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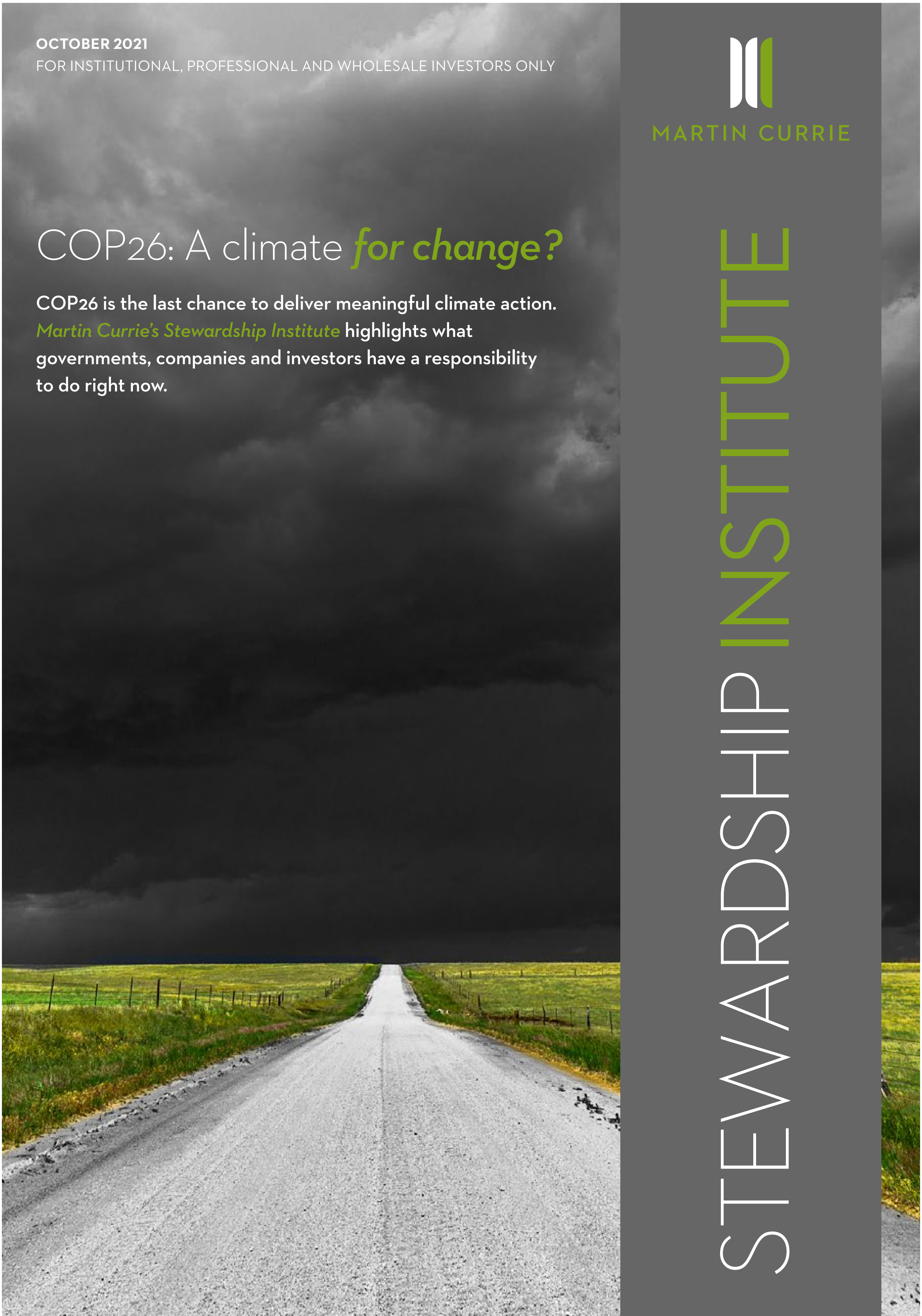
FOR INSTITUTIONAL, PROFESSIONAL AND WHOLESALE INVESTORS ONLY

MARTIN CURRIE

COP26: A climate *for change?*

COP26 is the last chance to deliver meaningful climate action. *Martin Currie's Stewardship Institute* highlights what governments, companies and investors have a responsibility to do right now.



