SARASIN
& PARTNERS

SARASIN CLIMATE ACTIVE

A Paris-aligned investment solution

Q1 2020

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Have you considered how your investments impact climate change?

WHY MIGHT CLIMATE ACTIVE SUIT YOU?

Climate change poses potentially catastrophic risks to our way of life. It is also driving government policy that is set to transform how we produce and consume energy, and how businesses operate within society. The world has set itself a target to keep temperature increases well below 2°C, and ideally 1.5°C (the Paris Climate Accord goals), which means we must collectively ensure net carbon emissions come down to zero between 2050 and 2070. The investment community must play its part in accelerating change, to align our long-term financial risks with the long-term well-being of our planet.

Sarasin & Partners Climate Active is designed for investors who are seeking to promote change, in alignment with the Paris Climate Accord goals, whilst seeking attractive and sustainable investment opportunities. It is appropriate for those who accept the material risks generated by climate change, and wish to play a collaborative role in driving transformation.

Sarasin & Partners Climate Active can be managed as either a multi-asset or a single asset class portfolio. Since launch in February 2018 the strategy has gathered over £500m of assets[1], via both pooled and segregated mandates.

Have you considered how climate change impacts your investments?

[1] As at December 2019

BACKGROUND

In the face of the overwhelming scientific consensus that the climate is warming at an unprecedented rate, with potentially devastating impacts for millions of people, in 2015 the world set itself a target to keep temperature increases well below 2°C, and ideally 1.5°C (the Paris Climate Accord goals).

Since then the evidence suggests that our planet is warming even faster than previously thought, and the dangers of exceeding the 1.5°C threshold graver than we had imagined. We must collectively ensure net carbon emissions come down to zero by 2050 if we wish to keep temperature increases to 1.5°C, and by 2070 for a 2°C cap. Given that current emissions look set to take us well above these targets, it is clear that policy needs to be more determined.

A PARIS-ALIGNED APPROACH

Sarasin & Partners Climate Active offers a timely investment solution for clients who are concerned by mounting climate risk and want their portfolio to be managed in a way that is aligned with the Paris Climate Accord. It is appropriate for those with a longer-term horizon and who feel one or more of the following:

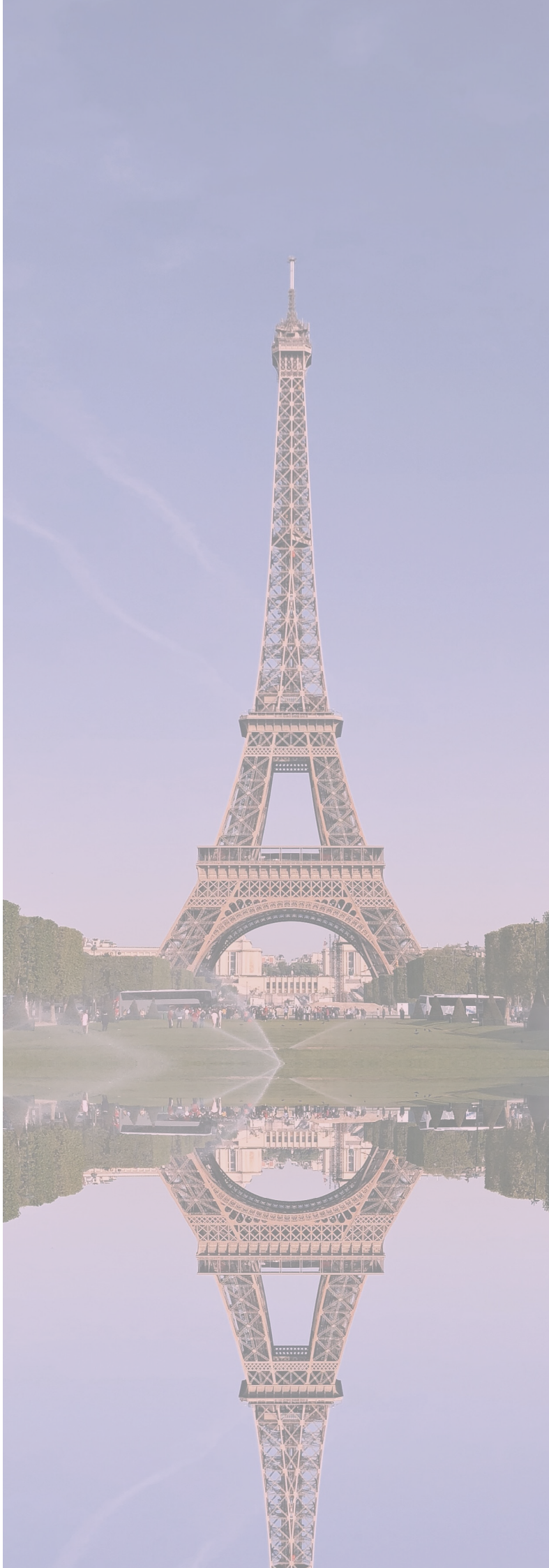
- Accelerating climate change poses a risk to financial capital
- Climate change will happen more quickly than current consensus opinion
- Governments will drive increasingly intense policy action to combat climate change in line with the Paris goals
- Shareholders have a role to play in guiding company boards to align with the Paris goals
- It is important to press for more determined government policy action

