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## New chapter of the Guideline for Ethically-Sustainable Investment in the German Protestant Church

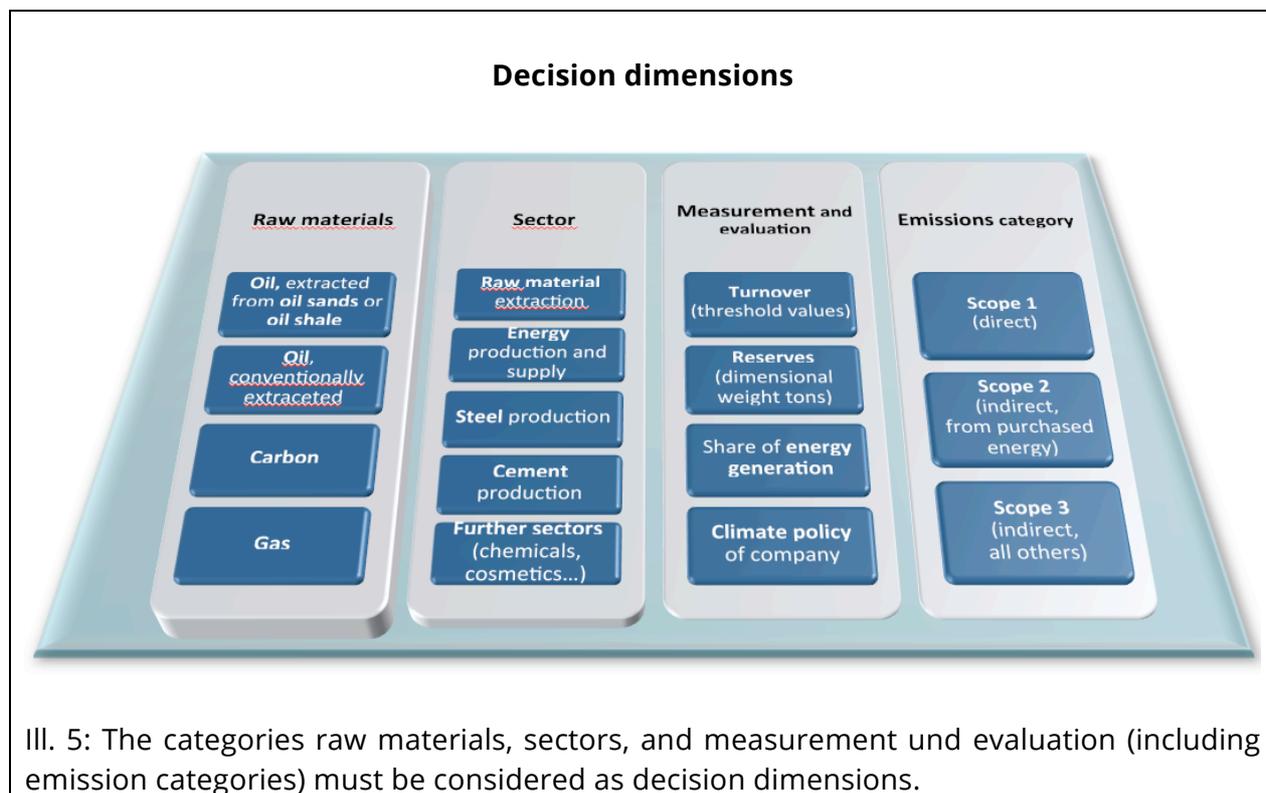
### 4.7 Climate strategies

Climate protection is no sufficient, but an indispensable component element of ethically-sustainable investment. In the process, a climate sensitive investment strategy—climate strategy in short—equally benefits ecological as well as social goals (such as climate protection, food security, protection of the local population and local ecosystems affected by the severe impacts of energy feedstock extractions). Likewise it serves economic goals by reducing the risk of economic loss due to non-performing devaluated or even valueless assets, so-called **stranded assets**. And by banking on business models that are sustainable in terms of climate impact.

