Engaging on climate change: an emerging markets equity perspective

Following the publication of the first RBC EM Equity Climate report at the start of October, Portfolio Manager Richard Farrell highlights the importance of integrating climate-related risks and opportunities into the team's emerging markets equity strategy.

Richard Farrell
Portfolio Manager,
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ESG has formed a critical part of our team's philosophy and process since the inception of the RBC Emerging Markets Equity Strategy ("the strategy") in 2010. Given this long-standing focus on integrating material climate change and environmental factors into our process, the strategy already has strong climate-related credentials, with a significantly lower carbon footprint than the MSCI EM Index.

Ultimately, our view has always been that companies that invest and plan for the future and focus on a range of ESG factors, including climate change, have more durable business practices and are therefore more likely to achieve resilient, long-term returns while also avoiding the risks.

We recognise the importance of the principles of the Paris Agreement[1] and the international goal of limiting the global temperature rise to well below 2°C and preferably no more than 1.5°C by the end of the century, in order to mitigate climate risk. As part of this commitment, we have made measuring and monitoring the climate-related risks and opportunities of our strategy a key focus of our ESG research.

One observation from engaging with our portfolio companies on climate change and the environment more generally over the last 10 years is that the quality of data and disclosures has improved significantly. That said, third-party climate data can be limited across emerging markets ("EM"), especially for smaller cap companies. Hence, doing our homework in this space is especially important.

We use a number of proprietary climate data tools to measure and monitor changes in our portfolio's climate-related risks and opportunities. Using these tools and other inputs, we can obtain metrics on our portfolio's carbon intensity relative to the benchmark, net-zero alignment and climate-related engagements.

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The latter is particularly important in relation to our activities as active owners, and we encourage in-depth and ongoing private dialogues with the companies in which we invest, and to establish strong, long-term relationships with management.

It is our intention to ensure that all the companies in our portfolio, where climate presents a material risk, have a short-term carbon reduction target, net-zero target year, and net-zero plan. We are particularly focused on ensuring that, as a minimum, all our holdings have a long-term, net-zero target year.

The net-zero target year of our portfolio companies can vary considerably depending on industry and country. Although the Paris Agreement, which focuses on climate change from a country perspective, was to achieve net-zero emissions by 2050 or sooner, a number of countries in EM only agreed to longer-term targets. Countries of particular note include Brazil, China, and Indonesia, which target to be net-zero by 2060, and India, which targets reaching net-zero by 2070. Some of our holdings have aligned to their country target, and we have started to engage with these companies in the hope that they will bring this target forward.

By meeting regularly with our portfolio companies to discuss risks and opportunities relating to ESG, including climate change, we can share our philosophy on responsible investment and better understand a company's approach to the issue. We maintain an engagement tracker, whereby we can track and monitor the progress of our engagement efforts.

As long-term investors, we are patient with our portfolio companies and give them time to change when we identify issues. If we are not satisfied with a company's progress, we can consider divesting, but first and foremost we try and work with our companies to help them improve on their climate change-related disclosure and net-zero targets.

To find out more or to download the report visit:
rbcbluebay.com/EMClimate

FOOTNOTE
1 The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 parties at the UN Climate Change Conference ("COP21") in Paris, France on 12 December 2015. It entered into force on 4 November 2016.

RBC BlueBay Asset Management