STEWARDSHIP INSTITUTE

URGENT ACTION CRITICAL TO COP26 SUCCESS

Urgent action on climate change must be on the agenda for the UN Climate Change Conference (COP26) in Glasgow.

COP26 is taking place in November, and in the run up, governments and companies around the world have been stepping up commitments to combat global warming. While making pledges was a key element in creating a trans-national response to climate change in the run up to the Paris conference in 2015, we no longer believe that high level commitments are enough. If COP26 is to be considered a success, then we need more specific action and a greater sense of urgency not just from governments, but also from companies and investors, that results in a tangible shift in the decarbonisation pathway of the wider economy.

The stark reality is that scepticism around the trajectory of emissions reductions is merited. The findings of the recent Intergovernmental Panel on Climate Change (IPCC) report[1] have been reinforced by recent research from Chatham House[2] that finds that the world is dangerously off track to meet the Paris Agreement goals. Even during a year of lockdowns, restricted industrial activity and travel in 2020, the UN has found that emissions for the 12 months only fell by a maximum of 7% which will have a negligible impact on climate change[3].

As investors, we are extremely concerned that action at COP26 will not be significant enough to put the world on a pathway to limiting warming to 1.5 degrees. The latest IPCC report published in August was rightly described by UN Secretary General, Antonio Guterres, as a 'Code red for humanity' and a warning that without a significant step up in efforts then keeping warming below a threshold of 1.5 degrees could become out of reach[4].

In our view, it is critical that COP26 is used as an opportunity to accelerate action and for governments, companies, and investors to take specific action to rejuvenate momentum on climate action.

We want to see COP26 set up a climate for real change, commitment, and action from all players. In the following pages, we set out what we want to see delivered by these stakeholders in order to make it a success.

[1]Source: IPCC; as of 7 August 2021. "Climate Change 2021: The Physical Science Basis", available from https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_SPM.pdf

[2]Source: Chatham House; as of 14 September 2021. "Climate change risk assessment 2021: available from https://www.chathamhouse.org/sites/default/files/2021-09/2021-09-14-climate-change-risk-assessment-quiggin-et-al.pdf

[3]Source: UN, as of 9 December 2020. "Green pandemic recovery essential to close climate action gap – UN report",

available from https://www.unep.org/news-and-stories/press-release/green-pandemic-recovery-essential-close-climate-action-gap-un-report

[4]Source: UN, as of 9 August 2021. "IPCC report: 'Code red' for human driven global heating, warns UN chief", available from https://news.un.org/en/story/2021/08/1097362

ABOUT DAVID SHEASBY

David joined Martin Currie in 2004 as a portfolio manager in our global team. He is now fully dedicated to his role as Head of Stewardship and ESG, overseeing the integration of ESG and active ownership into our process, working with our investment teams to ensure continued best practice and has ownership of our policies, strategy and execution in this key area. Before coming to Martin Currie, David was a portfolio manager for Aegon Asset Management (formerly Scottish Equitable) for 16 years. From 2002 he was a senior portfolio manager for global equities, developing and directing Aegon's global strategy. During his time with Aegon, David headed its global equity, emerging markets and European teams. He was also a European portfolio manager from 1987 to 1994.

ABOUT JOHN GILMORE

John joined Martin Currie in 2019 as Portfolio Manager/Analyst for our Global Equity Income strategy. Since 2020, he has been dedicated to supporting the business with our capability and leadership position in Stewardship & ESG. Prior to Martin Currie, John previously worked for Newton Investment Management as an investment analyst and portfolio manager in its Global Equity team, which included helping develop and implement its sustainable investment and enhanced ESG integration process for a new suite of sustainable funds. Prior to Newton he was at Kames Capital as an investment manager with responsibility for North American equities. He started his career at Alliance Trust as an investment analyst. John has an MA (Hons) in International Relations from St Andrews University. He is a CFA® charterholder.

GOVERNMENTS NEED TO SHOW INDIVIDUAL AND COLLECTIVE LEADERSHIP

Previous Conferences of the Parties (COP) have succeeded or failed based on a combination of climate leadership from key nations and pressure from wider stakeholders that enabled participants to break away from a status quo mindset on climate. The challenge this time around is that there is a lack of obvious leadership in showcasing best practice and there has been a clear gap on transnational action.

For COP26 to be a success in bridging the emissions gap, it must succeed in creating decisive action from governments in three key areas.

