COP 26: HOW CAN THE GLOBAL WARMING MITIGATION TARGET BE ACHIEVED?

Philippe Waechter
Head of Economic Research

Nathalie Pistre
Head of Research and SRI

Josephine Chevallier
ESG Strategy Leader

THE HARDEST PART IS YET TO COME

For each of its nearly 200 signatories, the goal of the Paris Climate Agreement is to establish conditions that will make it possible to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels. Paired with this goal is the concept of carbon neutrality, which is when net-zero carbon emissions are achieved. To that end, all carbon emissions must be offset by an equivalent level of emissions being removed. This is the prerequisite for the average temperature to be able to converge towards 1.5°C, which is the standard that was ultimately adopted. The aim is to reach carbon neutrality by 2050 in the European Union and the US, and by 2060 in China.

Converging towards this goal calls for a rapid breakthrough in greenhouse gas emissions. Emissions need to be reduced by 45% from 2010 levels by 2030. In light of recent developments and commitments made by government authorities, the world is actually headed for a +16% increase in emissions, with the temperature set to climb dangerously to 3°C above pre-industrial levels by the end of the century.
In Glasgow, the signatories of the Paris Agreement are going to need to redo their homework to get back on track to achieving the lowest possible target, and clearly below 2°C, because at that temperature the damages could potentially be very significant, much greater than if the target is pegged at 1.5°C. Nature is not linear.

It is vital to act very quickly to avoid taking the risk of veering off an acceptable path, because the longer the necessary measures are delayed, the higher the cost and the harder it will be to converge towards 1.5°C.

TEMPERATURE-RELATED MEASURES

Investors are increasingly involved in the fight against climate change and, to that end, are calling for asset managers to monitor climate-related metrics to substantiate their commitments.
The TCFD recommends using WACI (weighted average carbon intensity), a ratio of each company's carbon emissions to revenue. The resulting carbon intensity (weighted average for the portfolio) serves to measure the average volume of carbon emissions per dollar of revenue generated over a given period.

The new Sustainable Finance Disclosure Regulation (SFDR) shines the spotlight on the carbon footprint. Each company's share of "responsibility" for emissions is measured by taking the valuation of the position held and dividing it by the total enterprise value. This gives the total emissions for a given portfolio, and dividing that number by the portfolio's value gives the carbon footprint. This measurement can be used to compare portfolios on a "per euro invested" basis.

A dynamic view can be obtained by calculating the climate alignments of portfolios. This calculation factors in the past carbon emissions generated by issuers as well as a projection of their emissions in future years. The company's climate impact is then assessed by examining the alignment of its path with different global warming paths, and particularly the IEA's path for high-impact sectors. In addition, on an aggregated basis, we can calculate the difference in emissions compared to various scenarios and determine the portfolio's alignment scenario.

COAL EXIT POLICY: AN OPPORTUNITY TO DRIVE THE TRANSITION FORWARD

In 2020, Ostrum AM decided to adopt a determined investment policy recognised by the market and benchmark institutions as particularly demanding of companies operating in the Coal sector, with the aim of making disengagement from the sector a condition for its investment in a given company.

In practical terms, we rolled out a coal exit policy centred equally on exclusion and engagement. In the short term, this calls not only for the application of very strict threshold-based investment criteria - in line with the recommendations of the Global Coal Exit List (GCEL) - but also for active engagement with the companies in which Ostrum AM continues to invest in order to validate the credibility of their exit plan.

We have defined very precise engagement metrics with these companies, such as the deployment of their strategy through short/medium/long-term milestones, frequency of communication, measurability of their actions and investments rolled out to shift their business model outside the coal sector. This engagement is conducted yearly by our in-house experts as of 2021, and when we find an exit plan not to our satisfaction, we will divest our positions starting on 1 January 2022.

To round out our policy addressing fossil fuels, we are currently working on an Oil & Gas policy that will allow us to continue engaging directly with companies in a way that challenges them to be better.
In that way, we are effectively supporting their transition and contributing more comprehensively to their efforts to adopt low-carbon models.

ADDITIONAL NOTES

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www.ostrum.com

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