Kempen

ESG NEWSLETTER JULY 2019

Investing with a purpose

In this quarterly newsletter, we take a closer look at the world of responsible and sustainable investment. At Kempen Capital Management N.V. (hereafter Kempen), Environmental Social Governance (ESG) factors are fully integrated throughout our investment process, and for us responsible investment means being good stewards of the companies that we invest in. We encourage positive change through engagement with the management of our investee companies and through actively using our shareholder voting rights.

THIS SECOND EDITION OF OUR NEWSLETTER COVERS A KEY TOPIC IN THIS FIELD: CLIMATE CHANGE

WWW.KEMPEN.COM RESPONSIBLE INVESTMENT

Climate change, a global challenge

Climate change is a global development that will impact governments as well as the corporate sector and the public, both at a global and a local level. Climate change, therefore, is an essential aspect of responsible and sustainable investing.

This newsletter will outline the (possible) consequences of climate change, the investments required for its mitigation, and the correlation with the UN Sustainable Development Goals. In addition, it will address the various initiatives that are ongoing and what we are actively doing to rise to the challenge, as climate change poses risks but also offers opportunities. Finally, this newsletter will provide you with a number of tips on how you can address climate change in your investment portfolio.

(POSSIBLE) CONSEQUENCES OF CLIMATE CHANGE

There is ample scientific consensus that global warming is caused by human intervention. The earth has already warmed 1 degree Celsius relative to preindustrial times. That is why under the Paris Agreement, countries have agreed to pursue efforts to limit the global average rise in temperature to well below 2 degrees Celsius. Although the climate agreement is

> ‘Unlike other ESG topics, climate change is ubiquitous and all-encompassing. It will touch everyone’s lives, from governments to companies and citizens.’

DANNY DEKKER, SENIOR RESPONSIBLE INVESTMENT ADVISER AT KEMPEN

endorsed by virtually all countries except the US, current measures taken by the international community are not sufficient to achieve the 2 degrees Celsius goal (current pledges are estimated to get us to about 3 degrees Celsius of warming). More measures and investments are necessary.

WHAT WILL BE THE PRICE?

The transition to a low-carbon economy requires a fast and drastic transition in all systems, both in energy and agriculture as well as in urban, infrastructural, and industrial systems. The related economic and financial transformation will be significant, and will create both risks and opportunities. The costs of the consequences of climate change will increase as investments in the transition are delayed. Several organizations have estimated the investments needed to transition to a carbon-neutral economy, showing that substantial investments are required[1,2]:

- The **IPCC** predicts that the necessary additional energy-related investments, in line with the 1.5°C warming scenario for the period until 2050, will annually amount to approximately USD 800 billion.
- The **European Union** has estimated that there is an investment gap of nearly EUR 180 billion if they want to achieve their climate and energy goals (this corresponds to approximately 6% of current investments).
- The **OECD** estimates that in order to achieve the 2°C goal, the bonds that are used to finance renewable energy have the potential to yield an amount of USD 620 billion to USD 720 billion in annual issuances, and USD 4.7 trillion to USD 5.6 trillion in issued shares and bonds by 2035.
- The **IEA** expects that an average USD 3.5 trillion in annual investments in the energy sector will be necessary until 2050 in order to move towards a carbon-neutral economy.

CLIMATE CHANGE AND THE UN SUSTAINABLE DEVELOPMENT GOALS

Climate change is a global challenge and is related to the UN Sustainable Development Goals, or SDGs. For instance, the SDGs Affordable and clean energy (SDG 7) and Climate action (SDG 13) are directly related to

1 Source: *https://www.banquefrance.fr/sites/default/files/media/2019/04/17/ngfs_first_comprehensive_report_-_17042019_0.pdf p.15*

2 *International Energy Agency, Chapter 2 of “Perspectives of the Energy Transition – Investment Needs for a Low-Carbon Energy System”, 2017*

The most recent report from the Intergovernmental Panel on Climate Change (IPCC), which was released by the end of 2018, describes the (possible) consequences of a temperature rise of 1.5 degrees as compared with 2 degrees. Some of the differences in impact at a rise of 1.5 degrees compared to 2 degrees are listed below:

- Coral reefs will decline by 70-90% at 1.5 degrees warming, instead of becoming all but non-existent (>99%) at 2 degrees warming;
- Two to three times less animal species will be threatened with extinction (e.g., 6% instead of 18% of the studied insects);
- Hundreds of millions of fewer people will be exposed to climate-related risks, including poverty;
- The sea level will have risen less (10 cm) by the end of the century, exposing fewer people to related risks.