1. Climate laggards need to step up

G20 countries cover 78% of global emissions[5] and have the resources to tackle climate action effectively. There should be no excuses for inaction here, and key hold-outs such as Australia should stop vacillating and make national net-zero commitments and follow it up with real policy action.

In addition, those with goals but where interim targets are missing or lack detail, such as India and China, need to show a much clearer roadmap for immediate action rather than further postponement. China, for example, is still increasing its use of coal and that needs to change quickly.

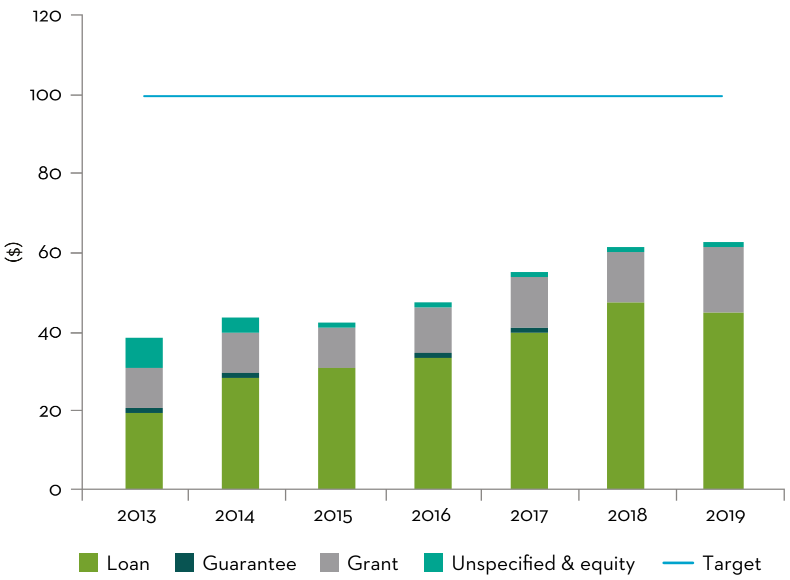
While this is most acute in the countries mentioned, it is worrying that of those with net-zero targets only one country, Gambia, has fully aligned to 1.5 degrees in their overall commitment[6].

2. Fair financing needs must be met

The US$100bn annual commitment from developed countries to fund climate transition at COP16 was meant to be the bedrock of financing the climate transition. It has failed thus far on meeting its financing commitments. In fact, we have yet to meet the $100bn commitment even once[7]. Furthermore, only a fraction of the financing comes from grants, too much of this funding comes with unwelcome conditions or in the form of loans, many of which have above market interest rates[8]. This creates a disincentive for climate investment by developing countries.

This must be addressed at COP26.

Public climate financing has fallen short of COP16 target (US$ billions)[9]



Too much of this funding comes with unwelcome conditions or in the form of loans, many of which have above market interest rates.

[5]Source: UN; as of 26 November 2019. "Cut global emissions by 7.6 percent every year for next decade to meet 1.5°C Paris target - UN report", available from https://www.unep.org/news-and-stories/press-release/cut-global-emissions-76-percent-every-year-next-decade-meet-15degc

[6]Source: Climate Action Tracker; as of October 2021. "Find your country", available from https://climateactiontracker.org/countries/

[7]Source: UK Parliament House of Commons Library; as of 12 October 2021. "COP26: Delivering on $100 billion climate finance", available from https://commonslibrary.parliament.uk/cop26-delivering-on-100-billion-climate-finance/

[8]Source: Oxfam; as of 20 October 2020. "Climate Finance Shadow Report 2020: Assessing progress", available from https://oxfamilibrary.openrepository.com/bitstream/handle/10546/621066/bp-climate-finance-shadow-report-2020-201020-en.pdf

[9]Source: UK Parliament House of Commons Library; as above.

3. *Fixing carbon pricing & ending fossil fuel subsidies*

Carbon pricing is a key mechanism for incentivising economies to move away from fossil fuels and carbon intensive activities. It works by shifting the responsibility of paying for the damages of climate change from the public to emission producers.[10]

Our view is that even in the absence of a global carbon tax or trading scheme being implemented, a commitment on a global floor for the cost of carbon would be a promising first step. Without this, there is a clear disincentive to move first on carbon pricing. For example, existing schemes such as the EU emission trading scheme are having to be supplemented by complex and contentious border adjustment mechanisms to avoid penalising domestic industry for taking climate action.