COMPANIES NEED TO BE PART OF THE SOLUTION

Governments must create the environment that drives decarbonisation, but it is companies that will be the principal vehicles for achieving the energy transformation.

There is a deeply entrenched relationship between virtually every company and fossil fuels; they have become part of our economic DNA. Moreover greenhouse gas emissions are a natural consequence of a range of land-based and industrial processes. This relationship leaves almost all companies exposed to some form of climate risk. Investors must be cognisant of these risks and all market participants, therefore, need to be part of navigating the global effort to meet the Paris goals.

To deliver sustained shareholder value many companies will need to rethink medium and long-term strategies, as well as near-term decisions on capital investment. Asset owners and managers must research and understand how different strategies and scenarios will impact each company's prospects, and hold management to account as and when necessary.



CLIMATE-AWARE INVESTING

The Sarasin thematic approach to investment is naturally climate-aware. Our investment philosophy and process explicitly identifies climate change as a global theme driving future economic value, and integrates specific climate risks in the valuation of prospective investee firms.

We do not simply seek to invest in companies directly involved in climate solutions. We firmly believe that all companies have some role to play in global de-carbonisation and managing the transitional and physical risks of climate change.

As active investors, we specifically assess materiality of climate risks across the portfolio as part of our bottom-up valuation.

COMBINING INVESTMENT AND ENGAGEMENT

We aim to deliver attractive returns as the world accelerates its transition to net-zero-emissions by investing in companies that we expect to create value from strategies consistent with a well below 2°C cap in global warming. We also look for companies that will be resilient to the physical impacts of climate change already in the pipeline.

Not all companies are today aligned with the Paris goals, but most have the potential to get onto a net-zero pathway. Consequently, a key aspect of our Climate Active philosophy is to drive positive change pressing boards of directors to take steps towards strategic and operational alignment. We will divest from companies that fail to articulate a compelling strategy that is aligned with the Paris goals within three years, we will divest our clients' shares.

ACTIVE OWNERSHIP

In our engagements with companies, Sarasin Climate Active is informed by the Oxford Martin School 'Investment and Engagement Principles'[2] – seeking explicit commitments by boards of directors to align a company's business strategy with the Paris Accord goals. This means that directors must commit to a 2050 to 2070 net-zero carbon emission pathway, and set out how they will get there in a way which enhances shareholder capital[3].

To achieve these engagement objectives, Sarasin Climate Active uses active ownership tools ranging from voting and engagement, to public calls for action and building coalitions with like-minded stakeholders.