climate change. In addition, other sustainable development goals that are associated with (the consequences of) climate change, including the reduction of poverty and hunger (SDGs 1 and 2) can be adversely impacted by increasing heat and drought, for example, or climate-induced migration. Furthermore, efforts to reduce inequality between people (SDG 10) may be adversely impacted by the fact that not everyone has the means or the ability to take out insurance against climate-related risks. In their most recent report (from 2018), the IPCC also stated that climate change will (potentially) affect all sustainable development goals[3]. Achieving the sustainable development goals will require considerable investments. The UN has estimated, for instance, that the annual investment gap to achieve the goals in developing countries alone amounts to approximately USD 2.5 trillion[4].

WHICH MEASURES HAVE ALREADY BEEN TAKEN IN TERMS OF LAWS AND REGULATIONS?

We see that the Paris Agreement is translated into commitments and policy, laws and regulations[5] by country policy-makers. Several countries have made a commitment to pursue full or partial climate neutrality within decades: the United Kingdom as the first of the G7 countries (climate-neutral by 2050), France (climate-neutral by 2050), Denmark (70% emissions reduction by 2030), Finland (climate-neutral by 2035), Sweden (zero emissions by 2045), and the Netherlands (95% emissions reduction by 2050).
In addition, states have expressed their intentions on the subject, including New York (zero emissions by 2050) and California (the sixth economy of the world, climate-neutral by 2045).

3 https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf

4 UNCTAD's World Investment Report 2014

5 Additional legislation at a European level that addresses climate change as one of the ESG topics, is the IORPII Directive, which makes it mandatory for institutional investors (pension funds), with effect from the beginning of 2019, to report explicitly how ESG factors, including climate change, are taken into account in their investment decisions.

We will focus specifically on five[1] of the 17 Sustainable Development Goals (SDGs). These five most closely match our core activities, enabling us to deliver a greater contribution. We investigate how to link these goals to our own objectives. In addition, we are working on measuring impact as well as reports to our clients - where possible - on the level of sustainability of their investments.

THE FOLLOWING SDGS HAVE OUR SPECIAL ATTENTION:

- **Goal 7**: Affordable and clean energy. We reduce our carbon footprint and encourage our clients to take climate-friendly measures, such as reducing energy consumption and switching to clean energy. We invest in companies and enter into an active dialogue with them to pursue the goal of reducing their CO2 emissions.
- **Goal 8**: Decent work and economic growth. In various roles – as an investor, lender, and adviser – we promote sustainable economic growth.
- **Goal 12**: Responsible consumption and production. As a long-term investor, we encourage the companies we invest in to produce sustainably, improve the level of sustainability of their processes, and streamline their sustainability reports.
- **Goal 16**: Peace, justice and strong institutions. In our different roles, we give serious consideration to international treaties, conventions, and agreements, and engage in dialogue with companies where we promote good governance and anticorruption measures.
- **Goal 17**: Partnerships to achieve the goals. Achieving all of the SDGs requires global cooperation. That is why we participate in sustainable organizations and initiatives such as PRI, CDP, IIGCC, and SDG initiatives.

1 Read more about Van Lanschot Kempen and SDGs: https://www.vanlanschotkempen.com/media/3318/our-contribution-to-the-sustainable-development-goals-van-lanschot-kempen.pdf

Besides, the European Commission (EC) has announced the long-term strategy for the EU economy to become climate-neutral by 2050. Their goal is to facilitate that this becomes a driver of economic growth, jobs, and a stronger competitive position for the European economy. One of the instruments that are being leveraged is the European Emissions Trading System (EU ETS), a market instrument that the EU uses to achieve a cost-effective reduction of greenhouse gas emissions. This is the world's largest emissions trading system for the greenhouse gas CO2. Also China, the world's leading carbon emitter country, is researching options for an emissions trading system and expects to introduce the system next year.
Currently, the EC is developing sustainable (climate-related) standards and legislation by means of the Action Plan on Sustainable Finance, which was introduced in 2018 and has led to the formation of the Technical Expert Group on Sustainable Finance. This group provides advice on the development of a taxonomy to determine the level of sustainability of economic activities, standards for European green bonds, benchmarks for strategies that invest in assets that contribute to carbon emission reduction, and guidelines to improve corporate disclosure of climate-related information. The expert group has since released reports on these subjects that are open for (public) inspection.

