A Just Transition to net zero

Just Transition is a movement defined by The Paris Agreement of 2015 as countries working together for equitable distribution of the costs and benefits of climate action via workers, employers, communities, society and governments.

There is a clear consensus among policymakers that an energy transition must happen to limit temperature increases to 1.5° C by 2050. Let’s look at the social aspects of the transition—namely, the cost of energy and economic development, which have received less attention up until now. Moving forward, policymakers will have to balance these competing demands to potentially accomplish a Just Transition.

Social costs

An immediate step to reducing temperature increases would necessitate a reduction in the overall production of energy, and most likely require the rationing of energy. Costs in terms of unemployment would be considerable—for instance, in the United States, 7.5 million people were employed in the energy, energy efficiency and motor vehicle sectors as of 2020. Statista reported that number as 257,284 in Canada for 2021.

The natural response is to say that these workers could be retrained in the renewables sector, but this is not an easy transition: many of the skills acquired are specialized and new roles may not be available within the same region—if at all. There would have to be significant additional public investment in skills and education.

But it isn’t only employment that would be affected. For example, in the United Kingdom, 13% of households in England, 25% in Scotland, 12% in Wales and 18% in Northern Ireland were classified as fuel poor—and an increase in these numbers is anticipated if access to fossil fuels is curtailed in the short term. Households in fuel poverty are more likely to ration energy, which can lead to increased risks, particularly in colder months as this may lead to increases in certain conditions such as bronchitis and asthma. The direct impact is estimated to cost the UK £1.3 billion a year, but the indirect costs are likely much higher.

Looking to the future, developing nations will require significant amounts of energy over the coming years, having not had the chance to grow their economies fully and benefit from the ensuing increases in standard of living. Fossil fuels will most likely be crucial to this, given the supply constraints faced in the energy market.

Further, 2.5 billion people in the developing world currently lack access to clean cooking facilities. They rely on alternatives such as wood, which contributes to 3.8 million deaths every year. In response, the IEA estimated that liquefied petroleum gas could be used to quickly scale up and achieve access to clean cooking by 2030, whilst at the same time reducing greenhouse gas emissions—highlighting the positive changes that fossil fuels can bring about.

These examples reinforce the importance of a Just Transition and highlight the social externalities that must be considered when pushing for decarbonization: previously, they had not received full attention, but can now be factored into investment decisions.
How investors can stay engaged with ESG through proxy votes

In the era of ESG, or investing according to environmental, social and governance principles, investors have become increasingly active in trying to drive support for ESG-related policies.

Those investors as shareholders in a large company can participate in a process called proxy voting, where they may submit a shareholder proposal or vote on other proposals on topics that are important to them.

“If investors just own a single share, that makes them a partial owner of the company,” says Kent McClanahan, vice president of Responsible Investing for RBC Wealth Management – U.S. “With proxy voting, CEOs and boards are out there asking owners: ‘What do you want the company to look like?’”

Particular areas that have seen the greatest increase in proposals: political activities and lobbying, climate governance and workforce diversity, according to RBC Capital Markets research.

Pushing for action

The fact that shareholders are pushing for action is not surprising, given how ESG investing has exploded in recent years. More than $17 trillion is now invested sustainably, according to the U.S. SIF Foundation’s 2020 Report on U.S. Sustainable and Impact Investing Trends, accounting for one-third of all professionally managed assets.

Of course, not all ESG proposals, nor all shareholder proposals in general, will pass. For the 2022 season, only around 10% of all shareholder proposals garnered majority support, says Sara Mahaffy, an ESG strategist with RBC Capital Markets. Environmental and social proposals, specifically, have drawn an average shareholder support of 24%—significant, but not a majority, Mahaffy adds.

But even if a particular proposal doesn’t gain majority support, that doesn’t mean the effort was in vain. Quite often, companies will take action on the matter anyway to demonstrate they are being responsive to shareholders, Mahaffy explains.

Implications for investors

Changes in personal behaviors — Investors can make small behavioral changes in shopping and product-usage habits, for example, to positively contribute toward a Just Transition. Individually, each change will be small, but collectively added together, they’ll make a big difference.

Increased investment in clean energy is needed — Given the drawbacks of renewable energy sources, investment is required to increase their scalability and effectiveness, representing a key opportunity to investors. Put simply, the renewables sector has capacity to grow further and capturing this could be an important focus of investor portfolios.

