives as a badge of honor, but rather making sure that there is progress.

**Lucy**

Thank you, Isobel, Karlijn and Nalini, for your participation. We hope we have given some insight into what the future of climate action looks like. Thank you for joining us today.

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