Carbon pricing should be combined with an end to subsidising fossil fuels, which the IMF has estimated at US$5.9 trillion in 2020. Just 8% of this reflects supply costs, with the remaining 92% from foregone consumption taxes and undercharging for environmental costs[11].

In the midst of a climate emergency, this is a clear misallocation of resources which could be used at improving energy access for the vulnerable in a much more sustainable fashion.

A resolution to fair financing of the climate transition and for laggards to set net zero goals and take tangible policy action are critical for taking the next step on climate action.

[10]Source: UN Framework Convention on Climate Change, https://unfccc.int/

[11]Source: IMF; as of 24 September 2021. "Still Not Getting Energy Prices Right: A Global and Country Update of Fossil Fuel Subsidies", available from https://www.imf.org/en/Publications/WP/Issues/2021/09/23/Still-Not-Getting-Energy-Prices-Right-A-Global-and-Country-Update-of-Fossil-Fuel-Subsidies-466004

COMPANIES & INVESTORS MUST ALSO HELP CLOSE THE EMISSIONS GAP

Our contention is that the ripple effect of actions taken during the build-up, during and after COP26 in Glasgow will have far-reaching consequences for the investment industry, many of which are under appreciated.

It is not just governments who bear responsibility for taking effective climate action, and it is clear there is more that both companies and investors can do to accelerate action. However, too often we have seen evidence of storytelling, cosmetic changes and other instances of what we would consider greenwashing instead of taking meaningful action. We encourage companies and investors to take real action instead.

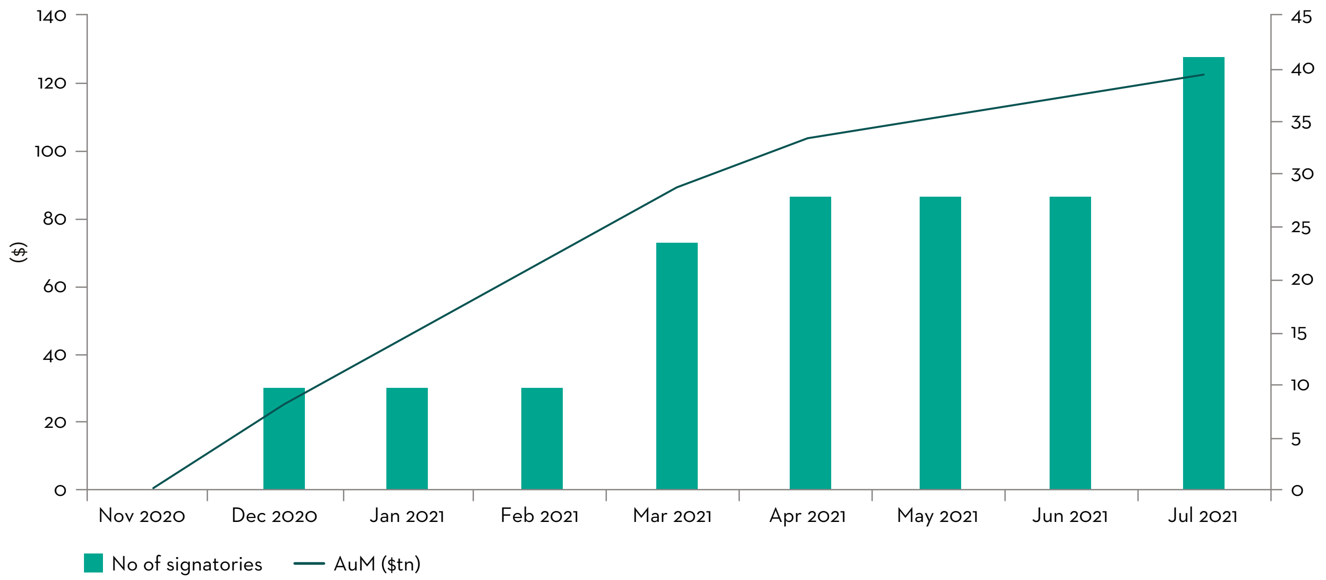
While not specific to COP26, we see an urgent need for more decisive action by investors and companies in following three key areas:

1. *Investors must take collective action to promote net zero*

The most effective action that investors can take is to use the collective weight of their assets and engagement activities to help accelerate the adoption of the key building blocks of net zero. This means encouraging companies to improve disclosure, set meaningful interim carbon targets, and build climate action into the strategic planning of the business.

