



CLIMATE CHANGE AND THE ENERGY TRANSITION

The science is unequivocal and the evidence is growing ever stronger: climate-related risks are larger, and coming through more rapidly, than previously thought.

The Intergovernmental Panel on Climate Change's (IPCC) 2018 special report Global Warming of 1.5°C argues that global warming of 2°C above pre-industrial levels poses greater risks than previously believed, and that these risks can be substantially reduced by limiting warming to 1.5°C (the ultimate aim of the 2015 Paris Agreement). As the report outlines, we are already experiencing detrimental climate change in our daily lives. Many human and natural systems, including land and ocean ecosystems, and some of the services they provide, have already changed.

Recent evidence suggests that the Earth, now exceeding 400 parts per million by volume of CO₂ in the atmosphere, has already transgressed one of the nine planetary boundaries, and is approaching several other Earth-system thresholds.⁵ We have reached a point at which the loss of summer polar sea-ice is almost certainly irreversible. By the end of 2017, global average temperatures were about 1.0°C warmer than in pre-industrial times. At the current rate of warming of about 0.2°C per decade, the IPCC report states that we will exceed 1.5°C of warming between 2030 and 2052.⁶

Today, action requires significant investment, but inaction will be significantly costlier – with estimates of 20% or more of global GDP being wiped out⁷ – and could pose a systemic risk to financial stability⁸. And while we will all be affected, the poorest will suffer the most. Climate change may prove to be the greatest market failure the world

has ever seen, with the most significant societal impacts. As the world gets warmer, the potential damage intensifies. A temperature rise of 4 or 5 degrees above pre-industrial levels would render life very difficult, increase the likelihood of serious conflict at international and regional levels, and will force hundreds of millions of people to migrate. The impacts on biodiversity and food systems would be catastrophic, much of it irreversible.

The 21st session of the Conference of the Parties (COP21) was pivotal in the fight to curb global warming, as 195 countries undertook to collectively build a low-carbon global economy. We no longer ask whether the transition from a fossil fuel-based economic model to a low-carbon economy will happen, but how long it will take, who will finance it, and how, because the alternative is both uninvestable and unacceptable. Reaching agreement was mainly down to governments; implementing it requires collective action, including, critically, by investors.

The Paris Agreement made history by establishing a clear, immovable goal and direction of travel: to keep global temperature rise well-below 2°C above pre-industrial levels.

BNPP AM committed alongside world leaders to aligning its investments to the Paris goals.





E#1: ENERGY TRANSITION

“Energy transition” is the term now widely used to describe the structural shifts that are occurring in the global energy system. The energy system of the past was based on a model dominated by centralised, fossil-fuel-based production where most of the value was in the production of energy itself, and most of the power was with large producers who did not have to worry about externalities. By contrast, the energy system of the future will be based on a decarbonised and decentralised model, where most of the value will be in the technology that delivers the energy, and much more of the power will be with consumers. This shift is already happening. We are also beginning to see polluters having to pay for their externalities, and governments prioritising the widest possible access to energy for society as a whole.

There are four main drivers of this energy transition: (i) public policy; (ii) technology; (iii) changing consumer preferences; and (iv) changing investor preferences. These four factors operate in a feedback loop, such that the energy transition will likely intensify and accelerate over the next decade.

Of course, this global energy transition will move at different speeds in different jurisdictions, and the emphasis on these factors will be different in each depending on the starting point. However, there can be no doubt about the radical transformation that it is already causing, or the financial risks and opportunities that it brings for investors.⁹

The transition is an opportunity in the short, medium and long-term to boost growth, first from increased investment in the low-carbon transition, then to foster innovation and technological progress.¹⁰ In the long run, it is the only plausible growth we can aspire to.

We choose not only to be on the ‘right side of history’ by anticipating these trends, but to actively use our investments and our leverage to ensure that the transition to a low-carbon energy system occurs at the speed and pace necessary to prevent catastrophic climate change.

ENERGY TRANSITION: OBJECTIVES AND TARGETS

Our objective is to make a substantive contribution to the low-carbon energy transition. We have three targets to structure our work towards this objective:

-1-

To align our investment portfolios with the goals of the Paris Agreement by 2025.

