Dear sir/madam,

Climate change is one of the major challenges of our time, and it requires a response from companies across all industries and countries. An effective climate strategy not only helps a company prepare for the risks of global warming, it can also confer a competitive advantage which may help the business to outperform over the long term. Conversely, an inadequate climate strategy can signal a business is at risk of long-term underperformance. So, it can be important for us to consider these strategies when making investment decisions.

But what do we look for in a climate strategy? And what information do we want companies to disclose to help us in our analysis?

Climate strategy and competitive advantage

Ruffer was founded in 1994 and is a leading asset manager for institutional and private clients. We are active and unconstrained investors, with a keen focus on protecting our clients' capital.

When making a significant investment in a company, we consider a range of factors that influence its future profitability. One important factor is the company's willingness and ability to address climate risk, both in its own operations and across its supplier and customer base. Specifically, we ask –

How strongly is the company positioned to pursue mitigation (to tackle transition risk) whilst preparing for adaptation (to guard against physical risk)?

As society tests the limits of the carbon budget and other planetary boundaries, resource-intensive assets may be shunned whilst resource-efficient business models may proliferate. Alongside a reconfiguration of economic activity, we may need more investment in adaptation so we can be better prepared to live with greater environmental turbulence.

Perhaps this disruption will give rise to risks and opportunities. To create and capture economic value, companies may need to strike a tricky balance between cooperating with other members of their ecosystem and securing the resources and cultivating the capabilities that may well underpin a sustainable competitive advantage.

We believe three types of companies could be best placed to meet the challenge

1. Innovators that emphasise productivity and flexibility
2. Those with influence and bargaining power over customers, suppliers and even policymakers and
3. Those whose robust processes help them respond to calls for greater transparency

Unfortunately, indicators of competitive advantage are harder to identify than science-based targets, decisive capital allocation plans and promising policies. But our focus on protecting clients' capital compels us to consider both the amount and the quality of investment in climate risk mitigation.

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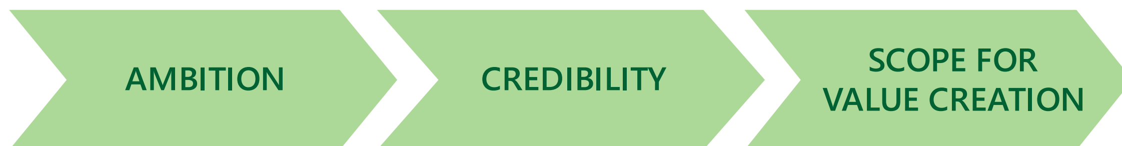
As we step up our evaluation of carbon emission abatement targets and transition plans, we look for ambition, credibility and scope for value creation. We are especially interested in any company whose market valuation does not fully reflect its potential for climate leadership.

Transition plan analysis: key criteria



Strategic steps and supportive disclosure

To aid our analysis, we are asking investee companies to take some strategic steps and disclose critical information.

Ambition

Well-framed targets can galvanise a business and attract the resources needed to make progress. Companies should seek to formulate ambitious, science-based targets that reflect their fair share of the remaining carbon budget in a 1.5˚C warming scenario (>50% probability, no or limited overshoot). These targets should be designed to spur action over the near term and to compound it over the long term.

Credibility

Ambitious targets are just the start. They should be supported by a coherent strategy and an appropriate capital allocation plan. To assess transition plans' credibility, we try to gauge the degree of carbon lock-in.[1] Incentives are important from the C-suite to the front line, as is corporate culture. Employee engagement and cross-function collaboration are vital for cost-effective abatement, and we look for strategic investment in the skills required for climate leadership.

Companies should cultivate the financial flexibility to invest in abatement projects and should scrutinise differences between internally derived acceptable rates of return and the market-implied cost of capital. Where carbon prices aren't effectively set by regulators, we encourage companies to have robust internal carbon prices. These should influence investments along a well-specified marginal abatement cost curve[2] (MACC), and companies should continually search for positive net present value extensions to the MACC.

We believe companies should address any bottlenecks in their ecosystem, using either partnerships or internal research and development. We expect them to report key performance indicators showing their progress on clearing these bottlenecks.

Scope for value creation

We look for companies with transition strategies that may drive competitive advantage and economic value. Companies should identify key dependencies and try to secure critical inputs at attractive prices. For example, we encourage proactive offtake agreements with suppliers, especially where green inputs are scarce and competition is likely to intensify as peers accelerate

their own transition plans. Similarly, we expect companies which are first movers on decarbonisation to be able to establish relationships with customers and governments, to attract top people and to enjoy favourable rates on financial capital.

We are interested in companies' abatement capabilities and capital productivity. Do they have abatement levers that are not available to peers, thanks to knowledge that is tough to replicate? Can they reduce emissions at a lower cost than the sector MACC suggests?

We encourage companies to report carbon-adjusted return on invested capital[3] (CA-ROIC), with a justifiable carbon price charged on emissions, consistent with geographical exposure. A decomposition of CA-ROIC will reveal realised abatement costs, capital efficiency, market share gains, pricing power and the potential impact of tightening regulation. We believe such a metric, tracked over an abatement investment cycle, could incentivise managers and employees.

If transition leaders pull away from transition laggards, they could set new industry standards and could support environmental regulations (such as a robust carbon price and green quotas) that reward their initiative. Transition leaders could also be expected to actively promote environmental benefits to their customers, preferably through rigorous quantitative benchmarking (for example, by disclosing avoided emissions).

To support our proprietary analysis, we use information from organisations like CDP, the Science Based Targets initiative, the Transition Pathway Initiative and Climate Action 100+. We encourage investee companies to provide comprehensive, timely disclosure so we can integrate all material information into our assessment.

We politely request companies to provide

1. a full emissions inventory (across Scopes 1, 2 and 3)
2. a verified 1.5˚C-aligned science-based target, with near-term milestones and a long-term Net Zero ambition
3. a coherent decarbonisation strategy and congruent capital allocation plan

In addition, we would welcome

4. a framework for thinking through adaptation and clear communication on how physical risk might affect the business model

But we plan to dig much deeper in our efforts to identify climate leaders.

In conclusion, Ruffer is a signatory to the Net Zero Asset Managers initiative, and we see our commitments to tackling climate risk and to protecting our clients' capital as mutually reinforcing. Through our engagements, we seek to catalyse the capital flows and innovation needed to decarbonise the economy and to enhance the stock of natural capital for future generations. To accelerate the transition, we want our investee companies to help drive down green premiums and promote the uptake of green solutions. Companies which fail to meet this challenge risk underperformance or even failure, whilst those which act decisively may find new sources of competitive advantage.

Regards,

Kevin Paul	Alex Jamieson	Miranda Best
Responsible Investment Director	Head of Responsible Investment	Deputy CEO

[1] Lock-in – a state of inertia arising from a combination of psychological resistance, technological constraints, financial inflexibility and incentives to maintain the status quo.

[2] Marginal abatement cost curve (MACC) – a chart depicting specific technologies' potential to reduce emissions relative to business as usual, alongside the cost of implementing these technologies.

[3] Carbon-adjusted return on invested capital (CA-ROIC) – a proposed indicator of productivity which seeks to account for carbon emissions. The denominator captures the balance sheet value of the company's investments in productive capacity, whilst the numerator is a measure of its profits adjusted for a theoretical price on emissions.

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