Company engagements are guided by our Climate Active Advisory Panel. The Panel comprises individuals with deep experience of activist investment, climate change, the Paris Accord and fossil fuel exposed companies. Their involvement helps to ensure that we select our targets wisely and the engagements are effective.

[2]Original principles published in 2015, with revised principles expected in 2018. See Appendix for further details
[3]Special Report: Global Warming of 1.5OC by IPCC, published October 2018

THE CLIMATE ACTIVE
ADVISORY PANEL

In 2017, we created a Climate Active Advisory Panel to help us consider all matters related to investing against a backdrop of climate change and the need for the world to decarbonise. The panel meets formally four times a year, supplemented by informal communications between meetings, to discuss divestments, corporate engagement and activist policies, together with potential policy work in conjunction with governments and like-minded institutions. You can read more about the panel members below.

DAVID PITT-WATSON (CHAIR)

David is a leading practitioner in the field of responsible investment. He is a Fellow of the Judge Business School at Cambridge University and previously an Executive Fellow at the London Business School. He was a Non-Executive Director of KPMG and chaired their Public Interest Committee until November. He was the Treasurer of OXFAM until 2017 and a trustee of Nesta, the innovation charity and Executive Fellow at The London Business School. Previously, David was Chair of Hermes Focus Funds. As co-founder, and CEO of the Focus Funds and Equity Ownership Service, he built and led the largest responsible investment group of any institutional fund manager in the world. David has co-chaired the UN Environment Programme's Finance Initiative and was closely involved in the setting up of the UN's Principles for Responsible Investment.

HEIDI HELLMAN

Heidi became Head of Group Strategy and Market & Competitor Intelligence at Centrica in 2016. She was previously Head of Strategy at BG Group and had various strategy roles at Royal Dutch Shell. Heidi has had over 25 years' experience working in the oil and gas and power sectors, having started her career at Exxon in 1991. She has an MBA in Finance and Multinational Management from The Wharton School, University of Pennsylvania

SIR JOHN BEDDINGTON

Sir John is Senior Advisor to the Oxford Martin School and Professor of Natural Resource Management at Oxford University, from 2008 until 2013 he was the Government Chief Scientific Adviser (GCSA) reporting directly to the Prime Minister. As GCSA, he was responsible for increasing scientific capacity across Whitehall. During his time as GCSA he set up the Scientific Advisory Group in Emergencies (SAGE) that reported to the COBRA committee. He is a Non-Executive Director of the Met Office, chairs the Cabot Institute External Board at Bristol University, the Global Academies Panel at Edinburgh University and the Systemic Risk Institute at the LSE.

PROFESSOR CAMERON HEPBURN

Cameron Hepburn is Director of the Smith School of Enterprise and the Environment, He is also Professor of Environmental Economics at the Smith School and at the Institute for New Economic Thinking at the Oxford Martin School. He is also Professional Research Fellow The Grantham Research Institute at the London School of Economics and a Fellow at New College, Oxford. He is an expert in environmental, resource and energy economics and is involved in policy formation, including as a member of the DECC Secretary of State's Economics Advisory Group. Cameron has advised governments (such as China, India, UK and Australia) and international institutions (e.g. OECD, UN organisations) on energy, resources and environmental policy.

THE SARASIN CLIMATE ACTIVE INVESTMENT APPROACH

Our approach to investment follows a global multi-thematic philosophy that explicitly considers climate change as a long-term theme. Sarasin Climate Active is built and managed by assessing the impacts of climate change within each security.

ACTIVE MANAGEMENT

We believe that the most effective approach to seriously integrate climate change analysis into a portfolio and align with the Paris Accord goals is to take an active approach.

Sarasin Climate Active invests following Sarasin & Partners' thematic and ESG integrated, bottom-up approach to security selection, which has been our investment philosophy for well over 20 years.