De Nederlandsche Bank

The financial sector as a whole has an important role to play in achieving the climate objectives and financial institutions should better take into account the risks involved in climate change and the transition to a climate-neutral economy. For this reason, De Nederlandsche Bank, the central bank of the Netherlands, has conducted several studies into climate-related risks and the approach of financial institutions, including a climate stress test in which the energy transition could lead to significant losses for the financial institutions. That is why DNB has anchored climate-related risks in its supervision as one of the three key focal points. In addition, DNB has established the Sustainable Finance Platform, containing the working groups Climate risk and PCAF (Platform Carbon Accounting Financials) Kempen actively participates in these working groups.

United Kingdom

The United Kingdom has recently committed to a target of net zero greenhouse gas emissions by 2050. In the financial sector, legislative proposals were introduced earlier, which will take effect in October of 2019, to ensure that pension fund administrators pay sufficient attention to sustainability in their investments. Climate change is an important aspect in this respect.

Market: Green bonds

The market also reflects the increasing importance of addressing climate change. One example is the rapid increase of green bonds, the first of which was issued in 2008 by the World Bank. While the total value of green bonds was USD 66 billion in 2015, this increased to USD 389 billion last year.

Green bonds allow countries, institutions, banks, and companies to raise funds that are specifically earmarked to finance new or existing projects that have a positive environmental or climate-related impact. The Netherlands has recently also issued a green bond as an incentive for this market, raising nearly EUR 6 billion for renewable energy (Renewable Energy Production Incentive Scheme), energy efficiency (Energy Performance Incentive Scheme for the Rental Sector), sustainable transport (expenditure and investments in railway infrastructure), and climate adaptation (Delta Fund).

In order to prevent greenwashing (the practice of making an unsubstantiated or misleading claim about the environmental benefits of a company or institution), a group of financial institutions, including the World Bank, have developed the Green Bond Principles (GBP). However, these are voluntary guidelines. That is why the Action Plan on Sustainable Finance, through the TEG expert group, has recommended that European green bonds decide on a common language so that investors can easily identify green bonds that meet the listed 'green criteria'.

WHAT IS KEMPEN'S APPROACH?

Kempen is an asset manager with a long-term investment approach. We strongly believe in engaged shareholdership that benefits all stakeholders. Climate change is an ESG focus area for Kempen, and as a long-term asset manager, we are convinced that we can contribute to progress in this area. We have committed to supporting our clients in dealing with the opportunities and risks that climate change entails.

We incorporate climate change into our policy in several ways:

- Climate change is incorporated into our sustainability goals.
- Climate change is included in our ESG policy.
- Climate change is part of our ESG integration process, which means that we consider, screen, and monitor these aspects in our investment process. In addition, we have measured the carbon footprint of the investments of our clients since 2017[6]. We currently do this for approximately 50% of the investments, and our aim is to get to a point where we can do this for all of the investments, but this is subject to an important condition: the availability of data. (Our measuring method is described in the recently published 2018 Responsible Investment report.)
- We give due consideration to climate change in our active shareholdership and engagement:
  - We enter into a dialogue with companies (so-called engagements) to encourage them to give due consideration to climate change in their operations and to take measures to comply with the Paris Agreement. We do this both through direct engage-

6 For the measuring method of our carbon footprint, please refer to: https://issuu.com/kempenpublications/docs/responsible_investment_jaarverslag__2a42611da49f10/1?ff&e=24013627/69854896 Our Climate policy: https://www.kempen.com/nl/asset-management/responsible-investment/climate-change

JOINT ENGAGEMENT

In order to increase our influence, we take part in joint engagement initiatives. One important climate-related initiative that we actively participate in is Climate Action 100+, via IIGCC.

Climate Action 100+ and IIGCC

An important international initiative in the financial sector is the Institutional Investors Group on Climate Change (IIGCC). In this initiative, institutional investors encourage companies and governments to live up to their responsibilities with respect to climate change. An important initiative that IIGCC coordinates within Europe is Climate Action 100+, in which a large group of asset managers and asset owners with the largest companies in carbon-intensive industries – jointly accounting for two-thirds of global emissions – enter into a dialogue for the purpose of making the transition to a climate-neutral economy.

ments and in conjunction with other investors through joint engagements. For examples of these engagements, please see the text box below.
- As an asset manager, we exercise voting rights. We consider this an essential aspect of our engagement and our active shareholdership. We support proposals that are in keeping with our climate policy. Last year at Shell, for instance, we voted in favour of the Follow This climate proposal. This year, we also voted in favour of similar climate proposals at other oil and gas companies (Equinor and BP).