-2-

To encourage our investee companies and countries to align their strategies with the goals of the Paris Agreement.

-3-

To encourage policymakers to adopt measures that align with the goals of the Paris Agreement.

We aim to align our portfolios, firstly, by reducing our exposure to fossil fuels while managing exposures in line with the well-below 2°C International Energy Agency (IEA) Sustainable Development Scenario (SDS). Of all the scenarios in line with the objectives of the Paris Agreement, this is the most reliable and widely used.¹¹ As part of that commitment, we are introducing an enhanced coal policy (effective January 2020, see panel on next page), further strengthening our existing approach. We will also measure our ‘sustainable economic’ investments, in line with the forthcoming EU taxonomy, once available.

Secondly, we are assessing how companies are managing climate-related risks and opportunities; but more concretely, we are examining how carbon intensities (current and expected) within the seven most carbon-intensive sectors¹² compared to the IEA SDS. Our assessments will allow us to benchmark companies' emissions trajectories against the international target defined by the Paris Agreement and will inform our active engagement with these issuers. We intend to align our investments in those seven sectors to the global target, starting with the electric utilities sector, by 2025. We will actively participate in the CA100+ initiative as the central feature of our company engagement platform.

Thirdly, while we have already engaged with policymakers calling for greater action and ambition in their climate strategies, our intention is to strengthen our direct engagement with governments. We will focus on three main areas:

- 1 -

Their commitments and their actions on mitigation (i.e. their efforts to reduce greenhouse gas (GHG) emissions across the economy).

- 2 -

Their commitments and their actions on adaptation (i.e. their efforts to minimise the negative consequences associated with the physical and transition impacts of climate change).

- 3 -

How much their efforts on mitigation and adaptation will cost, and how they intend to finance these investments.

These interactions will take place in three main ways. First, in our role as investors in sovereign debt. Second, in regular engagements with policymakers in the markets in which we are active investors. And finally, via our active participation in regulatory or pseudo-regulatory initiatives such as TCFD¹³.

Our approach to the energy transition incorporates the notion of a 'just transition' to ensure that the shift will be inclusive and responsive to the needs of displaced workers, poorer communities and communities and regions in the world most affected by the impacts of a changing climate (this aligns with our thematic pillar, "Equality and Inclusion").

ENHANCED COAL POLICY

(effective from January 2020)

- 1. We will exclude coal-mining companies that derive more than 10% of their revenue from mining thermal coal and/or account for 1% or more of total global production. The global production limit will capture those companies whose share of revenue from coal is below 10%, but which nonetheless account for a meaningful level of production on an absolute basis.**
- 2. We will exclude coal-power generators whose carbon intensity is above the 2017 global average of 491gCO₂/kWh and will subsequently follow the Paris-compliant trajectory for the sector as determined by the IEA SDS. The IEA SDS requires power generators' carbon intensity to fall to 327gCO₂/kWh by 2025, and we will therefore demand that companies reduce their carbon intensity between 2020 and 2025 at a rate consistent with this, excluding those that fail to do so.**
- 3. We acknowledge the importance of encouraging companies to reduce their dependence on coal mining and coal-fired power generation in order to align their activities with the Paris Agreement. We will therefore consider exceptions for those miners and power generators that make credible commitments to reducing their coal-based activities to levels consistent with the Paris Agreement within the required time frame. The credibility of commitments will be determined using quantitative and qualitative criteria, including disposal plans for coal assets or acquisition plans for lower-carbon generation capacity, and the extent to which management are prioritising a lower-carbon business model. Exemptions will be granted on a half-yearly basis, with those companies demonstrating their commitment to the policy expected to comply within two years.**
- 4. We will reach out to all the companies we will be divesting from as part of this new policy, explaining the rationale for the policy and giving them the opportunity to engage in a dialogue with us. We will actively engage with both diversified mining companies and utilities that exhibit proof of readiness and willingness to decarbonise their portfolios. We will use the influence of our voting and other stewardship activities to ensure that the largest possible number of companies within our portfolios meet our targets by the target date.**

BNP Paribas Asset Management is the source for all data in this document as of March 2019, unless otherwise specified.

Investments are subject to market fluctuations and other risks inherent in investments in securities.

The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay.

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