DIVEST FROM THE WORST OFFENDERS

Sarasin Climate Active will never own any company that derives 5% or more of its annual revenue from either the extraction of thermal coal or oil from tar sands, the most greenhouse gas intensive fossil fuels. Furthermore, our ESG embedded process naturally screens out firms that cause significant harm to natural capital in their regular course of business.

ENGAGEMENT TO DRIVE CHANGE

We believe we can catalyse change to enhance a company's resilience to climate risk and deliver attractive long-term returns for shareholders. Companies we prioritise for active engagement are vulnerable to climate risk and have the potential to remain profitable in a well below 2°C scenario; but have yet to articulate a compelling strategy.

Guided by our expert Climate Active Advisory Panel, the Oxford Martin School 'Investment and Engagement Principles' as well as our own extensive stewardship expertise we implement all appropriate methods to drive change in the companies we believe are exposed to material climate risks.

CLIMATE STRESS TESTING

Our investment process helps us determine and value companies we believe to be well positioned for future growth. Sarasin Climate Active goes one step further; for every company in the portfolio, or under consideration, where we believe climate risks are material we apply additional in-house climate stress testing, to determine the level of risks to shareholder capital.
By incorporating specific metrics and adjustments into our valuation models, based on Paris aligned scenarios, we seek to ascertain the Value at Climate Risk for companies that identifies the materiality and impact of climate risks to each firm.
This analysis informs our engagement activity as well as our valuation and position sizing.

VALUE AT CLIMATE RISK

The value at climate risk is the potential downside to capital valuation due to climate specific risks. There is no standardised model to capture this drop in economic value as it entirely depends on specific exposures and business activities within each company. We believe this can only be analysed through rigorous bottom-up analysis, to truly understand the extent of the risks within a portfolio. Some factors that are examined to evaluate the economic impacts of physical and transition risks include:

- Impact of higher carbon prices (Scope 1, 2 & 3 emissions)
- Physical impacts for property, plants and equipment
- Changes in demand and/or pricing of commodities, goods and services
- Impairments / stranded assets
- Change in CAPEX requirements
- Regulatory impacts for demand or supply (e.g. licenses)

DIVESTMENT ON A CASE-BY-CASE BASIS

We will divest from companies where the climate risks are not being adequately managed, and where we believe there is little prospect for a profitable strategy aligned with the Paris Accord.

We divest after or during an engagement if:

- There is no demonstrable commitment to revising the strategy in line with the Paris Accord's 2°C goal within three years; or
- Concerns arise over a company's financial outlook during an engagement process.

POLICY OUTREACH

Sarasin Climate Active prioritises policy outreach to promote regulatory and market-wide action that supports decarbonisation. This is important because climate change is a systemic challenge, which demands an economy-wide response. This dovetails our company engagements and investment positioning aimed at ensuring alignment with the Paris Climate Accord.

Climate Active will do this directly through submissions to government consultations, complaints to regulators and the publication of policy position papers. We also press key market actors like audit firms or proxy agencies to help catalyse broader responses. Finally we also support collective efforts convened by bodies like the Institutional Investor Group on Climate Change or the Climate Action 100+ initiative

WORKING WITH OUR INVESTORS

Investors in Sarasin & Partners Climate Active strategies can play a role in combatting climate change while seeking attractive investment returns and performing their fiduciary duties in a responsible and sustainable manner. We seek to partner with investors to help build a climate active solution that best complements their existing investments, in line with respective climate policies. We can help clients better understand potential risks across their portfolio and construct plans to mitigate those risks.

Where appropriate, our engagement and/or divestment decisions can also be informed by existing investors. We invite investors in Sarasin Climate Active to co-sign our letters to management and boards, should they wish to lend their voice to our own in driving for change.

COMPANY ENGAGEMENT IN MORE DETAIL

We take great care in our approach to company engagement. Utilising shareholder rights can be a powerful tool in mitigating climate risks

All our conversations with companies are based on an assessment of long-term shareholder returns, taking the Paris climate commitments into account. This assessment is holistic, incorporating scientific data on climate change, emerging regulation and technological advances.