#### I. Decision dimensions

When ethically-sustainable investors wish to take the climate impact of their investment into account, they must consider a variety of dimensional decisions in determining their position and choosing the introduction of corresponding criteria:

1. Which raw materials are taken into account?
2. Which sectors must be included?
3. Which measurement and evaluation parameters are used?



## 1. Which raw materials are taken into account?

Analyses of the main perpetrators of climate-damaging greenhouse gas emission served as a starting point for the reflections. Regarding the carbon dioxide released in **combustion** in global comparison, oil sands and oil shale can be identified as the largest contributor to CO<sub>2</sub> emissions; closely followed by carbon, oil from conventional extraction and gas follow though each less closely.

The first decision to be made is which raw materials shall be taken into account in further analysis. The more raw materials are selected, the more companies must be included in the analysis and the more complex gets the calculation of emissions of companies and countries.

## 2. Which sectors must be included?

Another decision dimension accrues from the question, which sectors should be included. **Raw material extracting companies** that produce, stock and sell for instance carbon or oil represent the first level. Additional sectors are the **utility companies**, producing energy based upon fossil fuels. And finally the oil and carbon processing sectors must be taken into account, especially the **cement and steel industry**.

## 3. How is the climate impact measured?

A common and widely accepted instrument in collecting climate impacts is the Greenhouse Gas (GHG) Protocol, developed by World Resource Institute (WRI) and World Business Council on Sustainable Development (WBCSD). The GHG Protocol categorizes the emissions of greenhouse gases into three different levels or scopes. **Scope 1** encompasses all emissions generated from sources owned and controlled by the reported company, **scope 2** contains emissions connected to purchased energy (e.g. electricity, district heating), and **scope 3** covers all other emissions, such as those generated by outsourced and purchased preliminary work in the supply chain as well as the emissions arising from the lifecycle of products. While the data belonging to scope 1 and 2 can be collected and compared rather reliably, the data for scope 3 is based on a variety of many assumptions, which can significantly limit data quality and comparability.

One indicator for measuring the climate impacts is the so-called **CO<sub>2</sub> footprint**, also known as **carbon footprint**. It measures the total greenhouse gas emissions caused directly (scope 1 according to GHG Protocol) and indirectly (scope 2 and 3 according to GHG Protocol) by an event or actor during a given period of time. With the help of specialised service providers such a carbon footprint can also be generated for securities portfolios. According to current surveys and validation methods the most reliable results can be achieved with shares and corporate bonds. But other asset classes can also be included in these CO<sub>2</sub> calculations. Hence ethically sustainable investors must not only decide up to which scope analyses shall be conducted but also upon the asset classes, which shall be consulted in calculating the portfolio's carbon footprint.

Another indicator for determining greenhouse gas emissions is calculating the so-called **CO<sub>2</sub> intensity**. It puts the amount of emitted greenhouse gases in ratio to a fixed reference (value), such as a company's turnover or market capitalisation and the gross national product or population of a country. One advantage provided by the calculation of CO<sub>2</sub> intensity is the comparability of ethically sustainable portfolios with each other or with conventional portfolios (provided that CO<sub>2</sub> intensity is calculated with the same **reference value**—e.g. turnover—at the same **level**—e.g. scope 2—and for the same **asset classes** of a portfolio). Yet the crucial advantage of calculating the CO<sub>2</sub> intensity lies in establishing the development of a specific portfolio over the course of years—regardless of its size. It is important to maintain the preferences once selected (reference value, scope, selection of asset classes), so as to record and document an improved climate impact of a specific portfolio.

The different, not interdependent dimensions that must be considered in making one's own decision are conveyed in illustration 5. Investors must determine their desired positions within each dimension. Furthermore turnover thresholds must be defined for the companies of the individual sectors.

## II. Ethically-sustainable instruments

Just as for ethically-sustainable investments in general, preventing, promoting and formative instruments can be used for the implementation of climate strategies too.

