Investing in sustainability

Giving Carbon Credit: Climate as a Performance Indicator

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This Tuesday, in the annual CDP Europe Awards, **Climetrics[1] awarded ten investment funds for their outstanding climate performance**. Two strategies managed by Mirova, the Mirova Europe Sustainable Equity Strategy and the Mirova Europe Environmental Strategy, figure among them. Climetrics, an initiative associated with the CDP (formerly Carbon Disclosure Project) is the first climate rating for investment funds. It measures the climate performance of funds based on the asset manager's approach, the fund's investment policy, and the portfolio holdings. It also considers the **lifecycle** greenhouse gas emissions of investee companies, an relatively rare approach in the financial sector.

This award demonstrates our commitment to responsible investment and our ability to create funds with high environmental value. More broadly, it recognizes the efforts being made within the financial sector to integrate climate and environmental considerations into investments. It reflects a growing awareness in the investment community: investors can and must play a role in the energy transition.

Reference to a ranking and/or a price does not indicate the future performance of the strategy or the fund manager.

Open Season on Emissions

The global consensus is that reducing greenhouse gas emissions as quickly as possible is the only sure way to stave off the worst of climate change. But what does this mean from an investment perspective?

The surest way to avoid investments in highly emitting companies is by divesting from fossil fuels. Excluding oil and gas, fossil fuel-fired utilities, and coal mining mean fewer financed greenhouse gas emissions. But, blindly excluding the energy sector can also mean portfolios composed entirely of healthcare companies or technology. These companies contribute little to overall carbon emissions, so a portfolio entirely composed of them is not necessarily better than the status quo. This highlights the need for investors to focus on solutions that facilitate the transition to a more sustainable economy, from products and services that improve energy efficiency to renewable energy systems, electric vehicles, and more.

Blindly excluding the energy sector can mean portfolios composed of companies that contribute little to overall carbon emissions

Implementing these principles can take several forms, but all share the same basic idea: no matter the sector, any meaningful climate strategy is about reducing fossil fuel exposure and increasing the share of climate-friendly activities.

A key tool for measuring climate impact is carbon footprinting; after all, we can't manage what we can't measure. Two types of emissions are easy to count and are widely available: direct emissions from fossil fuels burned on company premises, and emissions from electricity/heat used. Accessibility has historically won out, and this has been the main type of data used by investors looking to assess and improve the carbon profile of their funds.

However, we are convinced that going beyond direct emissions is essential to create meaningful climate-friendly investment products. Accounting for raw

[1] https://www.climetrics-rating.org/

material extraction, transportation, and final use of products is also necessary since these "lifecycle" emissions dwarf direct and electricity-related emissions in several key sectors. The use phase of an oil company or automobile manufacturer's products, for example, comprises over 80% of their carbon impacts; ignoring these emissions obscures a portfolio's true climate profile and can lead to counterintuitive conclusions.

Relying only on the available direct and electricity-related emissions data can lead to portfolios and indices that are not able to live up to their climate-friendly claims. Once emissions are accounted for using a lifecycle approach, "low-carbon" indices based exclusively on direct and electricity emissions often have carbon footprints very similar to their traditional counterparts (i.e. with no carbon considerations). Some hold large positions in oil majors that have made small reductions in their operational emissions without addressing the incompatibility between the fight against climate change and the company's existing business model.

Looking only at direct emissions obscures a portfolio's true climate profile and can lead to counterintuitive conclusions.

Considering the emissions saved relative to a baseline also produces another essential indicator of a company or portfolio's exposure to solutions providers for the energy transition. Otherwise, two companies with similar lifecycle carbon emissions are indistinguishable, even if one provides technological solutions instrumental for mitigating climate change and the other provides a product with low or no added value for the climate.

Method of Choice

Noting that lifecycle-based assessments and saved emissions data remain scarce and heterogeneous, several other methods for assessing and improving portfolios' climate profiles have emerged.

Some methods look at the way portfolios are aligned with a future energy scenario from a technological perspective. They analyze to what extent a portfolio is exposed to the same technologies suggested by a scenario compatible with limiting the worst effects of climate change. However, these methods rely heavily on their underlying technological assumptions and are only applicable to producers of the end technology. Actors that only supply a piece of the final technology or allow for higher energy efficiency somewhere in the value chain are left out, underlining a major gap in these approaches.

Others use proxies for carbon performance, like fossil fuel reserves or the share of environmentally-friendly revenues. The French Energy and Ecological Transition (TEEC) label, for example, is based on a classification of green and excluded activities. It provides a framework to analyze the environmental impact of a company's revenues and then, at the portfolio-level.

Convinced that a method based on induced emissions and emissions savings is the most pertinent way to asses investments' climate profiles, Mirova entered into a partnership with Carbone4[2], a consulting firm specialized in climate strategy. Using the Carbon Impact Analytics method co-developed through this partnership, Carbone4 calculates the emissions arising from a company's products and activities on a lifecycle basis as well as the lifecycle emissions saved relative to a pertinent baseline. This leads to more complete data company-by-company and paints a comprehensive picture of the role each and every company plays in the energy transition.

By considering both lifecycle-based induced and saved emissions, Mirova has reoriented its investments towards companies and projects that provide

[2] http://www.carbone4.com/?lang=en

solutions to climate change, improving the climate profile of its funds substantially. Over the last two years, we have improved the carbon impact of our consolidated equity portfolios from a “business-as-usual” scenario to one that spells a far healthier future for the planet, in line with international greenhouse gas objectives.

Climetrics is a good start. It recognizes the importance of investors in achieving global climate goals, supports their efforts to do so, and reinforces the notion that financial performance and sustainable development go hand-in-hand.

Mirova believes that the way investors allocate capital can and will make a difference in reducing the effects of climate change. And better measurement can only lead to better management: comprehensive company-level data and fund-level climate performance ratings can both support greater positive climate impact and more informed investment decisions.

The Climetrics initiative reinforces the notion that financial performance and sustainable development go hand-in-hand.

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