Our approach to engagement seeks to be supportive of positive action, but challenging to inaction. In keeping with the Oxford Martin School Investment and Engagement Principles (see Appendix), we look for an explicit statement of alignment of the business with the Paris goals with a net- zero-emissions target; a credible and profitable strategy to deliver this and measurable milestones. Key features of our approach include:

PRIORITISATION

Engagements are strictly prioritised to ensure we target companies where: 1) there are core strategic misalignments with the Paris goals that impede long-term value creation for shareholders; and 2) where we believe we can effect change.

THOROUGH ANALYSIS

Unless we can present a well-researched and compelling case for change, we will not gain traction with the broader shareholder base or the Board of Directors, which is essential for success. The focus is on capital allocation and strategy, but we also consider operational matters. Our input aims to point to emerging problems from a long-term shareholder perspective, taking climate risks into account.

CLEAR AND ACHIEVABLE TARGETS

The course of action identified by the Board should be achievable and include specific targets, e.g. new operational targets to minimise emissions, capex plans that take account of a lower carbon world or dividend policy to return cash to shareholders where suitable investment opportunities do not exist.

ESCALATING PRESSURE ON THE BOARD

We always seek a constructive dialogue with the Board. Initially we hold private conversations setting out our concerns. Where appropriate, we will reach out to other large and/or concerned shareholders to explore joint action. Where private engagement fails to gain sufficient traction, we may look to increase pressure on the Board. Possible actions include: publicly disclosing our concerns and calling for change; using our vote to apply pressure on directors; reporting breaches of director duties, or rules governing company reporting to shareholders; filing shareholder resolutions or in extreme cases putting forward director candidates.

WINNING THE ARGUMENT

We may make our case public to help raise awareness of risks to shareholder capital. Additional leverage is gained by building a network of supportive thought leaders in the business and policy worlds. Wherever appropriate, we seek to act in conjunction with our underlying investors and the Climate Active Advisory Panel to bring more voices to the debate and remind companies who their underlying shareholders are.

Sarasin Climate Active prioritises policy outreach to promote regulatory and market-wide action that supports decarbonisation. This is important because climate change is a systemic challenge, which demands an economy-wide response.

CHANGING THE SYSTEM
TO PROTECT OUR CLIMATE

Our policy outreach dovetails our company engagements aimed at ensuring alignment with the Paris Climate Accord. It is also supportive of our investment positioning for an accelerated policy response to climate change.

A key area where we are taking a lead is in promoting more reliable and prudent accounting and audit for material climate risk within companies' financial statements. This is vital to underpin the efficient allocation of capital companies, and ultimately to help prevent the emergence of dangerous carbon bubbles - i.e un-costed climate risks in the system that, when 'popped' have the potential to cause harmful disruption. It is also key to ensure company executive bonuses are based on performance numbers that incorporate climate risks.

PROFESSIONAL BODIES, COLLABORATIONS AND INITIATIVES WE CONTRIBUTE TO, OR INTERACT WITH:

- United Nations Principles for Responsible Investment (UNPRI)
- International Investor Group on Climate Change (IIGCC)
- Climate Action 100+
- Portfolio Decarbonisation Coalition (PDC)
- Transition Pathway Initiative (TPI)
- Financial Reporting Council Investor Advisory Group
- International Corporate Governance Network
- International Accounting Standards Board
- International Audit and Assurance Standards Board

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OPINION

Climate Change

Asset managers must use their votes to tackle climate change

Tasked with voting for directors on behalf of millions of savers, they have the power to make a difference

NATASHA LANDELL-MILLS

As we emerge from the 2019 voting season for listed companies — the time of year when shareholders elect company leaders — asset managers have once again ducked their responsibility to help address the climate crisis. At ExxonMobil, Chevron, BP, Shell and Total, directors were appointed with an average 97 per cent support from shareholders.