Our own actions and engagements will support this, and it is encouraging to see a tipping point of asset managers committing to collective action. This can be seen through the growth of the Net Zero Asset Managers Initiative (NZAMI), which shows a step change in assets committed to solving the climate crisis.

NZAMI signatories and committed AUM (US$ trillions)[12]



There is still significant work to be done, even in areas such as encouraging climate disclosure. The responsibility of this lies with investors who have not been forceful enough in pushing for disclosure and companies themselves who in many cases have been complacent in how they have reacted to the climate crisis.

> *The most effective action that investors can take is to use the collective weight of their assets and engagement activities to help accelerate the adoption of the key building blocks of net zero.*

[12] Source: NZAMI; as of 6 July 2021. "Net Zero Asset Managers initiative announces 41 new signatories, with sector seeing 'net zero tipping point'", available from https://www.netzeroassetmanagers.org/net-zero-asset-managers-initiative-announces-41-new-signatories-with-sector-seeing-net-zero-tipping-point

2. Companies need to deliver real world emissions reductions

The reality is that even with the increased focus on climate that has happened in the five years following the Paris Agreement, only 59% of the 2,854 companies within the MSCI ACWI disclose Scope 1 and 2 emissions, and even fewer disclose their Scope 3 emissions on top of this[13].

The importance of this lack of disclosure is highlighted by recent research suggesting that potentially up to 40% of global emissions are being accounted for by listed companies[14]. This means that delivering real action here is a prerequisite for being able to deliver on global promises and commitments on net zero.

After disclosure, the next step in delivering real world emissions reductions is setting science based targets for emissions and for investors to hold business accountable for delivering on these targets. In the design of targets or commitments three key principles should be followed.

1. Absolute emissions reduction should be a priority;
2. Offsets should not be used as a substitute for absolute emissions reductions;
3. Targets should be specific, deliver on both short- and long-term emissions reductions, and with clear accountability for delivering on these.

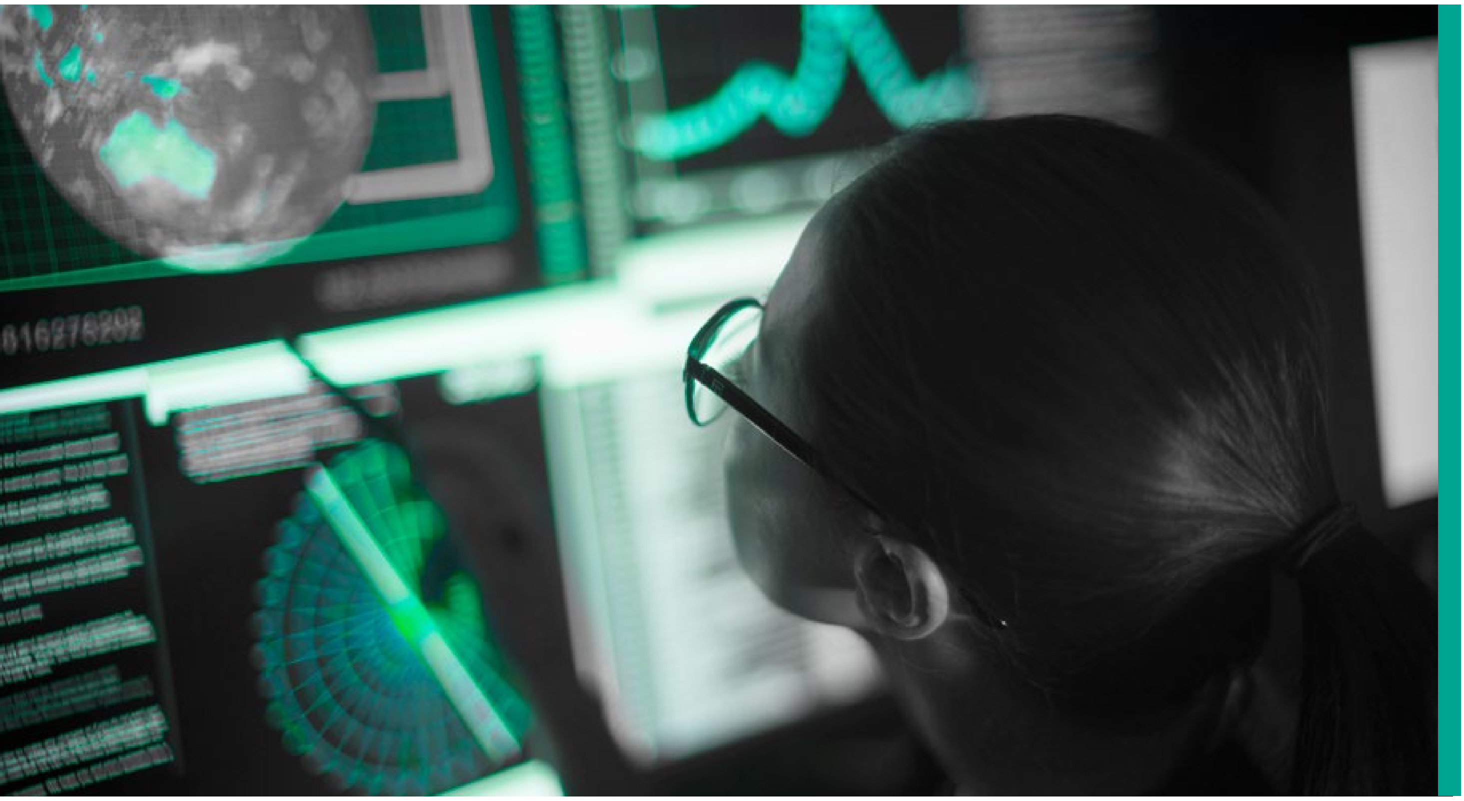
At this stage, a rapidly growing but still small cohort of listed companies have submitted Science Based Targets. As of June, 1,559 companies had joined the Science Based Targets initiative (SBTi) with only half having targets that are verified[15]. Getting to net zero will require those that have targets to hit them, and for the remaining over 10,000 companies globally that have yet to commit to specific targets to take action to rectify this.

