Sustainable finance: Investing for a 2°C World

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Responsible Investing

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Manuel Coeslier, Equity Portfolio Manager at responsible investment firm Mirova, is also a Member of the European Commission's Technical Expert Group on Sustainable Finance. Here, he explains why Mirova's carbon impact methodology is helping to address the challenges at the next frontier of impact investing.

Mirova is an investment manager with €9.3 billion AUM that is dedicated to responsible investing. Earlier this year, Mirova unveiled its new 'climate impact methodology'. It was the culmination of four years research into the climate impact of investment portfolios, and an ambitious project that aimed to develop investment solutions fit for a 2°C world.

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What was driving the need for developing a new carbon impact methodology?

Since the landmark Paris Agreement (COP21) in December 2015, leading institutions across the world have sought to understand more clearly the connection between their investment portfolios and climate change. This has been no easy task.

While 'carbon footprint' has become something of a mainstream concept, measuring the carbon footprint of an investment portfolio has remained an inexact science. There hasn't been a clear or accurate way of including the negative and positive impacts that companies can have, nor a robust consideration of a company's entire business model.

Some rely only on a company's direct emissions and the emissions from its energy use. Others do not consider the benefits of products through measures like avoided emissions.

Unsatisfied with existing methods, we decided to team up with experts to develop an innovative methodology able to calculate both induced and avoided emissions on a lifecycle basis. This data is then translated into a climate scenario indicator at portfolio level, which helps us to understand the relative impacts of our strategies and provides a roadmap for reorienting investments.

What does your research tell you about the state of companies today?

For one thing, indices of the world or European economy, such as the MSCI World or the Stoxx 600, simply aren't aligned with the needs of ambitious climate scenarios. Actually, most indices represent an economy on track to achieve a 4.5°C - 5.5°C climate scenario, indicating severe, adverse effects to come in the near future

Sectors most exposed to climate change (energy, resources, buildings and mobility) make up a substantial part of the major indices. Large companies in these sectors have yet to develop sufficiently the innovative solutions needed to compensate for their presence in, and contributions to, the fossil-fuel reliant economy.

This largely reflects the richness of large industrial groups in the world listed economy. As a result, passively managed funds that track traditional indices are in line with the 'old' economy rather than seeking to balance it with the 'new', low carbon or carbon efficient economy.

In short, it will likely take a long time for indices to align with a 2°C target. Climate-aware investors cannot afford simply to replicate the major indices if they are to reduce their environmental impact and improve their contribution to the energy transition.

How have you used the methodology at Mirova?

We have worked to improve our strategies' carbon impact by simultaneously reducing their induced emissions and improving their contribution to emissions savings, to line up with the 2°C objective, without hindering their performance. Today, our consolidated equity funds are compatible with a 1.5°C scenario, compared to 2.9°C two years ago.

We achieved this by looking for investment opportunities beyond the obvious: not just renewable equipment manufacturers but throughout the entire value chain of renewable energy and energy efficiency solutions. And not just large companies present in indices, but also mid-cap companies with sound business models proposing innovative solutions.

Through this active, climate-conscious management of both diversified and thematic strategies, Mirova has substantially improved the climate impact of its investments – and thus its exposure to the associated risks and opportunities – all with a view to generate sustainable, long-term performance.

We know how to create more accurately carbon neutral or low carbon portfolios, and we understand in more detail the dynamics of offsetting companies that help improve overall impact. The robustness of our methodology means it is now possible to measure the climate impact of our investment portfolios with some confidence.

Next up, we're developing a strategy that goes beyond targeting a low carbon footprint. It will make use of our carbon impact methodology, lifecycle analytics and an active management approach to leverage a pioneering carbon neutral strategy, whereby the overall portfolio's level of induced emissions is offset by the level of emissions savings. We believe climate-conscious, active management investment strategies are the only ones fit for a 2°C world.

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1 Source: Investing for a 2°C World – Expert Investor – Approved by compliance 14/08/2018 – Job Number 2183275 (http://image.news.im.natixis.com/lib/fe8f1372746d057e7c/m/3/50605275-1be1-453c-b380-0c380c26b0bd.pdf)

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