Policy Briefing

Climate Change & Transition to a Low Carbon Economy

January 12th , 2016

Post COP21: How well companies & investors are positioned to respond to climate change

Introduction

COP 21 is 'historic' – a first in history, and now, behind us. But the work towards realising its significant achievements has only just begun.

Rating agencies, such as Vigeo Eiris, have responsibility to hold companies to account on how they address climate change risks and their development of energy transition strategies.

As intermediaries between investors and companies, we too play a role in the process of the allocation of capital. All these stakeholder groups are vital in redirecting the allocation of capital to support the urgent pathway ahead that COP 21 aims to achieve.

The key role for investors and companies in achieving COP 21 aims

Representatives from 195 nations committed to limit global warming to 2˚C, and to strive towards 1.5˚C. The Agreement establishes a system for measuring and reporting on country by country commitments, including reviewing each country's contribution every five years, with an assessment of progress in 2018.[1] Vigeo Eiris welcomes the outcome of COP 21. It is positive to see such international commitments from countries with diverse economies and competing interests, in an effort to find a common ground.

Reactions to the Agreement have been mixed. As a number of commentators have noted, it sends a strong signal to financial markets. Other commentators have highlighted the limited nature of what is legally binding; others that it is too little too late.

Whether the Agreement is enough or too little stands to be seen, but it sets the tone for a policy and regulatory context that is much more aware of climate change risks in coming decades. We are likely to see significant political action towards mitigation globally before 2020, given the Agreement Preamble's stated resolve to 'enhance ambition in the pre-2020 period' to 'ensure the highest possible mitigation efforts'.[2]

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[1] Helen Briggs, 'Global Climate Deal in Summary', BBC news, 12 December 2015, http://www.bbc.co.uk/news/science-environment-35073297

[2] Agreement Preamble, IV Enhanced Action Prior to 2010, s. 106 (c)

It has been suggested that the success of the Agreement will depend heavily on external factors, such as global peer pressure and future government actions.[3] Investors and companies may not only be increasingly subject to this peer pressure, but some will continue to gain competitive edge by demonstrating leadership here. Investor pressure on companies can significantly drive forward their performance on climate change.

Although political commitments at the global level are fundamental to chart the way forward, their concrete application and real success are conditional on behavioural changes from all players of society - and in the first place, companies. Companies are today at the source of most of human activities responsible for climate change: from power production to transportation, to industry processes, to commercial buildings, to agriculture and to land use and forestry.[4] It is thus critical that industries and investors, as central players in climate change, also play a leading role in the transition to a low carbon economy.

The importance of investors and other stakeholders in this transition is recognised by the COP21 Agreement itself. The Agreement makes reference to '[m]aking finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development'.[5] The private sector and financial institutions are among the stakeholders encouraged to increase their engagement.[6] They are invited to 'scale up their efforts' and to support actions to reduce emissions and / or build resilience, and to demonstrate these.[7]

Given that the self-determination of country targets and the Agreement's emphasis on reporting, review, and the ratcheting up of targets in subsequent years, investors and companies are vital in ensuring meaningful reductions result.

Top level observations: How corporates are currently performing

Vigeo Eiris makes the following observations about current global corporate performance on climate change from analysis of our data.

1. Overall assessment

The majority of companies could do much more to address climate change and to develop an energy transition strategy. Our data indicates that only a very small proportion of companies are rated by us as 'advanced' in both of these areas. Notably, a higher majority are addressing climate change in an 'intermediate' way than the majority that have 'weak' energy transition strategies. [8]

2. How committed are companies?

We are encouraged to see that the great majority of companies across sectors and countries have at least adopted some general policy on the reduction of their energy consumption and related emissions. However, group-wide quantitative objectives on these aspects are still seldom defined: less than 20% of all companies have set such targets.[9]

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[3] Coral Davenport, 'Nations Approve Landmark Climate Accord in Paris', New York Times, 12 December 2015, http://www.nytimes.com/2015/12/13/world/europe/climate-change-accord-paris.html?hp&action=click&pgtype=Homepage&clickSource=story-heading&module=a-lede-package-region&region=top-news&WT.nav=top-news