After disclosure, the next step in delivering real world emissions reductions is setting science based targets for emissions and for investors to hold business accountable for delivering on these targets.

[13]Source: MSCI, Martin Currie; as of 30 June 2021. Percentage based on equal weighted index.

[14]Source: Generation Investment Management; as of 11 October 2021. "Listed Companies Account for 40% of Climate-Warming Emissions", available from https://www.generationim.com/our-thinking/news/listed-companies-account-for-40-of-climate-warming-emissions/

[15]Source: SBTi, Martin Currie; as of 30 June 2021. Full list of companies available from https://sciencebasedtargets.org/companies-taking-action#table



3. Investors must identify and facilitate investment in climate solutions

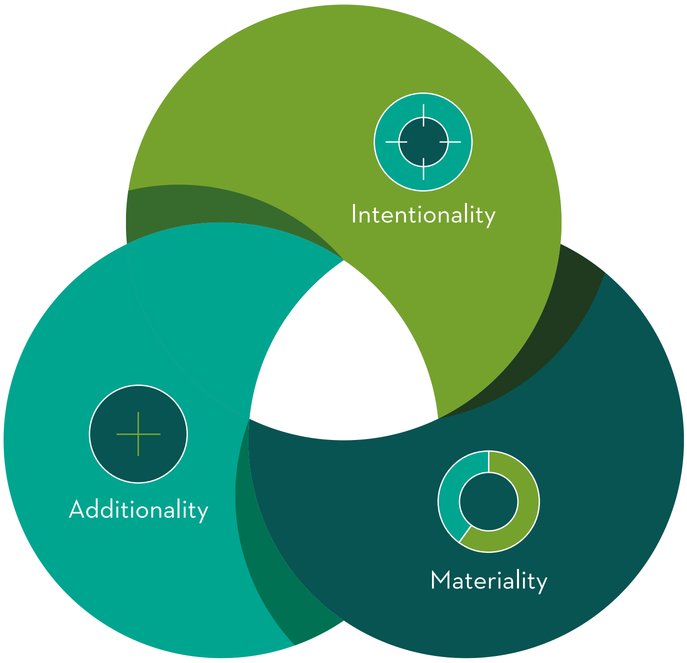
Achieving the climate transition will also require a significant increase in low-carbon investment. At the global level, the IPCC estimates an immediate investment requirement of US$2.4 trillion per year in the energy system until 2035[16].