Yet these companies are collectively ploughing billions of dollars into future fossil fuel extraction, which threatens the climate and makes increasingly questionable investment returns. Business-as-usual is unsustainable and this must mean change to the corporate leadership promoting it. Asset managers, tasked with overseeing companies and voting for boards of directors on behalf of millions of savers, have the power to achieve this.

Companies continuing to deploy capital in a way that perpetuates the fossil fuel economy is harmful to shareholders for two reasons. First, they lock us on to a pathway that scientists tell us threatens planetary stability. According to research by Carbon Tracker, for example, the carbon emissions generated by roughly 60-80 per cent of expected capital spending on new oil projects for the next decade will exceed what the world can cope with if it is to avoid climate chaos. Auto manufacturers, construction companies and heavy industry likewise often invest in new infrastructure and equipment without considering its climate impact.

Second, where companies fail to take into account the regulatory measures that governments will inevitably take to combat climate change, their profits are likely to be hit, harming shareholders. Rapid advances in clean technology only bring forward this headwind.

It should be self-evident that businesses linked to the fossil fuel economy need to change. Boards need to commit to align with the 2015 Paris agreement's goal of keeping global warming well below 2C and set out a credible strategy for getting there, which protects shareholder capital. This may mean shifting capital into low carbon alternatives or shrinking and returning cash to investors. According to think-tank Aurora, the $500bn or so a year being invested in oil and gas is roughly what is needed for wind and solar every year to meet the Paris goals.

To drive decarbonisation, asset managers must move beyond supportive statements and use their votes. If a company's strategy is flawed, shareholders can change the leadership. The question is why so many asset managers are failing to vote for change. One problem is a lack of accountability: few savers have any idea how their shares are being voted. Often, they do not even know which companies they hold shares in.

Another obstacle is short-termism. Too many fund managers believe climate change is unlikely to affect them over the next quarter or financial year where they are focused. Some believe their fiduciary duty prevents them from acting. The opposite is more likely to be true. Where asset managers fail to reflect material risks in their investment process, it is hard to see how they are putting their clients' interests first.

We've seen the story of failed accountability before. It resulted in the financial crisis. Directors at banks were routinely reappointed with more than 95 per cent support despite overseeing strategies that led to a dangerous build-up of risk. The consequences this time around will probably be far graver than in 2008.

There is some good news. Directors at Maersk, the global shipping company, last year committed to aligning their strategy with the Paris goals. Amazon has just announced they will get to net zero carbon emissions by 2040. On the investor side, the ClimateAction 100+ initiative has brought together institutions managing assets worth more than $35tn to call for better climate governance.

But time is running out. It is no longer enough to applaud progress that only gets us half way.

The writer is partner at Sarasin & Partners

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Another focus is promoting more thoughtful voting by the asset management industry, which as a whole is failing to use its votes to hold directors to account. This is reflected in 95% plus levels of support directors at climate-exposed companies routinely receive an annual elections. Where material, directors need to be held to account for failing to align with Paris.

We are prepared to speak out publicly when we believe this would be helpful, with regular appearances across mainstream media.

Apart from the change that can result from policy outreach, engaging in the broader policy debate is a powerful complement to individual company dialogues because it:

- Builds credibility with Boards with whom we speak; and
- Helps us form alliances with like-minded investors and supportive thought leaders, improving chances of success in company engagements

KEY ACTIVITES
SINCE LAUNCH

DIVESTMENT FROM TOTAL AND BP (Q3 2018)

Sarasin Climate Active divested from two of its inherited holdings from the flagship Sarasin Endowments CAIF – BP and Total in 2018. Following engagements, we concluded that neither company was seriously committed to taking action to mitigate climate change risks. In contrast, Royal Dutch Shell had made public commitments to support the Paris Climate Agreement and its goals to keep temperature increases below 2°C, and ideally to 1.5°C.