[4] Sources of Greenhouse gas Emissions – United States Environmental Protection Agency – Climate Change

[5] Agreement, Article 2, 1, (c)

[6] Agreement Preamble ss. 110, 120, 125

[7] Agreement Preamble, s.135

[8] From an analysis of FTSE AWD companies 2014 reporting on climate change EIRIS rates only approx. 3% of corporates as 'Advanced' in addressing climate change, with 17% rated in descending order as 'Good', 44% as 'Intermediate', 30% 'Limited' and 6% have no evidence that they are addressing the issue. Similarly, Vigeo's analysis of companies' energy transition strategy finds that only 4.5% rate as 'Advanced', 6.5% as 'Robust', while 29.5% achieve 'Limited' performances and finally the majority (59.5%) only obtains 'Weak' scores. Vigeo data is based on several indexes (companies are listed either in the Russell Developed Global index or the iboxx €uro Corporate Overall) researched in 2014 and 2015.

[9] Figure based on Vigeo data. Vigeo universe based on Russell Developed Global index or the iboxx €uro Corporate Overall as of October 2015.

There is thus clearly room for progression in the way companies first commit to limit their climate footprint, starting with engagement at leadership level.

Greater involvement of leadership in climate change targets could drive forward the pace of these issues being addressed. Whilst nearly three quarters (74%) of companies have taken some form of Board-level responsibility for climate change, less than half (34%) of Board/senior management remuneration is linked to GHG emissions reductions or other equivalent strategies. [10] Greater senior remuneration linked to GHG emissions could be adopted by more companies.

3. How far are companies disclosing the implementation of targets?

Most companies are transparent on the means they implement to reduce their energy use and limit their CO_2 emissions, and most show that they have taken at least some measures.

However, about 60% of those analysed only report on basic monitoring, which means also that the remaining 40% take further efforts with corrective actions (use of renewable energy sources, energy recovery, etc.). Only a few companies adopt innovative technologies and preventive initiatives.[11]

4. Are the indicators, targets and disclosures quantitative?

Many companies need to develop and disclose quantitative indicators on climate change.

We find that only 46% of companies have short term quantitative targets on climate change, and even less (35%) have these for the long term. Significantly, less than half (only 45%) of companies have assessed and provided quantified disclosure of financial, regulatory or physical risks and opportunities faced by the company as a result of climate change. [12] This suggests that less than half of companies have quantified the risks.

5. Where are corporate leaders?

We observe that European companies appear to generally perform better in this area than other companies, mainly on account of higher reporting levels. Other geographies with high performance are Australia, Japan, South Korea and USA.

Some sectors that are energy intensive and have a large climate footprint, such as the Chemicals or the Paper industries for example, are notably those that seem to be among the most advanced on tackling these challenges. Strong exposure to climate change risks, both operational and reputational, may have pushed them to adapt and initiate changes earlier.

Low Carbon Transition needs holistic analysis

However, we need to go beyond these initial observations - analysis should be comprehensive so as to avoid as far as possible simplistic and partial conclusions. The transition to a low carbon economy needs to be regarded **holistically**.

First, it is critical to consider not only the direct impacts, but to **analyse the whole value chain**, as well as the **life cycle** of products. In this area enhanced efforts are required from companies.

Our data shows, for example, an overall very weak performance from companies on the management of their environmental impacts from transportation, while we all know that transport is responsible for a significant proportion of global warming. Similarly, the setting of specific targets to improve the environmental performance of products, particularly in terms of energy efficiency, is still infrequent.[13] Whilst the proportion of companies reporting on absolute emissions, normalised emissions and trend data are substantial, by contrast the proportion of companies reporting on emissions from the *use of products* is much less.[14] Reporting upon emissions from end use of product sold can make a striking difference in emissions size – consider the difference for an oil and gas company from direct operational emissions compared to emissions from the product sold (the latter being vastly larger).

[10] All EIRIS analysis given in this paper is based on FTSE AWD companies 2014 reporting on climate change.
[11] Based on Vigeo data.
[12] Based on EIRIS data.
[13] Based on Vigeo data.
[14] Based on EIRIS data.