× We report in line with the standard in the field of climate change, called Task Force on Climate-related Financial Disclosures (TCFD). Through this report, we demonstrate how we take climate risks and opportunities into account in our governance, risk management, metrics, and reports. One element that we are currently working on is scenario analysis, in which process the effects of climate change are extrapolated to the future. These analyses will include both physical risks (such as floods) and transition risks (e.g., the energy sector). The availability and quality of relevant data is of critical importance also in this respect.

TIPS ON HOW TO RESPOND TO CLIMATE CHANGE IN INVESTMENTS

Climate change is an essential topic when it comes to responsible and sustainable investments. Below is a list of tips to help you incorporate the issue of climate change into your investment portfolio:

× Determine the importance of the subject of climate change. How important is the subject to your organization, participants, and other stakeholders? You can use the Sustainable Development Goals (SDGs) as a broader frame of reference in this respect. What are the goals to which your organization wants to contribute?

× Determine where you want climate change to be reflected in your organization, including investments.

× Determine how you want to incorporate climate change into your investments:
- Incorporate it into the 'investment beliefs'.
- Incorporate it into the ESG policy, including the definition, ambition, and guidelines. The following questions may be helpful in this respect:
  - What do you want to achieve and how do you want to achieve it? Does your goal mainly involve risk control, or do you want to contribute to society, or both?
  - Do you consider climate risks in determining the strategic asset allocation, in an ALM study, for instance?
  - Do you want to reduce the CO_2 emissions of the investments, and if so, to what extent, and how? Do you want to exclude certain sectors or provide incentives through engagement with companies, such as coal mining or public utility companies with coal-fired power stations?
  - Can you see added value in engagement activities? Does your asset

EXAMPLES OF ENGAGEMENTS

× **Royal Dutch Shell**: both long-term and short-term goals have been formulated by Shell in the area of carbon emission reduction, which were furthermore linked to directors' remuneration. In addition, Shell has committed to more transparency about their lobbying activities. We stimulate Shell to adhere to their climate ambition.

× **Glencore**: Commitment from Glencore, one of the world's leading commodity trading and mining companies, to scale down coal production.

For our complete engagement case with Shell and Glencore, but also our other company engagement cases, please refer to our website.

manager support initiatives such as Climate Action 100+?
  - Would you consider investing in certain asset classes (e.g., green bonds)? Would you include this in existing mandates or would you prefer a specific allocation?
  - Would you consider investing in certain companies (e.g., best-in-class companies with respect to this topic)? Would a generic ESG rating, including climate, suffice, or do you want to target specific objectives?
  - Incorporate the subject into reporting.
- Share the results of the policy and implementation with your stakeholders and ask them for feedback.

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KEMPEN BELIEFS

Kempen Capital Management is an asset manager that believes in stewardship and investment focusing on the long-term for the benefit of all stakeholders. Value creation is at the heart of the services we provide to our clients. We believe that being an engaged shareholder on environmental, social and governance (ESG) issues and retaining a long-term focus, is critical to helping our clients to preserve and create sustainable wealth that has positive real world impact and economic returns.

KEMPEN WIDE APPROACH TO RESPONSIBLE INVESTMENT

We are committed to create sustainable alpha. The four pillars of our ESG-policy are:

- ESG integration: Ensuring sustainability risks and opportunities are adequately considered in our investment analysis and processes.
- Exclusion & avoidance: Not investing in companies involved in controversial activities or conduct.
- Active ownership: Being responsible stewards of our clients' capital and using our influence through engagement and voting to improve corporate behaviour on specific ESG issues and achieve positive change
- Positive impact: Investing with an objective to achieve positive real world outcomes and impact, such as contributing to the UN Sustainable Development Goals.

To put our mission and vision into practice we engage with our investee companies on a wide array of strategic, financial, and ESG topics. As an active owner we use our influence to improve our investee companies' ESG performance. This helps us address some of the most pressing and important sustainability issues facing business and the world. Our focus themes for engagement are: human rights, labour rights, climate change and governance.

Through collaboration with other investors and industry think tanks we contribute to the development of principles and standards of corporate responsibility both at sector levels, as well as investee company level.