As long-term, high-conviction equity investors, we believe an effective way to do this is by channelling capital towards businesses that are creating solutions. For instance, these could be companies that aim to solve challenges such as net zero or to support other sustainable development frameworks such as the UN Sustainable Development Goals.

Specifically, we believe that investors need to look at how companies can contribute to, rather than simply align to, these goals. In our view, they can best do this through understanding the impact of the products and services companies create rather than simply just aligning through their behaviour. This requires a shift in analysis to capture opportunities effectively with a focus on highlighting solutions.

When assessing impact, we believe that impactful investments should have evidence of:

1. **Intentionality:** that the specific intent of the business, product or service is to help solve a challenge, in this case a specific intention to help achieve net zero.
2. **Materiality:** if a significant portion of current or future profits from the investment case is meaningfully associated with solving challenges such as net zero.
3. **Additionality:** that the solution created is differentiated and impactful enough to make a significant difference in reaching net zero.

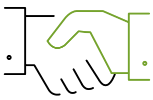


> *Achieving the climate transition will also require a significant increase in low-carbon investment. At the global level, the IPCC estimates an immediate investment requirement of US$2.4 trillion per year in the energy system until 2035.*

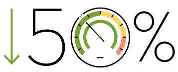
[16]Source: IPCC; 2018. "Global Warming of 1.5°C: Summary for Policymakers", available from https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf

HOW WE ARE TACKLING THE ISSUES

At Martin Currie, we have accelerated our own climate change commitments, and have taken concrete action to step up our activities to be part of the solution to the climate crisis in the following areas:



Through **active engagement**, we increased our focus on climate change and we ask investee companies to be more transparent about how they are managing climate risks and setting targets around their own emissions. Our engagement is increasingly focused on outcomes and being specific about where we are having success and failure in our engagements and escalating future engagement activity accordingly.



We are **reducing our carbon footprint as a business**, with a commitment to reduce our Carbon Intensity by 50% before 2030, prioritise reductions in absolute emissions and, to offset 200% of any residual emissions to become a net zero business going forward. We cannot ask our investee companies to take action we would not be willing to adopt ourselves.

We have become a **signatory to the Net Zero Asset Managers Initiative**. Acting on such a commitment is no small task, and we will spend the next nine months engaging with clients and conducting detailed analysis of portfolios with the intention of setting out specific targets in relation to aligning portfolios with net zero by 2050.

We are building and creating climate resilient portfolios. To do this as consistently and effectively as possible, we are applying climate change analysis that:

- Is fully integrated into the investment process and has an effective transmission mechanism to be considered in valuation.
- Assesses the theoretical and real-world impact of climate transition risks and opportunities by considering the response beyond a company's own operations.
- Forms the basis for climate-related engagement to accelerate the transition to a net zero economy.
- Evolve to capture all aspects of climate risk using the best available evidence and to find ways to capture both physical risk and transition risk from climate change.

We recognise that these conditions of structural change make it increasingly important for us as investors to have a clear view of material risks and opportunities in the portfolios we manage on behalf of our clients. We can use our insights to better price risk and scope opportunities – separating investment winners and losers. We can also leverage these insights to generate better risk-adjusted returns and sources of alpha.

Through our commitments and actions, we strive to both protect and grow clients' capital. By identifying areas of positive impact in our engagements and analysis of climate-related risks and opportunities, we can play our part in redirecting capital in support of net zero targets.

> *We are taking action through our analysis, active ownership and how we behave as a business.*

