Climate change framework

Introduction

Climate change has been debated at the highest levels for more than a quarter of a century but more recently there has been widespread acceptance of its occurrence. Arguably one of the most important steps in achieving this was the Intergovernmental Panel on Climate Change (IPCC) report released in November 2014, which stated that climate warming is now 'unequivocal' and that human activity is 'extremely likely' to be the dominant cause.[1] Importantly this report emphasised the link between greenhouse gas emissions and climate change. As the effects of greenhouse gas emissions are cumulative, persistent and not localised, it is fundamental that this issue is considered in a global context. The response needs to be international, and it must be based on a shared vision of long-term goals and agreement on frameworks that will accelerate action over the next decade.

The ratification of the Paris Agreement to limit the rise in global temperatures this century to, at most, 2° celsius above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5° celsius was a further step forward and an example of the co-operation required[2]. To achieve the goals of the Paris Agreement, greenhouse gas emissions need to be substantially reduced. Much more needs to be done by governments but also by companies. Therefore, how companies are managing their greenhouse gas emissions has become fundamental to their long-term financial performance.

The IPCC report released in October 2018, starkly laid out the likely consequences of global warming of 1.5° celsius, and the additional damage that warming of 2° celsius could cause. The report stated that global temperatures have, on average, already risen 1° celsius above pre-industrial levels, and are currently increasing at 0.2° celsius per decade. Therefore, it is likely that an increase of 1.5° celsius about pre-industrial levels will be reached between 2030 and 2052.[3] An increase of this extent will have considerable negative consequences around the world from ice-free summers in the Arctic to species loss and extinction, but importantly the magnitude of the environmental damage if temperatures rise to 2° celsius above pre-industrial levels is likely to be substantially worse.

The Paris Agreement requires each country to set out in its Nationally Determined Contributions (NDCs) its commitment to reduce greenhouse gas emissions and how it intends to adapt to the impacts of climate change. Ruffer acknowledges that there are a diverse range of views on what greenhouse gas emissions reduction targets should be but we expect that the NDCs will be tightened in 2023 to align with the pathway to meet the goals of the Paris Agreement.

Ruffer's approach[4]

Integration

At Ruffer, we believe that environmental, social and corporate governance (ESG) considerations contribute to the risk of an investment and so, to manage this effectively, we incorporate these considerations into our investment process.

1 Intergovernmental Panel on Climate Change (IPCC) 2014 Synthesis Report

2 Paris Agreement unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf

3 Intergovernmental Panel on Climate Change (IPCC) 2018 Global Warming of 1.5°C Report, Summary for Policy Makers

4 The initiatives described in this policy represent only some of the work being undertaken by Ruffer and its ESG and Research team. Ruffer has strengthened and will continue to strengthen its contribution to combat climate change.

This is particularly important when the implications of climate change are considered, given the number of companies that are likely to be effected and the variety of ways this is likely to occur. Consequently, Ruffer considers the effects of climate change, including both the risks and the opportunities this presents, for all of our investments.

Stewardship and active ownership

Engagement

As concerns about climate change have intensified, the desire to engage with companies on this issue has grown. Due to the scale and global nature of the problem, a number of shareholder initiatives, including Climate Action 100+, have been launched. Ruffer believes in the power of collaborative engagement and so was a founding investor signatory to this initiative and is a member of the Institutional Investor Group on Climate Change (IIGCC). By becoming a signatory to Climate Action 100+, Ruffer acknowledged in its sign-on statement, that we 'are aware of the risks climate change presents to our portfolios and asset values in the short, medium and long term. We therefore support the Paris Agreement and the need for the world to transition to a lower carbon economy consistent with a goal of keeping the increase in global average temperature to well below 2° celsius above pre-industrial levels.'[5]

Investment managers and asset owners, along with many environmental groups, have been engaging with fossil fuel companies about climate change for a number of years and the concerns raised about the success of engagement with these companies cannot be dismissed. However, in the last few years there have been considerable changes which suggest that engagement could now be a very powerful tool to effect real change. Organisations such as CDP (formerly Carbon Disclosure Project) and the Transition Pathway Initiative, which Ruffer supports, have given investors tools and quantitative analysis to use as the basis of meaningful engagement with companies.