DIVESTMENT FROM AIR PRODUCTS & INVESTMENT IN ORSTED (Q4 2018)

The outcome of our stress testing and engagement considerations saw us divest from the industrial gas producer, Air Products, in 2018. We determined that Air Products shareholder capital was at risk under a Paris aligned scenario, driven by a lack of confidence that company management were sufficiently engaged in consideration of three factors identified below.

1. The company has material exposure to the fossil fuel industry, an industry that clearly faces existential demand challenges in a well below 2°C scenario

2. It has an exceptionally high emissions intensity that points towards increased risk in a carbon pricing scenario

3. Most importantly, its capital allocation policy is heavily weighted towards coal gasification – a technology that is incompatible with a well below 2°C scenario

Conversely, we continue to identify companies with high value creation opportunities that stem from climate change. As such, during the final quarter of 2018, we increased our position in the Danish wind utility firm Orsted. Our analysis shows Orsted as well positioned to capitalise upon the transition to a low and zero carbon power, given the company's expertise in constructing and operating offshore windfarms.

DIVESTMENT FROM MORANT WRIGHT (Q1 2019)

We conducted further analysis on third party fund managers with a review of the underlying holdings deemed to present potential climate risks.

Subsequent to this review, the Morant Wright Japanese Equity fund was determined to be weighted towards basic industry and includes heavy emitters including steel producers, chemicals companies, auto manufacturers and an oil and gas company (Inpex).

We engaged with Morant Wright to understand how transition and physical risks were integrated into the process and received a response that noted no climate factors were considered in the investment process.

Given this response, and the portfolio holdings, we were unable to derive comfort that further engagement would yield results and therefore divested from this fund in Sarasin Climate Active.

ROYAL DUTCH SHELL DIVESTMENT (Q2 2019)

Following two years of active engagement, Sarasin Climate Active sold Royal Dutch Shell in June 2019.

The catalyst was Shell's publication of its five-year strategy on 4 June, which set out its intention to allocate

$28bn of shareholder capital a year to fossil fuel activities, representing over 90% of the total budget. The consequence of this capital deployment plan is a rising fossil fuel production profile.

We believe that this strategy runs contrary to Shell's public commitments to support the Paris Climate Agreement. To achieve the Paris goals, greenhouse gas emissions need to fall to net zero by between 2050 and 2070.

While it is technically possible for Shell to implement deep cuts in fossil fuel production after 2030, this will become increasingly disruptive and management made no such commitment. There was also no explanation in Shell's presentation as to how the announced capital expenditure would deliver its commitment to support the Paris Agreement. The reality is that as long as emissions keep rising, the risks to our climate also rise.

This was a disappointing outcome given our extensive engagements with the company over a two-year period, including one-on-one meetings with several Board members and senior executives. Our engagements were alongside the collective effort of the Climate Action 100+ initiative, representing over $35 trillion in assets, with which we are also involved.

To draw public attention to Shell's misalignment with the Paris goals, we published our letter to the Board. This was covered widely in the mainstream and financial press including the Financial Times, the Guardian, Telegraph, Bloomberg and Reuters. We hope that our action will encourage other shareholders to consider carefully the climate implications not just of Shell's capex plans but also those of other oil and gas companies.

APPENDIX

The Climate Active investment philosophy can also be accessed at Sarasin & Partners via segregated portfolios and can be offered as a multi-asset solution, or as a single asset class portfolio for charities, pension funds and other investors.

The Oxford Martin School Investment and Engagement Principles:

1. Commitment to net-zero-emissions by a specific date or at a temperature increase cap (e.g. "well below 2°C"), including supply chains and products sold (i.e. Scope 3 emissions)

2. A profitable net-zero-emission business model: to demonstrate viability & credibility of strategy

3. Quantitative mid-term targets: to enable verification of progress towards net-zero emissions

If you would like to learn more about the Fund and our approach, please contact:

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