GOVERNMENTS, COMPANIES AND INVESTORS HAVE A RESPONSIBILITY TO ACT NOW

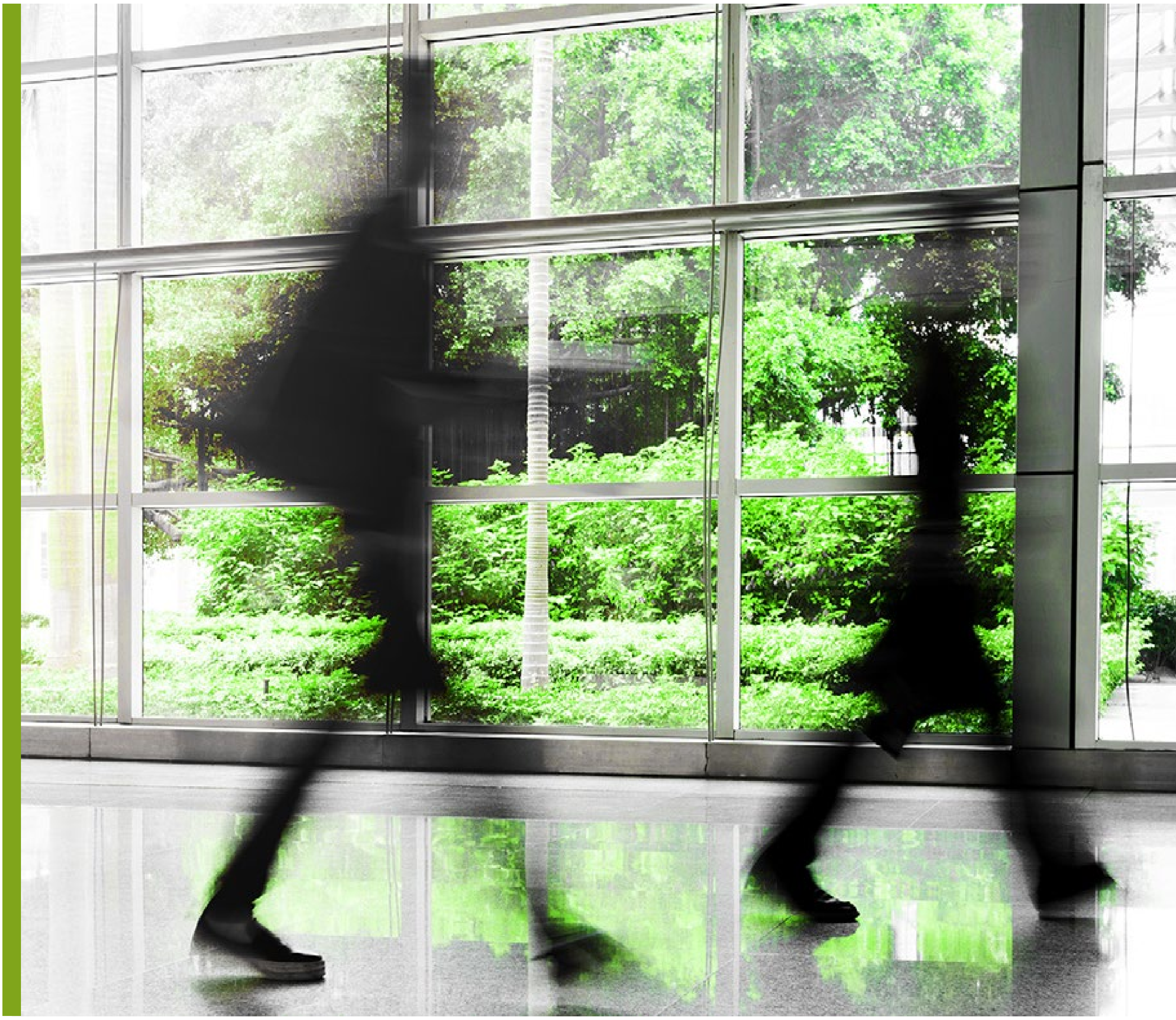
COP26 is a key milestone in the fight against climate change and it is critical that governments step up to the plate to deliver effective action on climate now.

As we have highlighted, this needs to be centred on:

- Climate laggards in the G20 such as Australia, China and India adopting net zero goals and targets and following through with concrete policies that drive near-term reductions in emissions.
- Delivering fair financing for developing countries that focusses on grants instead of loans and is delivered in significantly greater quantity that makes the $100bn per annum a floor of climate finance rather than an aspiration.
- Taking collective action on carbon pricing which at a minimum produces a global floor for the cost of carbon and to phase our remaining fossil fuel subsidies, redirecting them to supporting renewable alternatives.

Companies and investors also have a clear role in creating wider momentum in delivering better disclosure, science-based targets, and ultimately real-world emissions reductions.

Our hope is that both governments and the private sector will take the decisive action needed to tackle climate change during COP26. The necessity of doing this now is clear, and the consequences of inaction are significant for the planet. Our window for taking concrete action is closing rapidly, and as such, it is essential that COP26 is a success.



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