But not just clean energy — Renewables will have a pivotal role in our future energy mix. That said, it is questionable that they will be able to fully meet our energy needs. Given this reality, it will be necessary to increase energy efficiency—particularly in carbon-intensive sectors. Investors hopefully will be able to buy into firms with lower emissions, such as those in the technology sector.
“Look at how companies react when they see voting results,” she says. “If a shareholder proposal gets meaningful support of at least 20%, they may do something. Last year, we saw a number of companies voluntarily come out with new initiatives to address shareholder proposals.”

Moreover, for every ESG issue that actually makes it to the stage of a proxy vote, there are multiple issues that have already been addressed behind the scenes. For example, if a shareholder proposal suggests boosting diversity on the board, the company may engage and take action pre-emptively to prevent the need for an official vote—and to avoid any potential public embarrassment.

What investors should know about proxy voting

It’s not just individual shareholders who can participate in proxy voting. Even if you own shares of a company through a broader mutual fund or exchange-traded fund (ETF), you can still get involved. In these cases, the fund’s asset manager will vote on such matters—and you, in turn, can register your stance with them.

Because of asset managers’ size and stake, they hold significant sway and their votes matter. If your asset manager tends to vote in a way that’s contrary to your values, you as an individual investor always have the option of moving your assets to a different firm.

“Asset managers have become much more engaged as ESG has become a bigger part of the investing world,” says McClanahan. “They talk directly to companies about environmental, social and governance issues, and how those factors can impact future earnings. They might say, ‘Did you know your peers are doing this, and that it is helping their bottom line?’”

For any investor looking learn more about the proxy process, a key challenge, especially for those with sizeable portfolios, is researching and keeping track of all these complex issues and upcoming votes. McClanahan points to a number of resources that are available to help investors in these situations, including:

• Principles for Responsible Investment, a United Nations-supported network of investors, for those who want to become more-engaged investors.
• The Forum for Sustainable and Responsible Investment for investor education.
• The U.S. Securities and Exchange Commission which keeps track of proxy voting records.
• Proxy advisories ISS and Glass Lewis—two leaders in the space which list voting recommendations and publish frequent trend reports.

Even with all those resources and research available to investors, it can take effort and due diligence to keep abreast of the proxy votes taking place. But it’s possible to stay informed and participate in the proxy process for investors and shareholders who choose to do so.

“If you have a 401(k) or an IRA or any stock market investment of any kind, you own at least part of a company,” says McClanahan. “So be aware of what you hold and what is going on in your portfolio and whether you approve of the way companies are running their businesses. Investors are starting to pay attention—and that’s the most encouraging thing of all.”
Making the most of ESG data and scores

As environmental, social and governance (ESG) investing continues to gain interest, so do the ESG scores and ratings that are used to measure risk. With ESG data providers using different methodologies and rating scales, it can be challenging and create confusion for investors to fully understand and compare the scores.

What does ESG data show?

Something that may have become lost along the way is that ESG data is just that, data. It is non-financial information that helps describe the activities, products and operations of a company. The good news is that ESG data allows for more information to be included in the investment process and decisions. ESG scores—regardless of the provider—are simply one interpretation of that data. What third-party ESG data does not show is a company’s impact on the world. It’s up to investors to understand the provider’s methodology to understand which information the score is showing.

Materiality is key to understanding the impacts of ESG data on the future performance of the company. Material information is any information that would impact an informed investor’s opinion of the company. Examples of this might be the amount of water that a company uses to make its product. Water is important to a soft-drink maker, but not all that important to a technology company.

As ESG data continues to grow, and regulations become more concrete, it will provide more opportunities for investors to achieve ESG integration into their portfolios with additional information.

Using data to build portfolios

Investors are increasingly interested in what’s in the company beyond the traditional financial statements, and ESG data can help add the additional lens. But there is no widely accepted rating system to determine what makes a company good or bad when it comes to ESG-related factors being tracked.

It is important to understand that ESG rating providers look at all factors that fall into the three categories. A company may receive a strong score for its positive impact on environmental but concerns of social and governance issues may impact the overall ESG rating. In turn, investors need to determine if the data being reported reflects their values in what they want to invest.

Translating third-party scores

Interpretation of the methodology being used is key to understanding ESG data and scores from third party providers and the impact they may have on a company’s future performance.

For example, you might get a rating of 20 from one company, an AAA from another, and an E-2, S-2, and G-3 all for the same security. This lack of correlation has led to the ambiguity around ESG ratings.