### 1. Preventing strategies: exclusion criteria for companies and divestment

Today data on the climate impacts of companies and countries is in general accessible. Initiatives and NGOs such as CDP, Fossil Free and Germanwatch frequently publish their analyses. Research agencies develop based upon that and other acknowledged sources screening models for portfolios. Ethically-sustainable investors can determine within the scope of the above outlined decision dimensions criteria and threshold values for the exclusion of specific companies and countries. Within the scope of a climate strategy the following decisions should be made first:

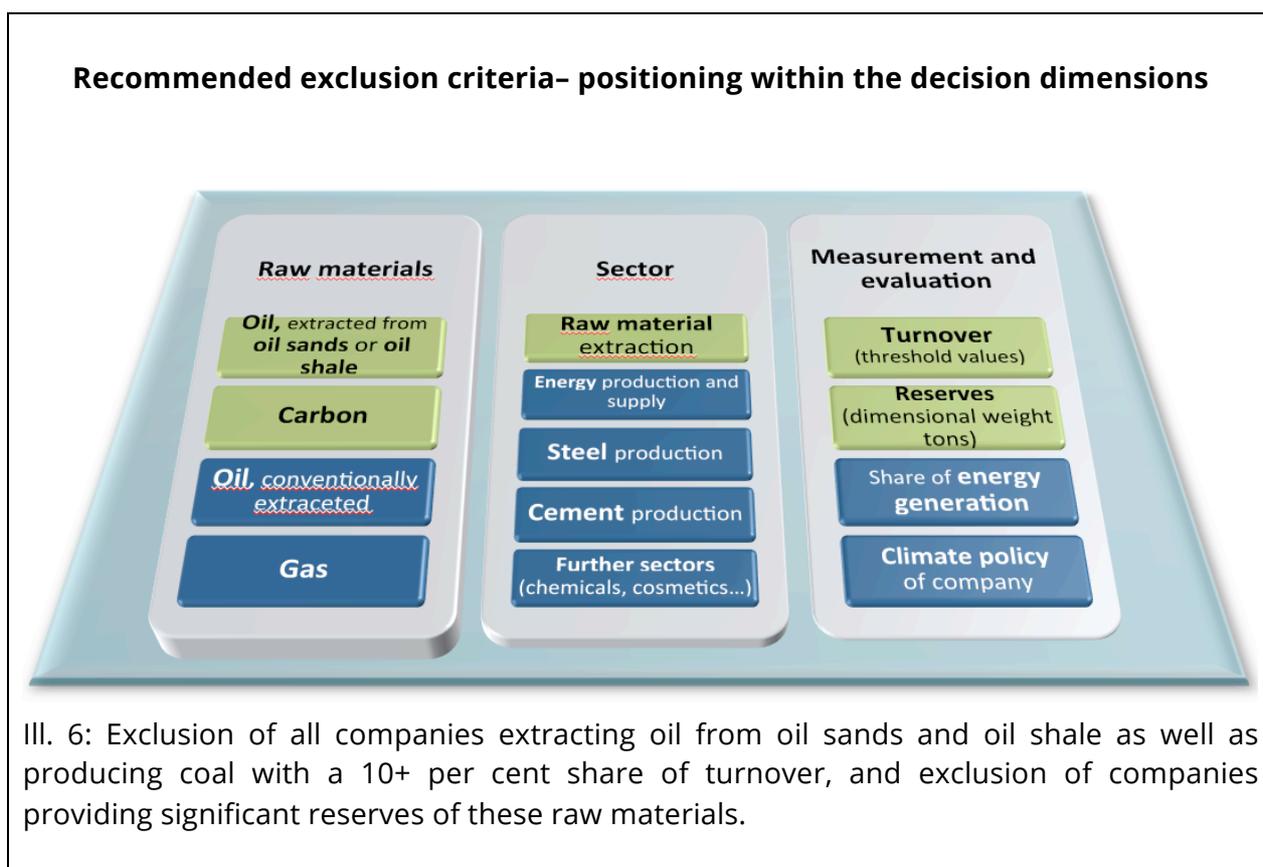
- Which fossil fuels shall be excluded?
- Which sectors shall be excluded?
- Which turnover thresholds shall apply?