Secondly, to be as effective as possible, the transition to a low carbon economy needs to be based on a transparent, democratic and participatory process. It needs to involve all stakeholders, including social partners, to secure their support and active participation. Corporates could play a greater public policy role – indeed, we find that less than a quarter (21%) of companies are currently taking a leading policy role by contributing to changes in public policy frameworks or existing systems.[15]

Research Services to support Low Carbon Transition

Vigeo Eiris has a range of research and analytical services designed to help investors assess corporate performance on climate change and energy transition.

Our offering takes into account the variety of approaches investors may have, whether that be need for detail on fossil fuels or carbon footprints; for engagement support; trend analysis through our Historical Databases, or top-level analysis in Sustainability Ratings.

The Vigeo Eiris Carbon & Energy Transition Portfolio Screening helps investors be aware and monitor carbon risk. This includes carbon footprinting of direct and indirect GHG emissions, and assessment of energy transition levels to understand what is needed for a reduction in carbon footprint.

Conclusion

Investors have already played a key role in bringing about COP21, and in the post COP21 landscape, investors are vital to ensure meaningful results.

No doubt initiatives such as the Montreal Pledge, the RE100 investor initiative, investor campaigns on stranded assets, and the plethora of events both before and during COP21, demonstrated to governments investor will and thought-leadership here. The growing corporate-investor-government nexus whereby some companies are calling for a credible carbon price/tax is significant. The importance of incentives for emissions reduction activities are recognised in the Agreement preamble, including domestic policies and carbon pricing.[16] These calls to action will drive forward collective performance on climate change, in addition to the ongoing pressure investors can put on companies through the investment process.

Responsible investment plays a leading role in highlighting companies' exposure to the risks of climate change and evaluating their capacity to mitigate them. Analyses from research intermediaries such as Vigeo Eiris can help investors to understand and better manage these mounting climate change risks.

At present, only a small proportion of companies are found to have an advanced response to climate change and energy transition. To drive forward performance, companies could be encouraged to tie Board-level remuneration to climate change targets. Corporate reporting could be improved, particularly through use of quantitative assessments, and companies should be encouraged to report on the impact of the whole product lifecycle on emissions. There is also room for much greater corporate acknowledgement of the policy context.

Given our role as a research provider, and given Vigeo Eiris' office in Casablanca, we look forward to the 22nd session of the Conference of the Parties (COP 22) that is to be hosted in Morocco, and we will be following the 2016 developments with interest.

[15] Based on EIRIS data.
[16] Agreement Preamble, V Non-Party Stakeholders, s. 137.

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About Vigeo Eiris

On December 15th, 2015, Vigeo's Assembly of Shareholders endorsed the merger of these two established environmental, social and governance (ESG) research agencies from France and the United Kingdom, and the transaction was completed on December 22nd. **Vigeo** was founded in 2002 by Nicole Notat and **EIRIS** was created 32 years ago. Vigeo proceeded to raise 6.3 million euros of new capital to fund the EIRIS acquisition and to ensure that the new entity has the funds necessary for Vigeo Eiris' future.

Vigeo Eiris will continue to offer two types of services through two business units:

- ***Vigeo Eiris rating,*** utilizing its teams' expertise and its unique and well-regarded methodologies, offers a large range of products and services designed for investors and asset managers engaged in sustainable and responsible investment practices. This research covers more than 4,000 issuers, including companies, regions and states and is used by more than 300 clients, partners, investors, asset managers, NGOs and international institutions.
- ***Vigeo Eiris enterprise*** works with organizations of all sizes, from all sectors, public and private to support them in the integration of ESG criteria into their business functions and strategic operations.

Vigeo and EIRIS services and methodologies adhere to the strictest quality standards and have been certified to the independent ARISTA® standard, the leading quality standard for research in responsible investment.

Vigeo Eiris is present in Paris, London, Boston, Brussels, Casablanca, Milan, Montreal and Santiago and has a team of 180. The agency works also with partners in Canberra, Hannover, Istanbul, Jerusalem, Madrid, Mexico City, Rio de Janeiro, Seoul, Tokyo and Zaragoza.

For more information: www.vigeo.com and www.eiris.org

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