It is important to understand the process of how each provider looks at the information. Additionally, rating firms can change their own methodologies over time, which leads to different scores for securities.

Often, ratings will vary from industry to industry for a provider’s methodology. Take energy and technology as examples of industries that may portray different levels of risk to ESG than others. Some rating providers use a relative-to-industry measure, while others might not consider the industry’s impact overall. Plus, ratings often depend on the amount of information and data available from the company for the rating provider to score.

An investment firm’s use of ESG ratings

Processes and frameworks are continuing to be built out and enhanced at many investing firms as the demand for ESG investing continues to grow from clients. We think understanding how ESG data is applied to an investment process is the most important decision that needs to be understood as opposed to the overall ESG score of the portfolio.

Many investment firms use third-party ESG ratings to supplement their in-house data and expertise. Third-party ESG data can provide an additional lens into a company’s ESG risks, involvement and analysis. This qualitative

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Demand versus supply in the net zero journey

President and CEO of RBC, Dave McKay, recently outlined the progress in RBC's climate strategy and how RBC is contributing to a more inclusive, sustainable and prosperous future. While it will take time and continued financing, consumers may not realize the impact and choice they have at hand to contribute to an orderly, inclusive and just transition to net zero.

Driving down demand on the products you are misaligned with can help lower the supply and need for producing them. Certain high emitting industries will continue to play a part in our current quality of life as it will take time to transform, but minimizing demand can help in the meantime. Without changing your lifestyle, consumers can make small, conscious behavioral changes that can positively contribute toward the net zero journey. It’s all about balance.

What is net zero?

Net zero refers to achieving an overall balance between emissions (greenhouse gases) produced and emissions taken out of the atmosphere. Compared to a gross zero target, which would mean reducing emissions from all sources to zero, a net zero emissions target allows for some residual emissions from hard-to-eliminate sources and recognizes the important role of carbon sinks—both natural and technology-driven—to absorb carbon dioxide from the atmosphere.

A 1.5°C is recognized as a crucial global target. Most countries in the world have joined the Paris Agreement, which commits to holding the increase in global average temperatures to well below 2°C and to pursue actions to keep the temperature increase below 1.5°C, compared to pre-industrial levels. This requires emissions to peak as soon as possible, and to be net zero by 2050.

What is important for the net zero journey?

To keep rising global temperatures under 1.5°C, emissions from warming gases need to be reduced to avoid fewer negative impacts on intensity and frequency of extreme events, on resources, ecosystems, biodiversity, food security, cities, human and natural systems.

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Demand versus supply in the net zero journey, continued from page 5

Deloitte recently released a report, The Turning Point, saying that time is no longer running out to act on climate change; time is now up 1. If the world acts now to rapidly achieve net zero emissions by mid-century, the transformation of the economy would set the world up for stronger economic growth by 2070. Such a transformation could increase the size of the world economy by US$43 trillion in net present value terms from 2021–2070. The report says the technologies, business models and policy approaches are available today to deliver rapid decarbonization and limit global warming to close to 1.5°C by century’s end.

On the other side, the cost of climate inaction is at US$178 trillion in GDP destruction over 50 years, compared with the potential US$43 trillion of economic benefit over the same period 1.

The supply and demand sides of the journey

Economics can help tell the supply and demand story here. To lower the supply of emission-producing products, demand will need to be lowered.

For example, the rise in demand for electric vehicles resulted in almost every car company releasing new models of hybrid or electric vehicles. Less demand for gas-powered vehicles may result in a future reduction in supply.

Consumers have an individual impact that can be positive, negative or balanced. While corporations (the supply side) work to make meaningful changes, investments and continue to invest in ESG-friendly solutions, there is a role for everyone in the meantime. In fact, households on average around the world contribute to more than 60% of global greenhouse gas emissions through consumption of products 2.

The expectation is that corporations will be able to better measure the carbon footprint on products used by consumers, which will help consumers better understand and make decisions about the products they consume. Corporations are raising awareness and enabling consumers to be more conscious of their impact. Individual consumer responsibility is a requirement to achieving the net-zero goal through consumption practices of emission-producing products—corporations and governments won’t be able to do it alone.

There are policies, regulations and instruments widely scaled to support emissions reductions and stimulate innovation for solutions. Consumers, companies and countries all have choices at hand to help determine the way of the future for generations to come.

For consumers, without changing lifestyle, being conscious of small changes can lead to dramatic shifts in Earth’s entire life support system.