5 climateaction100.org

Ruffer believes that engagement is an effective tool and so we are committed to engaging with those companies in which our clients' assets are invested. For those companies that make a significant contribution to global greenhouse gas emissions we are engaging to encourage them to adapt their business models to align with the transition to a low carbon economy. This includes fossil fuel producers, utilities companies and producers of energy intensive products. We also appreciate the significance of discussing with these companies why greater transparency with regards to climate change disclosure as well as tangible targets for greenhouse gas emissions reductions are important for investors.

Given the largest corporate greenhouse gas emitters often have operations in many countries around the world, and the effects of climate change are not localised, we think that engagement through collaborative initiatives has the best chance of achieving real change. As part of Climate Action 100+, Ruffer is in specific working groups, and so has committed to engaging with, a number of European and American oil and gas companies. At the end of September 2018, more than 296 investors representing over $31 trillion of assets had signed up and the list is continuing to grow.[6] The scale of this initiative gives considerable power to investors and creates a valuable opportunity to exert continued pressure on these systematically important companies. These companies are of such great importance given their combined greenhouse gas emissions and so their actions will have a meaningful effect on whether the goals of the Paris Agreement are met.

The aims of Climate Action 100+[7] for these companies over the next five years are detailed below.

1. Governance: implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risk and opportunities.
2. Action: take action to reduce greenhouse gas emissions across their value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2° celsius above pre-industrial levels.

6 climateaction100.org

7 climateaction100.org

3 Disclosure: provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures and, when applicable, sector-specific Global Investor Coalition on Climate Change Investor Expectations on Climate Change[8] to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2° celsius, and improve investment decision-making.

For those companies in which our clients' assets are invested, which are not part of the Climate Action 100+ focus list, we will continue to engage on a wide range of climate change related issues where we deem these issues to be important to our investment case.

Voting

It is Ruffer's policy to vote on annual and extraordinary general meetings, and shareholder resolutions. We take the opportunity to vote seriously, as it enables us to encourage boards and management teams to consider and address issues that we are concerned about. When voting we consider companies' explanations and our internal voting guidelines in order to vote in the best interest of our clients.

At Ruffer, we are supportive of the IIGCC's shareholder resolution subgroup, and we think that shareholder resolutions are likely to have an increasingly important role to play in the years ahead. We see shareholder resolutions as a useful communication tool when engagement has not been successful as it gives companies a clear picture of the preferences of its shareholder.

Other climate change related issues on which we will vote and engage with companies include corporate and trade association lobbying. It is important to Ruffer that a company's policy on climate change is aligned with its lobbying activities and practices.

Constructing portfolios

Ruffer's ability to construct segregated portfolios gives us the flexibility to incorporate client specific ethical investment restrictions into the management of portfolios. We currently use MSCI ESG Research as our screening and research provider and this allows us to include restrictions in relation to fossil fuel companies if desired. One advantage of a segregated portfolio is the transparency it provides, and this gives comfort to our clients that we are investing in line with their ethical investment restrictions.

We plan to further align our client disclosures and reporting with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures.

Managing our carbon footprint

In addition to considering the greenhouse gases emitted by the companies in which we invest, it is prudent for us to consider the emissions from our own business. Consequently, Ruffer has decided to calculate its carbon footprint. We believe this will allow us to focus on how best to reduce our greenhouse gas emissions and we will be exploring the options available to offset these emissions.

8 The Global Investor Coalition on Climate Change Investor Expectations on Climate Change sector guides cover oil and gas, mining, utilities and auto manufacturers and provide additional sector specific disclosure recommendations, particularly regarding the oversight of public policy positions.

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