Examples for exclusion criteria are:

- **Exclusion of companies extracting oil from oil sands and oil shales with a 10+ per cent share of turnover**
- **Exclusion of companies providing significant reserves of these raw materials**
- Exclusion of companies with a share of more than 1% in global coal extraction
- Exclusion of companies with a more than 30% share of turnover from coal, oil or gas

- Exclusion of energy suppliers, generating more than 10% of their turnover from coal-fired power plants, while at the same time showing little activity in the expansion of renewable energies
- Exclusion of every 10% of the worst performing companies in a sector regarding CO<sub>2</sub> intensity

→ At least the first two criteria should form part of an ethically-sustainable climate strategy. The following illustration (ill. 6) conveys the positions to be selected within the decision dimensions.



## 2. Promoting strategies: indicators, positive criteria, themed and direct investments

Positive criteria for companies—such as using the best-in-class approach—can also emphasize a special focus on the climate responsibility of a company. The term **carbon rating** is often used for that. Such carbon ratings are based upon the objectifiable carbon footprint and carbon intensity, but consider moreover additional criteria, such as size and quality of a company's carbon reporting, development of the carbon footprint, criteria for and extent of climate goals, product and supply chain orientation to climate goals, and integration of climate goals into the variable compensation system of the management.

By now there are numerous established agencies that provide a variety of carbon ratings as a base for investment decisions. It is important to review these ratings with regard to

the above outlined decision dimensions und suitability for the assessment of individual decisions, because no standard is acknowledged by all parties involved. Assessing the climate strategy of a company or the climate achievement of a country and providing it with a ranking/an indicator is, after all, a comprehensible, yet subjective evaluation of a particular service provider.

An important component of climate strategy consists in providing funds for the development of renewable energy systems, storage technologies, networks and efficiency measures. This can happen, for instance, with liquid investments such as **green bonds** or with **equity funds for renewable energies**.

A larger proportion of **themed and direct investments** belongs into the field of **infrastructure**, which holds specific risks and is moreover less fungible than shares or bonds. Advancing the global development of renewable energies systems requires reliable regulatory frameworks, but also public-private partnerships as well as private investments into infrastructure. Themed and direct investments can be made in the following fields: regenerative energy (hydropower, wind power, solar energy, biomass, ocean energy, geothermics), development of storage technologies and networks, funding of energetic building refurbishment and further energy efficiency measures.

#### **4. Formative strategies: engagement and campaigns**

Within the scope of engagement events investors can reflect together with companies on their climate risks and unlock potential for improvements. In doing so it is fitting to get involved with established alliances, such as the »Aiming for A« coalition of British church investors, the Carbon Disclosure Project (CDP), the Institutional Investors Group on Climate Change (IIGCC) or the UN Principles for Responsible Investment (UN PRI).

### **III. Communication of a climate sensitive investment policy**

It would seem reasonable to accompany a climate sensitive investment policy with adequate communication measures both, internally as well as externally. This is a particular challenge regarding the great complexity of calculating climate impacts of the individual investment strategy as well as the fact that the seemingly exact indicators conceal assumptions and investigation procedures, which make comparability with the statements of other investors difficult, if not impossible. Hence any communication strategy should primarily aim at clarifying one's own investment goals and explaining the changed climate impact of the own portfolio.

Climate protection is a cross-sectional task that must be addressed not only by church investors but by churches in general. Thus a climate strategy for financial investments of the Church should be embedded in comprehensive catalogues of measures, and communicated as part of a climate protection concept that encompasses all life areas of the Church.

## Annex

### 1. Explanation of exclusion criteria

#### Coal, oil sands, oil shale

Coal, oil sands, and oil shale are the fossil fuels with the worst CO<sub>2</sub> and environmental balance. Some of the largest global coal producers are so widely diversified that they cannot always be identified with a coal-related turnover threshold. Hence it is recommendable to complement the exclusion of all oil sands, oil shale and coal extracting companies with a 10+ per cent share of turnover as follows: exclusion of companies that provide significant reserves of those raw materials or companies with share of more than 1% in global coal extraction.